



**ISLE OF MAN
FINANCIAL SERVICES AUTHORITY**

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INSURANCE INTERMEDIARIES

Discussion Paper

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This Discussion Paper is issued by the Isle of Man Financial Services Authority (“the IOMFSA”, “the Authority”), the regulatory authority responsible for the supervision of the financial services, insurance and pensions sectors in the Isle of Man.

What is it for?

In June 2013 the Insurance and Pensions Authority¹ (“IPA”) published its ‘Roadmap for updating the Isle of Man’s regulatory framework for insurance business’ (“the Roadmap”) and through that document set out the objective to establish a project to enhance the Island’s regulatory framework to ensure that it remains up to date, proportionate and where appropriate consistent with the updated and revised Insurance Core Principles (“ICPs”) issued by the International Association of Insurance Supervisors (“IAIS”). Since its issue the Roadmap has been updated annually to reflect progress made across the various work streams established under the project.

The activities of intermediaries operating in or from the Island are regulated under two separate sets of legislation, with intermediation of investment business covered by the Financial Services Act 2008 and intermediation of general insurance business covered by the requirements set out under the Insurance Act 2008 (“the Act”) and the Insurance Intermediaries (General Business) Regulations 1999, as amended (“Regulations”). There is no proposal to change the current framework of regulation which segregates the intermediaries in this way.

This paper sets out the Authority’s current views in respect of the work stream established to review developments in the supervision of insurance intermediaries. The paper includes, for initial consideration, suggestions for potential developments to enhance the Island’s existing framework, with the intention of giving interested parties early sight of the Authority’s considerations in this area to supplement and help inform full, formal consultation in due course.

Who is affected by it?

This document will be of direct interest to general insurance intermediaries and reinsurance brokers carrying on business in or from the Isle of Man as well as to existing and prospective insurance companies distributing insurance through such intermediaries. In particular, the

¹ With effect from 1st November 2015 the functions of the Insurance and Pensions Authority were transferred into the Isle of Man Financial Services Authority

<http://www.iomfsa.im/ViewNews.gov?page=lib/news/iomfsa/transfereoffuncti.xml&menuid=11570>

paper is intended to be relevant to those with responsibility for the management and oversight of governance functions within those companies.

Other parties with an interest in the Isle of Man insurance sector, including the legal and auditing professions, companies carrying on insurance intermediation that are currently exempt from registration and intermediaries not regulated by the Authority (those regulated in other jurisdictions), may also find this discussion paper and the issues raised of interest.

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Glossary of Terms

Term	Meaning in this document
Act	Insurance Act 2008
Authority	The Isle of Man Financial Services Authority
Bill	Insurance (Amendment) Bill
CGC	Corporate Governance Code of Practice for Regulated Insurance Entities
CIDRA	Consumer Insurance (Disclosure and Representations) Act 2012 (an Act of UK Paliament)
CTP	Common Trading Practices within the Regulations
FCA	UK Financial Conduct Authority
FSC	The former Financial Supervision Commission
General insurance business	Insurance business that does not fit within the definition of investment as outlined within the Regulated Activities Order 2011 (as amended)
General insurance intemediairy	A person who for remuneration brings together, either directly or through the agency of a thrid party, with a view to the insurance of risks, persons seeking insurance and insurers and carries out work preparatory to the conclusion of contracts of general insurance
IAIS	International Association of Insurance Supervisors
ICPs	Insurance Core Principles (of the IAIS)
IDD	EU Insurance Distribution Directive
IFA	Independent Financial Advisors – intermediaries doing business that would fall under the Financial Services Act 2008
Insurance business	The business of effecting or carrying out contracts of insurance
IOMFSA	The Isle of Man Financial Services Authority

IPA	The former Insurance and Pensions Authority
Regulations	Insurance Intermediaries (General Business) Regulations 1999, as amended
Roadmap	Roadmap for updating the Isle of Man's regulatory framework for insurance business
TOBA	Terms of Business Agreement

Executive Summary

This paper sets out the Authority's initial views on developing the Island's existing regulatory framework for the supervision of general insurance intermediaries.

This paper focusses solely on the intermediation of general insurance business and pure protection business, and proposes developments to existing insurance regulation set out under the Act and the Regulations.

The paper presents the Authority's initial views following an overarching review of all aspects of the existing framework, from the initial and ongoing registration and licensing requirements, competency and fit and proper requirements through to corporate governance and conduct of business considerations.

In accordance with the breadth of that review, the Authority considers it appropriate to invite interested parties to provide early feedback to inform the Authority's further consideration of these matters before it produces firm proposals.

The developments proposed for discussion in this paper are designed to reinforce the principle that intermediaries conduct business in a professional and transparent manner ensuring that the boards and senior management of intermediaries embed the fair treatment of customers within business culture, through the implementation of policies and procedures which reflect fair treatment as a key strategic objective.

The proposed developments and enhancements to the Island's existing regulatory framework discussed in the paper include:

- the introduction of principles-based guidance for corporate governance (this will be based on the current Corporate Governance Code of Practice for Regulated Insurance Entities ("CGC") which is also subject to revision as part of the ICP Project);
- proposals to enhance the Common Trading Practices² and introduce a Conduct of Business Code for general insurance intermediaries;
- proposals to enhance requirements for the treatment of clients' money within Regulations; and
- enhancements to the licensing and suitability requirements.

Throughout the document consideration is given to requirements and developments in other jurisdictions, in line with international standards, and a proportionate approach for general insurance intermediaries.

² As set out in Schedule 3 of the Regulations

1 Introduction

1.1 Developing standards for the intermediation of general insurance business

The Authority recognises the need to assess the effectiveness of its framework relevant to general insurance intermediation in line with developing industry practice and regulatory standards and, where necessary, update the framework to ensure it: provides for an appropriate level of customer protection; promotes professional standards; and, maintains confidence in the Island's insurance sector.

The requirements for the supervision and oversight of intermediation of general insurance business in or from the Island are currently contained within the Act and the Regulations, which set out, inter alia, the registration and ongoing conduct requirements for general insurance intermediaries.

In order to ensure that the Island's regulatory framework remains effective in securing an appropriate standard of advice for consumers in the distribution of general insurance products in or from the Island, the Authority has identified areas where enhancements to the existing regulatory framework are likely to be needed.

As part of this work the Authority undertook a gap analysis of its regulatory framework in response to the significant revision of ICPs by the IAIS in October 2011. Whilst the Act and Regulations address many of the standards in the ICPs, the conclusion of the gap analysis is that more detailed requirements are required in a number of areas.

Specifically, the gap analysis highlighted requirements within ICP18 (Intermediaries), under which the current supervisory framework is insufficiently detailed. Whilst the Common Trading Practices ("CTPs") establish some good principles to be followed by general insurance intermediaries, further detailed requirements will need to be developed to supplement, enhance or replace these requirements.

1.2 The purpose of this discussion paper

The Authority is committed to working closely with the Island's insurance sector and other stakeholders throughout the project, including by way of pre-consultation discussions and discussion papers.

Building on initial discussions with FPIBA, the purpose of this discussion paper is to present the Authority's current views on the requirements within relevant ICPs in the context of the

Authority's existing regulatory framework and to set out for initial consideration possible implementation measures ahead of a more formal consultation exercise.

While the Authority may express a view on potential implementation measures in this document, this should not be taken as an indication that a particular policy or approach has already been determined. The main purpose of this document is to invite comments from stakeholders, either in response to the specific questions raised throughout the document or through more general feedback, as part of the Authority's considerations in putting forward proposals for consultation in due course.

2 Background to the IAIS ICPs and ICP18

2.1 Overview of the IAIS ICPs

A key benchmark for the development of the Island's insurance regulatory framework are the IAIS ICPs, which represent the standards that the International Monetary Fund ("IMF") uses to assess a jurisdiction's regulatory framework.

Importantly, ICPs do not prescribe requirements for supervisory authorities to incorporate into supervisory frameworks, but provide an approach under which supervisors have sufficient flexibility to tailor supervisory requirements and actions according to the nature, scale and complexity of insurers and intermediaries operating in the sector under supervision.

In that context, the following ICPs have informed the Authority's current review of the general insurance intermediary sector:

2.1.1 ICP18 – Intermediaries

The supervisory oversight and conduct of insurance intermediaries is dealt with specifically in ICP18. The definition of insurance intermediary within the ICPs would include general insurance intermediaries, reinsurance brokers and Independent Financial Advisors ("IFA") (intermediaries advising on insurance contracts with an investment element that would be regulated under the Financial Services Act 2008).

The IAIS suggest that the supervisor may wish to consider the advantages of a risk based approach in which greater attention is focussed on areas which may be of higher risk. To some extent this occurs naturally by virtue of the Authority's legislative framework, which distinguishes between the intermediation on long term insurance with an investment element which is regulated as Class 2 activity under the Financial Services Act 2008 and intermediation on general insurance business and any other long term insurance (such as pure protection business) which is regulated under the Insurance Act 2008.

When considering the ICPs for discussion within this paper, the Authority's intention is to apply supervisory requirement in a way that is proportionate to the business of general insurance intermediaries. ICP18 is attached for reference in appendix 1.

In addition to ICP 18, there are additional ICPs that contain principles that are of relevance to intermediaries, such as:

2.1.1.1 ICP 19 (Conduct of Business)

ICP 19 states:

The supervisor sets requirements for the conduct of business of insurance to ensure that 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 established.”

Applicable conduct of business considerations from the standards underlying this principle are discussed in more detail included within the relevant sections of this paper.

2.1.1.2 ICP 21 (Fraud)

ICP 21 states:

The supervisor requires that insurers and intermediaries take effective measures to deter prevent, detect, report and remedy fraud in insurance.

Under this, intermediary firms would be expected to assess what parts of its business could be targeted by those conducting fraudulent activities, which products, services and distribution channels are vulnerable and to what degree. Deliberately exaggerating a claim (for example a customer claiming for possessions they never had or claiming higher value for the property lost or damaged) is fraud, as is deliberately destroying an asset and then making an insurance claim. Another example is misleading insurers when applying for insurance. Helping a customer committing insurance fraud, even inadvertently, could mean you are committing an offence.

The CGC includes a requirement for regulated entities to put in place internal controls and procedures for fraud prevention. Whilst this does not currently apply to intermediaries it is proposed, as an outcome of this discussion paper, that certain aspects of the CGC are applied to intermediaries.

If this section of the CGC was applied to intermediaries it would mean that financial crime issues should be considered at board meetings as part of the board’s oversight responsibilities to see that risks to the firm are being mitigated. Additionally, staff should be trained so that they know what to do if they suspect fraud.

2.1.1.3 ICP 22 (Anti-money Laundering and Countering the Financing of Terrorism)

ICP 22 states:

The supervisor requires insurers and intermediaries to take effective measures to combat money laundering and the financing of terrorism. In addition, the supervisor takes effective measures to combat money laundering and the financing of terrorism.

The standards underlying this are broad and relate to the supervisor ensuring that there is an effective legislative framework in place to ensure that money laundering and financing

terrorism risks to which intermediaries are exposed are covered and that this framework is consistent with the FATF recommendations.

The Island's current anti-money laundering requirements are detailed in the Proceeds of Crime Act 2008 ("POCA"). Section 157 of POCA requires the Department of Home Affairs to publish a Code for the purposes of preventing and detecting money laundering. This Code is the Anti-Money Laundering and Countering the Financing of Terrorism Code 2015 ("the Code") and applies to all relevant persons, which includes intermediaries.

The Authority is of the opinion that the existing framework is generally in compliance with the ICPs and so does not require any enhancement. However, the Authority would like to formalise its remit for conducting fit and proper checks on the appointed money laundering reporting officers (and any deputies) for intermediaries. This will be achieved through the introduction of the 'principle control officer' role within the Insurance (Amendment) Bill 2016 ("the Bill"), which is being consulted upon separately. The Authority already has the remit within its legislation to conduct such vetting checks on the MLROs for other financial services businesses and insurers on the Island so this will regularise the position.

3 Enhancing requirements in the Island's regulatory framework for general insurance intermediaries

In developing its proposals in this paper, the Authority has given consideration to the ICP framework, developments in other jurisdictions as well as the Authority's view of different parts and risk profile within the Isle of Man's insurance and financial services sector.

The Authority continues to consider the risk profile of the general insurance intermediary sector to be generally lower than the other sectors supervised by the Authority and in the context of that view this section highlights possible enhancements to the Island's regulatory framework that the Authority considers appropriate to ensure that its framework remains up to date, proportionate and where appropriate consistent with standards adopted internationally in other reputable jurisdictions.

3.1 Registration

General insurance intermediaries are required under current legislation to be registered at regulated entity level by the Authority, with an annual renewal of that registration. This would meet the requirement for licensing under the ICPs.

Where a registration is granted at the entity level, the ICP guidance indicates that the supervisor may consider a framework that requires an assessment of the procedures an entity has in place to ensure that the individuals who conduct insurance intermediation under its responsibility meet appropriate standards of professionalism and competence. Alternatively, the supervisor may set its own requirements for approval of individuals who conduct intermediary business, based on an assessment of fitness and propriety.

This is discussed further in section 3.3 below.

3.1.1 Registration process and requirements

The ICP guidance advocates an application based registration process, which is broadly consistent with the approach in the current framework. However, the supplementary information that will typically be requested by the Authority at registration is not currently published in regulation or guidance. The following requirements are proposed to be incorporated into the registration application:

- Confirmation of compliance with any published Conduct of Business and Corporate Governance requirements;
- Details of ownership, including all relevant information necessary to provide a full understanding of the insurance intermediary's ownership and control

- The proposed method of capitalisation
- A business plan, including details of proposed business and financial projections
- Information on personnel, in particular on key functionaries
- Successful due diligence in respect of key functionaries
- Details of any significant third party service providers
- Details of the proposed auditor,
- Details of professional indemnity insurance cover (“PII”), including amount and limitations, or comparable guarantee – the current requirement for an intermediary to effect PII is contained within the Regulations and this will be reviewed as part of the current project
- Business continuity plans
- Relevant information on incorporation such as memorandum and articles of association and certificate of incorporation
- Details of policies, procedures and controls in key areas such as:
 - compliance
 - combating financial crime (including AML/CFT and fraud)
 - new business
 - client money
 - complaints
 - conflicts of interest.

An application process will be developed to give flexibility for the Authority to request additional information to complete the registration process, upon request.

3.1.2 Categories of licence

Consideration is being given to restricting the types or classes of insurance business that an insurance intermediary may undertake, in line with the skill and experience required to provide appropriate advice. As part of the registration process, the Authority may specify the classes of business to be undertaken and make this available to the public on its register of insurance intermediaries.

3.1.3 Financial resources

The ICP framework advocates an approach under which a supervisor sets minimum financial resource requirements, to ensure market participants have sufficient financial resources to withstand shocks, for example.

There are currently no minimum financial requirements for intermediaries. However, the Authority will review financial statements and other relevant financial information as part of its ongoing supervisory process. It is the Authority’s intention to extend the application of

the CGC, with modifications, to general insurance intermediaries. This would codify, inter alia, the requirement for intermediaries to maintain adequate capital and other financial resources appropriate to its business and the risks to which it is exposed. It would also be a requirement that the intermediary's rationale and calculation is documented and the Authority may require enhanced financial reporting. Further discussion on the application of the CGC to intermediaries can be found below within section 3.4.

The Authority is also considering the degree to which further detailed regulation or guidance would be required in this area, which may include setting minimum capital requirements for intermediaries similar to the approach operated in other jurisdictions, to ensure the ongoing continuity and quality of service to customers, even in adverse scenarios. An intermediary should be in a position to meet its financial obligations in full as they fall due, and the minimum capital requirement would be expected to cover the risk of any operational losses.

Such requirements might take into account risk factors such as the nature of the business to be intermediated, whether the intermediary operates client accounts and the scale of the business indicated by level of operating expenses or other measure of business turnover, to be defined, to ensure that an appropriately risk-based financial resource requirement is set.

Discussion point 1

The Authority welcomes views on developing rules in relation to financial resources, and encourages existing registered general insurance intermediaries to share examples of practice in this area in order that the Authority can evaluate current market practice to the approach adopted in other jurisdictions.

3.1.4 Renewal of registration

The current requirement for an insurance intermediary to apply annually for re-registration (currently under Section s26(7) of the Act) is to be removed with the enactment of the Bill. It is likely that the Authority will seek an annual regulatory return to provide confirmation that all key regulations and guidance are being adhered to, as well as requiring the information currently supplied at the renewal of registration (currently captured within Appendix 1 to the Regulations).

3.1.5 Exemptions and cross border operations

The ICP framework allows, in specific and limited circumstances, for the supervisor to make exceptions or exemptions to certain licensing requirements; however, where such exemptions are permitted, the supervisor should ensure that they do not encourage regulatory arbitrage or increase the risk to consumers.

The current regulatory framework includes certain categories of exempt intermediaries, with the intention to exempt:

- those only acting as an intermediary in respect of long term insurance that falls within the definition of “investment³” business;
- those arranging insurance that covers the risk of loss or damage to goods or services provided by that person, where the principal business is not that of an insurance intermediary;
- an insurance intermediary regulated by the UK Financial Conduct Authority (“FCA”) not ordinarily resident on the Isle of Man.

Additionally, intermediaries that advise on pure protection products and that hold a Class 2 financial services licence are exempted from some of the Regulations, such as the requirement to register as an Insurance Intermediary with the Authority. However, the requirements to effect professional indemnity insurance and to comply with the CTPs in relation to the pure protection products remain.

Consideration is given to each current exemption, below:

3.1.5.1 Investment business

The intermediation of investment business is currently regulated under the Financial Services Act 2008 with advising on investments a regulated activity under the Regulated Activities Order 2011 (as amended 2013). Long term insurance business, with the exception of pure protection business, is considered investment business for the purpose of the Regulated Activities Order 2011 (as amended).

The Authority considers it appropriate that, long term insurance contracts that include an investment element, continue to be considered as investments for the purpose of regulation under the Financial Services Act 2008; and therefore, intermediaries advising solely on insurance contracts of this form are exempt from registration under the framework for the regulation of general insurance intermediaries.

3.1.5.2 Ancillary insurance business

Many businesses offer insurance in respect of goods or services being offered as the principal activity of the business in question and the current regulatory framework provides for an exemption for such activity. For example, this would include vets offering pet insurance;

³ as defined in the Regulated Activities Order 2011 (as amended 2013) - <http://www.iomfsa.im/lib/docs/iomfsa/consultations/regulATEDactivitiesorder2011.pdf>

travel agents offering travel insurance; and, electrical retailers offering insurance on white goods sold. These businesses can offer insurance in respect of the primary goods or services in which they trade without being registered with the Authority.

This has been a long standing exemption; however, the Authority has considered developments in the UK to extend the scope of insurance regulation to cover the bundled travel market i.e. travel insurance sold by travel agents, airlines etc. (termed “connected travel insurance”).

Travel insurance is a relatively specialised insurance product and is considered to present a higher risk of inappropriate advice than the other types of insurance caught within this exemption. Before connected travel insurance became regulated, the UK Government concluded “that there is significant evidence of consumer detriment in the travel insurance market. Consumers are at risk of being sold policies which do not meet their needs...” and “that there is evidence to suggest that problems in the sales process are likely to be accentuated when sales take place away from the professional regulated insurance environment through an intermediary such as a travel agent” (House of Commons Treasury Committee Fourth Report of Session 2006-07).

Under the Authority’s current exemption, travel agents are not regulated for the travel insurance they provide. Those that are ABTA registered must comply with the ABTA Code of Conduct which includes some requirements around intermediation of travel insurance; however, this does not provide the same degree of customer protection as the Regulations applicable to intermediaries. Additionally, consumers who purchase an insurance policy alongside a holiday would have no recourse to the Financial Services Ombudsman Scheme if his or her complaint relates to the selling of the policy when compared to policies provided through registered intermediaries. Therefore, the Authority can see the merit in the introduction of a coherent and unified system of statutory regulation for the travel insurance market.

Ancillary insurance businesses are caught within the scope of the European directive on insurance distribution (“IDD”) i.e. persons that pursue the activity of insurance distribution for remuneration but whose principal professional activity is not insurance distribution and who only distribute insurance products that are complementary to their goods or services.

An exemption for connected contracts of insurance is retained within the IDD and now applies to ancillary insurance intermediaries who carry out distribution activities if:

- the insurance complements the good or service supplied by the provider;
- the insurance covers:

- risk of breakdown, loss of, or damage to, the good or non-use of the service; or
- damage to, or loss of, baggage and other risks linked to travel booked with that provider; and
- the premium does not exceed:
 - in the event the insurance is complementary to a service and the duration of that service does not exceed 3 months, €200; or
 - in any other event, €600.

Therefore, under the IDD connected travel insurance may remain exempt if the premium does not exceed the levels defined above.

3.1.5.3 FCA regulated intermediaries

The exemption available within the Regulations for an FCA regulated insurance intermediary not establishing a presence in the Island, was developed in conjunction with the local insurance market and recognises the level of regulatory oversight under the FCA framework. This exemption would only capture those doing business in or from the Island i.e. those actually coming to the Island to carry on insurance intermediation business.

Discussion point 2

The Authority considers the current project as an appropriate opportunity to review exemptions to registration under the current framework, to consider whether the exemptions available remain current and consistent with international standards.

In this regard, the Authority is interested in feedback from the industry to help formulate its views in this area, particularly if the industry is aware of firms utilising the exemptions currently available.

3.1.5.4 Cross border operations

The ICPs require the Authority to consider what licensing requirements, if any, are applicable to intermediaries operating on a cross-border basis from outside the jurisdiction i.e. provision of intermediation services to Isle of Man customers on a services basis (without establishing a local presence). These requirements should be transparent to consumers, as well as to intermediaries, so that customers can make an informed decision when choosing to deal with intermediaries from other jurisdictions.

Currently, intermediaries operating on a cross-border basis from outside the jurisdiction are not required to be registered under the Act as they would not be considered to be operating 'in or from the Isle of Man'. Intermediaries merely marketing into the Island would not be covered under this provision, or the 'holding out' provision, unless the intermediary did not

make it clear that its business was being conducted other than in or from the Island. A change to primary legislation would be required in order to change the scope of the Act.

The Authority will take into account the position for IFAs doing business that would fall under the Financial Services Act 2008 and operating on a cross border basis when reviewing this issue, to consider whether a consistent position across the Authority in this regard would be possible and appropriate.

It is understood from comments made in relation to the consultation on the Bill that this issue is of concern to local intermediaries and the Authority welcomes views on this matter.

Discussion point 3

The Authority is interested in further feedback from the industry regarding the services being provided by off Island intermediaries to IOM residents on a cross border basis.

3.2 Ongoing Supervisory Review

Once an entity is registered the Authority must ensure that compliance with the ongoing regulatory requirements is maintained. The Authority's current supervisory approach includes desk based supervision, in particular following the annual submission of documentation as part of the renewal process of registration. Onsite inspections are also carried out periodically. The Authority prioritises its workload by conducting a process of risk assessment. The risk profile of the business drives type and frequency of onsite visits. Generally as an industry, insurance intermediation is viewed as lower risk when compared to other types of business regulated by the Authority.

Guidance underlying ICP standards suggests that certain information should be provided to the Authority for offsite monitoring purposes including:

- Financial statements;
- Auditor's management letter;
- Confirmation of professional indemnity cover;
- Information on the sources of and placement of business;
- Summary of movements on client money accounts;
- Changes in key functionaries and significant owners;
- Information on breaches and other matters of regulatory concern; and
- Information on any complaints.

It is likely that the Authority will request information in these areas within the annual regulatory return.

3.3 Professional knowledge and experience, integrity and competence

3.3.1 Professional Knowledge and Experience

The Authority considers it important that individuals working as insurance intermediaries have adequate professional knowledge to carry out their responsibilities. Professional knowledge can be gained from experience, education and training. In order to be able to demonstrate that professional knowledge has been achieved, it is preferable that this is supported by the attainment of relevant professional qualifications. Notwithstanding this, the Authority is aware that qualifications are not the only way to demonstrate competence and that expertise can also be attained through experience practising in the industry. The qualifications and experience of individuals should be appropriate for the type of intermediation being carried out, and should be supported by real world experience in order that the knowledge gained from any qualifications is applied correctly.

Intermediaries should also be knowledgeable about the status of the insurers whose products they sell.

Once competence has been demonstrated (through the attainment of professional qualifications or otherwise), it is important that individuals who continue to work as insurance intermediaries keep their professional knowledge up to date. To date the Authority has not recommended any specified minimum amount of time that must be spent on continuous professional development (“CPD”); although, it is expected that intermediaries who are members of professional bodies will have a requirement for a minimum amount of CPD to be undertaken.

3.3.2 Current position

Currently the CTPs within the Regulations require a registered insurance intermediary to give advice only on those insurance matters in which he or she is knowledgeable and seeks to recommend other specialist advice where he or she does not have the requisite knowledge. This should ensure that individuals working as insurance intermediaries have adequate professional knowledge to carry out their responsibilities; however, it is sometimes challenging to demonstrate that this is the case. The Authority is considering further reinforcing this requirement by identifying the types of policy the intermediary is considered competent to advise upon at the registration stage and restricting the registration accordingly.

The Authority is also proposing to introduce a policy document in relation to standards of fitness and propriety (“the F&P Standards”) for insurers and intermediaries. This will be subject to consultation at a later stage in the ICP Project, under the suitability and licensing work stream. It is proposed that the F&P standards will outline the criteria that are applied by the Authority when assessing fitness and probity, which include competence, integrity and financial standing. The F&P standards are proposed to include a new obligation for all regulated insurance entities to have a policy on the fit and proper requirements, and to review this policy at appropriate intervals. This will ensure that insurers and intermediaries are taking necessary measures to ensure that the suitability requirements are being met by all of their staff by ensuring that high internal standards are being promoted and adhered to.

3.3.3 Intermediaries advising on investment products

In 2010, the Financial Supervision Commission implemented a project to vet all IFAs (including those giving advice on long term insurance products with an investment element). This was carried out alongside the Island’s implementation of the retail distribution review (“RDR”) which also sought to increase the minimum level of qualification that individuals providing

investment advice to retail clients must hold. These qualifications are taken into account in the Authority's review of competence of such IFA's.

The Authority acknowledges that the level of risk attached to giving advice on investment products is different to that of giving advice on other types of insurance product with no investment element. However, customers of general insurance intermediaries tend to include those considered to be "retail" in nature as they are members of the general public and therefore, the Authority wishes to ensure that they are afforded an adequate level of protection in accordance with its regulatory objectives.

3.3.3.1 The Authority's view and discussion points

The Authority feels that it is appropriate to review its approach with regard to the vetting and review of insurance intermediaries' professional knowledge and experience.

The Authority's initial view in this area is that increased scrutiny of intermediaries' professional knowledge and experience, and the application of such, would be beneficial and mitigate a key risk for intermediary business, namely the suitability of advice given. A key consideration is whether the individuals giving face to face advice should have a minimum level of qualification.

Although it is recognised that qualifications are important, other factors such as the culture of the business, in terms of treating customers fairly, and conflicts of interest are also essential and will be addressed further within this paper.

A possible approach that may be adopted is one whereby one of an intermediary firm's management team (who must be appropriately qualified) must take on the role of 'responsible member', similar to that adopted by the CII Chartered Insurance Broker status or the concept of 'supervisor' in the UK FCA's T&C Sourcebook.

Taking this principle, the Authority's initial preference in this regard is that, instead of vetting all brokers and ensuring that they are qualified to a certain level, the Authority would require each firm to nominate a senior person to be responsible for the advice given by the firm. This role would involve:

- oversight of all brokers including training and monitoring;
- approving brokers to provide face to face advice unsupervised; and
- countersigning advice given by brokers prior to the above approval.

The person carrying out this role would need to have sufficient knowledge and experience and may become subject to the Authority's fit and proper requirements under Section 29 of the Act.

A governance framework around this would need to be set out in legislation including areas such as the requirement for intermediary firms to: implement policies and procedures detailing what the necessary level of competence would be for that firm; set minimum CPD levels to ensure that brokers maintain competence to fulfil their role; evidence that individuals are competent to give advice about the products and services included in any recommendation; and review and assess competence on an ongoing basis. This would help to continue to raise standards within intermediaries and give the required focus to professional knowledge and experience within the operation of such businesses.

Reinsurance brokers would also need to nominate this senior person, but the parameters around the role would need to be tailored to the nature and risk of this business.

Discussion point 4

In addition to general feedback on the professional knowledge and experience, integrity and competence within the industry currently and the issues raised within this paper, the Authority is interested in specific comments from intermediaries on the degree to which the outlined suggestions are consistent or in conflict with existing practice.

3.3.4 Integrity

It is essential that insurance intermediaries act with integrity and high ethical standards. ICP guidance in this area suggests a number of ways for supervisors to approach this, including ensuring that intermediary firms operate procedures to assess the integrity of those acting as intermediaries on its behalf, including pre-employment checks as well as ongoing requirements.

As noted above, the introduction of the F&P standards will require all insurers and intermediaries to ensure that its staff are fit and proper, which includes integrity as one of the factors.

Currently, the CTPs require intermediaries to conduct business with the utmost good faith and integrity. It is likely that this will be further supplemented by a Conduct of Business Code and the application of some aspects of the CGC to intermediaries.

3.4 Corporate governance

The Island's existing framework currently has few specific corporate governance requirements for intermediaries, although directors of intermediaries are subject to the requirements of the Companies Acts which set out their duties and responsibilities. The majority of onsite reviews to intermediary firms will include the Authority reviewing matters around corporate governance arrangements and processes; therefore, the Authority considers that further detailed requirements should be developed to build on these principles.

Insurance intermediaries should be subject to corporate governance requirements appropriate to the nature and scale of the intermediary and the complexity of its business. These should at a minimum provide for sound and prudent management of the business and protect the interests of stakeholders. The guidance underlying the ICPs suggests that supervisors should issue a Code of Practice setting out expectations in areas such as:

- Achieving and maintaining standards on suitability of persons,
- Ensuring appropriate standards for conduct of business,
- Ensuring that the making of key decisions is subject to sufficient discussion at board level ,
- Ensuring adequate human resources to conduct the business,
- Ensuring an appropriate level of internal controls of the business,
- Maintaining adequate files and records and ensuring their availability for inspection,
- Maintaining appropriate controls over outsourced functions, and
- Compliance with all relevant legislation, including non-insurance legislation such as in respect of anti-money laundering, bribery and fraud.

The Authority proposes covering these areas by application of relevant sections of the CGC to intermediaries. As noted earlier, this may be further supported by a Conduct of Business Code specifically tailored to intermediary businesses, which is discussed in more detail in section 3.5 below.

On an initial review, it is the Authority's view that the majority of the principles of the CGC would be applicable to intermediaries as long as they were applied in a way that is proportionate to the size and nature of the business. The Authority may need to issue additional guidance to indicate how it would expect the CGC to sensibly and practically apply to small businesses.

Some of the areas that warrant additional discussion for intermediaries might include:

1. Section 5.5 – Financial Management

Due to the nature of intermediary business and its obligations, any forward looking analysis required for intermediaries should be proportionate, with a focus on securing adequate operational capacity and liquidity to ensure that service levels can be maintained for customers.

2. Section 5.7 - Asset protection

The Authority considers that this could apply to intermediaries in terms of its clients' money; however, more detailed regulations are likely to be prescribed in relation to safeguarding of clients' money (see also section 3.6 below).

3. Section 6.2 - Board composition

The CGC currently requires insurers to have at least one independent non-executive director ("INED") and two directors who are resident in the Isle of Man. It is a principle of good corporate governance that companies are headed by an effective board of directors where no one person has unfettered power over decision making. Effective boards are comprised of people with different perspectives, backgrounds, expertise and experience.

The Authority acknowledges that some intermediary businesses are small, family run businesses and so the appointment of an INED may not be proportionate. Therefore extending the application of this requirement within the CGC to intermediaries is under review, however, wherever possible the Authority would encourage a business to invite an independent director onto its board to help in focusing the board on the interests of the company and to provide expertise in key strategic areas. Where this is not possible, the Authority would still expect small firms to put in place measures which deliver equivalent outcomes. In line with this, further guidance may be given specifically for intermediaries around independence of decision making on the board and ensuring that the relationship of the directors within the company is such to ensure that they can all exercise objective judgement without undue influence from one another in the best interests of clients.

4. Section 11 – Actuary

This section would not be applicable.

5. Section 12 – Internal Audit Function

Again, the Authority is of the view that the internal audit function of an intermediary should be proportionate. This may mean that a separate function is not appropriate for every intermediary business and may be performed by an individual within the firm conducting an objective check on compliance with the intermediary's internal controls and procedures. This may be conducted by the Board, by a senior manager

or a compliance professional as appropriate in the context of the scale and nature of the business, for example.

6. Section 15 – Risk management System

This would be applicable to intermediaries in relation to specific risks such as key man risk, business continuity risk, mis-selling risk.

7. Section 19 - Fair treatment of Policyholder

This section is more suited to insurers in its current form. It could be applied to intermediaries, with amendments to the wording as applicable; however, it is unlikely that the Authority would apply this as principles relating to the fair treatment of customers will be captured within conduct of business requirements which are to be discussed in further detail at 3.5 below.

8. Schedule 1 – Risks

Although some of these risks would be applicable to an intermediary's business, it is likely that the Authority may substitute this Schedule with risks more directly appropriate to intermediation.

Discussion point 5

The Authority invites feedback on the proposal to extend the CGC to intermediaries, including where it is felt application may be impractical or require further guidance.

3.5 Conduct of business

3.5.1 Disclosure of information on insurance products to customers

A previous discussion paper on conduct of business (DP14-05) in relation to disclosure of information on insurance products was issued by the Authority in July 2014. The feedback from general insurance intermediaries in response to this paper was generally unsupportive of the proposed approach, which led to the Authority concluding that separate conduct of business rules would need to be developed for general business.

Since that time the Authority has further reviewed recent regulatory developments in general insurance mediation including the IDD and has completed a review of requirements in other jurisdictions, including the UK, Jersey and Guernsey. The IDD principles will inform the Authority's view of conduct of business for intermediaries and are consistent with the ICPs in this regard.

The ICPs include the following standard in relation to the provision of information to customers:

The supervisor sets requirements for insurers and intermediaries with regard to the timing, delivery, and content of information provided to customers at point of sale.

The guidance supporting this standard is detailed and clearly sets the expectations for intermediaries in dealing with the provision of information to consumers.

The guidance focuses on both the timing and quality of information disclosure to customers, with the emphasis for the effective provision of information to customers being placed on quality of disclosure rather than quantity.

In terms of timing of disclosure the guidance is relatively prescriptive in setting a requirement that customers should be appropriately informed before and at the point of sale, taking account of the relative importance of information required in the customer decision making process and the point in time at which such information becomes most important.

The concept of varying customer needs is again a feature in the guidance supporting this standard, with recognition that to be adequate for customer needs information should be tailored both to customer groups and the complexity of products in question. The information should enable a customer to understand the characteristics of the products they are buying and help them understand whether and why it meets their requirements.

The current CTPs require the intermediary to give an explanation of the contract and define information that must be provided to the customer. It is implied within this section that the information should be given before a sale, but it is not stated explicitly and it does not state that the information should be given in a documented form.

The guidance also covers disclosure of rights and obligations. Retail customers, in particular, often have only limited knowledge about the legal rights and obligations arising from an insurance contract. Before an insurance contract is concluded, the intermediary should therefore inform a retail customer on matters such as:

- General provisions – including the law applicable to the contract;
- Obligation to disclose material facts – including prominent and clear information on the obligation on the customer to truthfully disclose material facts. Ways of ensuring a customer knows what he or she must disclose include explaining the duty to disclose all circumstances material to a policy and what needs to be disclosed, and explaining the consequences of any failure to make such a disclosure. Alternatively, rather than an obligation of disclosure, the customer may be asked clear questions about any matter material to the insurer;
- Obligations to be complied with when a contract is concluded and during its lifetime, as well as the legal consequences of non-compliance;

- Obligation to monitor cover – including a statement, where relevant, that the customer may need to review and update the cover periodically to ensure it remains adequate;
- Right to cancel – including the existence, duration and conditions relating to the right to cancel. If there are any charges related to the early cancellation or switching of a policy, this should be prominently disclosed;
- Right to claim benefits – including conditions under which the policyholder can claim and the contact details to notify a claim; and
- Right to complain – including the arrangements for handling policyholders' complaints, which might include an insurer's internal claims dispute mechanism or the existence of an independent dispute resolution mechanism.

Other than CTP 3, stating that an intermediary must make it clear that it is the customer's responsibility to answer honestly, and that the intermediary must make clear to the customer the consequences of not disclosing material facts, the majority of the above matters are not currently stated requirements. Some of these areas would be reviewed by the Authority as part of any on-site inspection as they would be deemed to be areas of best practice within the industry and there may be an expectation that such explanations are happening as part of any advice being given.

In terms of the current requirement that the intermediary must make clear to the customer the consequences of not disclosing material facts, the Authority is cognisant of developments in UK insurance contract law around the requirements for disclosure of material facts, with the introduction of the Consumer Insurance (Disclosure and Representations) Act 2012 ("CIDRA"). Under this Act, it is the duty of the consumer to take reasonable care not to make a misrepresentation to the insurer before the contract is entered into or varied. This modifies the consumer's duty of utmost good faith by removing the obligation to volunteer all material facts. Although IOM registered intermediaries are not subject to UK law, any contracts taken out with UK insurers would be subject to UK legislation and so intermediaries should be aware of this difference when collecting information from customers in support of an application.

Discussion point 6

The Authority is interested in feedback from intermediaries on practice adopted around disclosures currently made to customers prior to a contract being concluded, and how developments in insurance law around customer disclosure of material facts, such as through CIDRA, have modified such practice.

3.5.2 Fair treatment of customers

The CTPs establish many of the principles central to the fair treatment of an intermediary's customer. The concept of conducting business with utmost good faith and integrity is central to these requirements, however, the actual principles required under the CTPs are high level and relatively limited in terms of giving guidance on the desirable components of appropriate conduct. The existing framework therefore establishes the foundations for further development supporting the overarching customer fair treatment standards in ICP19.

It is likely that a principles based general insurance intermediary Conduct of Business Code will be implemented to underpin the requirement for the fair treatment of customers. There will be a need for further regulatory developments around procedures, culture, internal controls and performance management and reward to build on the concept of conducting business with utmost good faith and integrity that is currently in place within the CTPs.

3.5.3 Pre-sales process

Intermediaries currently have a requirement to explain the insurance contract to customers under paragraph 2 (ii) of the CTPs including all the essential provisions of the cover and drawing attention to any restrictions or exclusions. It is not explicitly stated within the CTPs how intermediaries should evidence this requirement. The Authority considers that, as well as drawing customers' attention to such exclusions verbally when discussing any contract, an intermediary should again point out any restrictions or exclusions in writing within a post-sale document accompanying the contract. In the majority of cases reviewed by the Authority, it is noted that current compliance with this requirement is not sufficiently robust.

Additionally, the CTPs state that an intermediary must not make comparisons with other types of policy unless he or she makes clear the differing characteristics of the policy. However, the current requirements may lead intermediaries to be reticent to offer different types of policy to customers as it could add an additional layer of complexity to the process.

The overriding principle here is that any information provided to customers whether documented or verbal should be clear, fair and not misleading. This is taken further under section 3.5.4 where appropriateness of advice is considered.

3.5.4 Appropriateness of advice

Advice goes beyond the provision of product information and relates to the provision of a recommendation on the appropriateness of a product to the disclosed customer's demands and needs.

The ICP guidance makes specific reference to the requirement for the basis for any product recommendation arising from advice to be explained and documented by the person

providing the recommendation. All advice should be communicated in a clear and accurate manner. In circumstances where products are taken up on a “no advice” basis it is recommended that customers are required to acknowledge the same in writing.

Emphasis is given to the promotion of quality advice through ongoing training and monitoring of relevant staff i.e. those staff that are directly involved in the giving of advice. A responsibility is placed on the intermediary to promote quality advice by establishing continuous training programs.

Currently the CTPs require that an intermediary must ensure, as far as possible, that the policy proposed is suitable to the needs and resources of the prospective policyholder. Therefore, at a high level suitability of advice is covered; however, the type of detail expected within the ICPs is not covered. Furthermore, it is not specified that where advice is provided, the basis for any recommendation should be documented and the documentation should be provided to the customer. Therefore, it is the Authority’s view that the proposed code of conduct mentioned above would provide further guidance in this regard.

3.5.5 Managing conflicts of interest

There is the potential for conflicts to arise as part of the pre-sales process and any such conflicts should be appropriately managed. The ICP guidance describes a conflict as:

“Conflicts of interest arise where a party has competing professional and personal interests. This includes soliciting or accepting inducements where this would conflict with the intermediary’s duties to its customers. An inducement can be defined as a benefit offered to an intermediary, or any person acting on its behalf, with a view to that firm/person adopting a particular course of action. This can include, but is not limited to, cash, cash equivalents, commission, goods and hospitality. Where intermediaries who represent the interests of customers receive inducements from insurers, this could result in a conflict of interest that could affect the independence of advice given by them.”

The guidance indicates that conflicts of interest may be managed in different ways, with appropriate disclosure a central theme. Additionally, informed consent from customers is a further mechanism through which conflicts can be managed.

Information on charging structures is arguably of more importance to customers purchasing insurance products with an investment element because information on any fees or other costs deducted from the initial amount invested, as well as on fees or commissions deducted from the investment amount thereafter will be significant to the performance of the investment overall. For non-life insurance and pure protection products, where fees are not paid directly by the customer, such information may have less of a direct impact but may still have a bearing on the independence of any advice that is provided.

Despite the fact that the CTP require an intermediary to act in good faith and with integrity, there is still a risk that an intermediary may be biased toward recommending a product that provides higher fees or commissions than another product. The Authority is also aware of the use of non-monetary benefits, so called “soft commission”, offered by insurers to intermediaries. These may include less tangible benefits such as professional support or corporate entertainment. Such inducements may lead to conflicts of interest and are less transparent than fees or commissions. The Authority wishes to ensure that customers’ best interests are served at all times and so enhancements in the standards for conflicts of interest management in relation to gifts may be implemented.

Performance and reward strategies for staff may also contribute to a culture which does not always put customer outcome first and could result in another conflict of interest for the business. Recruitment, training and ongoing performance management of staff should ensure high standards of ethics and integrity. In order to embed the principle of fair treatment of customers, it is important that any performance and reward strategies are aligned with the principle of fair treatment of customers and do not result in unfair policyholder outcomes.

3.5.5.1 The Authority’s view and discussion points

For the majority of general insurance intermediaries, the payment of commission in various forms remains the overriding basis by which intermediaries are remunerated for the advice and services provided to customers ahead of a contract being established.

The Authority does not view the payment of commission, within reasonable industry standard levels commensurate with the services being provided, as necessarily presenting an unacceptable level of risk of customer detriment in all situations; however, the Authority recognises the risk of a conflict of interest arising where financial benefit can be obtained as part of the conclusion of an insurance contract.

Currently, a general insurance intermediary must disclose his commission on request under paragraph 2 of the CTPs but there is no requirement to make the customer aware of his/her right to do this and there is no reference to the need for the intermediary to have policies and procedures to address conflicts of interest situations. It is considered that further guidance on what might be regarded as a conflict of interest situation (and what would not be regarded as such) could be useful for intermediaries.

The Authority has reviewed several jurisdictions to get a better understanding of current market practice in this regard. Although there is a lot of variance in the conduct of business models used by different jurisdictions, it is clear that there is a trend towards greater disclosure in this area. The IDD for EU intermediaries includes disclosure requirements for remuneration which would mean that the basis of remuneration received in relation to an

insurance contract is disclosed to customers i.e. whether it is in the form of a fee paid by the customer, a commission included within the insurance premium or a combination of both. If a fee is payable directly by the customer this must be disclosed, but it does not appear that the amount of commission must be disclosed. The UK and Guernsey currently require that commission is disclosed on request.

The Authority is of the view that it is not always necessary for an intermediary to disclose its commission for general insurance products where the risk is perceived to be lower, as long as any conflicts of interest are adequately managed. Consequently, it is likely that the requirement for commission to be disclosed on request will be maintained; but, the Authority may include an obligation to make the customer aware of his right to do this within the proposals for a terms of business agreement (“TOBA”) considered further at 3.5.6.1.

The Authority may wish to make enhancements to the current requirements, in terms of intermediaries having to pay more regard to conflicts of interest within their business model and to have appropriate policies and procedures to manage such conflicts including in terms of its remuneration.

Discussion Point 7

The Authority invites feedback on the proposal for enhancements to the requirements in relation to conflicts of interest, including whether additional guidance would be welcomed by the industry and, if so, on what areas it would be required.

3.5.6 Provision of information on the intermediary to customers

3.5.6.1 Terms of business agreement

A TOBA is a commonly adopted method by which an intermediary can provide important information to a customer to satisfy regulatory disclosure requirements. ICP guidance states that intermediaries should be expected to provide information on terms of business to customers and to do so prior to an insurance policy being entered into. Currently this is not required within the legislation for intermediaries.

It is considered best practice for a copy of the TOBA to be signed by the customer and retained by the intermediary as part of its records. However, it is acknowledged by the Authority that there are cases where insurance cover needs to be arranged immediately or where insurance is arranged over the phone or via the Internet where this method will not be possible. In such situations, it may be appropriate to provide the information verbally or on screen and follow this up in writing within a reasonable period of time.

A TOBA might include information such as:

- The basis on which services are provided, including whether products are offered from a full range of insurers, from a limited range or from a single insurer;
- By whom the intermediary is registered and supervised;
- Whether the intermediary acts as an agent or a broker;
- Charging arrangements and information on the basis on which the intermediary is remunerated;
- Cancellation rights;
- Notification of complaints and information on the Financial Services Ombudsman Scheme;
- Client money arrangements, including treatment of interest;
- Claims procedures contacts; and
- Confidentiality of information provided.

A TOBA should follow the general principle of being clear, fair and not misleading that is applicable to all communication with customers. In particular, the TOBA should not deprive the client of any rights which he or she would have had if the terms had not existed.

The majority of the items listed above are discussed throughout the conduct of business section of this paper. However, some of these items are covered by other ICP standards applicable to intermediaries as follows:

3.5.6.1.1 Complaints and Dispute Resolution

The CGC currently sets expectations for insurers to handle complaints effectively and fairly through an easily understood, well disclosed, easily accessible and equitable process. This requirement is supplemented by guidance issued jointly by the IOMFSA and the Isle of Man Office of Fair Trading providing “Advice to suppliers on complaints handling and the Financial Services Ombudsman Scheme”.

As noted under section 3.4 above, the Authority is minded to apply certain relevant sections of the CGC to intermediaries and the complaints section would form a part of this. It is anticipated that the TOBA should reference these procedures and state that they will be made available to customers on request.

3.5.6.1.2 Privacy and data protection

The ICP standards set out expectations with regard to privacy and the protection of personal information. Generally, an individual’s right to privacy and the legitimate needs of businesses and organisations to process personal information is dealt with outside of insurance legislation, through the Data Protection Act 2002. Intermediaries have an obligation to comply with legal obligations established under the Data Protection Act 2002.

In addition to this, paragraph 1(vi) of the CTPs requires intermediaries to treat all information supplied as completely confidential to himself and the company to which the business is being offered. The Authority expects that legislation governing privacy and data protection will continue to be dealt with in this way and accordingly does not foresee bringing forward additional legislation in this area, other than for the intermediary to include a confidentiality statement within its TOBA.

Demonstration of ongoing compliance by regulated entities with privacy and data protection requirements will continue to inform the Authority's risk based approach to the supervision of each regulated entity and any breaches of such legislation will by their nature affect the Authority's view of the regulated entity.

Discussion Point 8

It is assumed that the majority of intermediaries already have TOBAs in place. The Authority invites feedback on the proposal to introduce a requirement for a TOBA to be signed by the customer prior to an insurance policy being entered into. The Authority is interested in hearing detail of intermediaries' current practice in this area, especially in terms of situations where this is not possible and how the customer is given adequate disclosure of the above information in such circumstances.

3.5.6.2 Intermediary's status

The CTPs currently cover general sales principles and require, amongst other things disclosure of the intermediary's status as an independent intermediary. This implies that the intermediary will act on behalf of the customer rather than the insurer; however, the Authority does not currently define "independent" or impose a minimum number of agency requirements to ensure that an intermediary who states this is truly independent. It is anticipated that further information in this regard will be required to be disclosed to customers under the revised framework so that customers have a clearer idea of the range of products from which recommendations are made by the intermediary.

3.5.7 Summary of the Authority's views on conduct of business

The CTPs establish some principles to be followed by general insurance intermediaries but, having reviewed developments in international standards, the Authority recognises that further detailed requirements will need to be developed to supplement or replace the requirements under the Act and the Regulations.

In developing these requirements, the Authority currently considers the following potential developments as appropriate:

- Application of relevant paragraphs of the CGC to general insurance intermediaries, likely to include requirements in relation to:
 - Sound and prudent management;
 - General good governance such as conducting business with due skill, care and diligence, maintaining standards on suitability of persons, record keeping, and business continuity planning;
 - Board composition and operation;
 - Key functions and responsibilities of the Board, such as making of key decisions, ensuring adequate human resources to conduct business, ensuring an appropriate level of internal controls, culture;
 - Key responsibilities of directors and senior management;
 - Outsourcing;
 - Compliance function and compliance with all relevant legislation including non-insurance legislation such as in respect of anti-money laundering, terrorist financing, fraud, bribery and data protection;
 - External audit;
 - Risk management system;
 - Internal control framework; and
 - Fraud prevention.

- A Conduct of Business Code for Intermediaries, likely to include requirements in relation to:
 - Terms of business agreement
 - Providing customers with clear information before, during and after the point of sale on the insurance product and about the intermediary to ensure that the customer is appropriately informed about the product
 - Disclosure of legal rights and obligations of contracts
 - Ensuring that advice given is of high quality and suitable for the customer, including that the basis for the advice is documented and provided to the customer
 - Dealing with customer complaints in a fair manner
 - Status of the intermediary – independent or tied
 - Protecting the privacy of information obtained from customers
 - Advertising
 - Claims
 - Conflicts of interest
 - Treatment of clients' money
 - Remuneration

The detail of such proposals will be subject to full consultation, including consultation on any proposed legislation. However, feedback on any of the suggested developments is welcome as part of the response to this paper.

3.6 Clients' Money

ICP 18.6 requires an insurance intermediary to have sufficient safeguards in place to protect client monies.

In the course of carrying on its business, an insurance intermediary may receive money from a client for the payment of premiums to an insurer and may receive monies from an insurer in respect of claims or refunded premiums for onward payment to a client.

Where funds are held at the risk of the client, they are referred to as "clients' money". The intermediary should be expected to have adequate policies and procedures in place for the safeguarding of such funds in the interests of their customers.

The protection of client money is considered a key element of meeting the Authority's objective of protecting policyholders, members and customers. The Authority therefore considers it essential that intermediaries have proper policies and procedures in place to limit the potential for loss to clients by theft, misappropriation of funds etc. In this regard, it is important that the clients' money is not held on the intermediary's balance sheet and that client accounts are set up in such a manner that they are segregated from intermediary's own accounts.

Following the Authority's gap analysis it became apparent that the current client money requirements within paragraph 4 of the CTPs are limited and require enhancement.

In setting requirements for insurance intermediaries in this regard, the Authority will consider introducing requirements under the following headings within an intermediary's policies and procedures on clients' money:

- The use of separate accounts clearly distinguishable from the intermediary's own bank accounts;
- Ensuring that client accounts are held within licensed banks;
- Disallowing monies other than clients' money within the account, except in specific circumstances such as to achieve or maintain a minimum balance or to receive interest;
- Ensuring that monies are paid into the account promptly;
- Ensuring that adequate financial systems and controls are maintained, including authorisation of payments from the account;
- Ensuring that adequate books and records are maintained and subject to audit;
- Ensuring that reconciliations are performed on a regular basis and reviewed;
- Ensuring that discrepancies on the account are followed up promptly and resolved satisfactorily;

- Ensuring, for each client, that payments from a client account are not made before sufficient monies paid into the account have cleared, thus ensuring that any balance held in respect of each client is not negative (i.e. one client’s money should not be used for another client; and
- The treatment of interest.

Investment intermediaries regulated under the Financial Services Act 2008 are subject to detailed client money rules and the Authority will look to these to provide a framework for the development of requirements for general insurance intermediaries.

Discussion Point 9

The Authority invites feedback on the proposal for enhancements to the requirements in relation to clients’ money. It would be useful if respondents could inform the Authority of the frequency with which they hold clients’ money in the normal course of business.

3.7 Professional Indemnity Insurance (“PII”)

Insurance intermediaries are currently required to maintain the level of PII stated in Schedule 2 to the Regulations and the contract must incorporate terms that make provision for the items listed. This list was updated with the introduction of the Insurance Intermediaries (General Business) (Amendment) Regulations 2012 to include, inter alia, legal defence costs in addition to the minimum level of indemnity. By way of background to our considerations, the Authority is aware that “costs in addition” cover has proved particularly difficult for some insurance intermediaries that also hold a Class 2 financial services licence (“IFAs”) to obtain. Therefore, the Authority will be undertaking more extensive jurisdictional market research into the availability of PII for intermediaries.

Removing the requirement for a minimum level of PII cover in preference of an intermediary calculating its own required level of cover is a possible approach that may be considered as part of the Authority’s review. Insurance intermediaries should be best placed to determine the level of cover appropriate for the risk of the intermediaries business, although the Authority anticipates that any development of this type would include a requirement for the rationale of the level maintained to be documented and available for supervisory review.

Another consideration in relation to PII, for groups and for IFAs, is the level of cover required to meet varying obligations (i.e. obligations under the Financial Services Rule Book 2013 and under the Regulations, or obligations for individual group companies under a group policy). The Authority will endeavour to ensure a consistent approach is taken for its regulated entities, as far as possible.

Discussion point 10

The Authority is seeking the views of the sector on the issues with the PII requirements as they currently stand, and any suggested improvements to these.

3.8 Supervisory action

The ICPs set out expectations for regulators to ensure that appropriate supervisory action is taken against licensed insurance intermediaries, where necessary, and that they have powers to take action against those individuals or entities that are carrying on insurance intermediation without the necessary licence.

The Authority's current approach to the supervision of regulated entities focuses on the ongoing assessment of the regulated entity, its activities and the principal risks to which it is exposed and is achieved through a combination of desk-based analysis and on-site inspection visits.

The submission and review of regular regulatory reporting is the principal tool for the Authority's desk based analysis, supplemented by meetings to address specific issues arising. For intermediaries this has to date mainly been fulfilled by the annual re-registration process which also comprises a review of the audited accounts. As noted above, it is proposed that going forward intermediaries will no longer be required to apply for registration on an annual basis but it is anticipated that this process will be replaced by an annual regulatory return.

The Authority's on-site inspection programme complements its desk-based analysis, and may take the format of routine visits or may focus on specific areas of interest, policy or procedure, including that of compliance with applicable anti-money laundering and prevention of terrorist financing and proliferation legislation.

Where an intermediary fails to meet regulatory requirements, the Authority has the power under the Act to take such supervisory action as it believes to be appropriate and proportionate. Minor breaches or offences might be dealt with through verbal or written communications with management and subsequent monitoring, whereas more significant deficiencies which result in a risk to any of the Authority's regulatory objectives are likely to warrant immediate and more significant action. The Authority considers that published guidance on what actions by the intermediary would trigger supervisory intervention would introduce greater transparency in this regard and intends to publish its approach to the use of enforcement powers, for example the criteria it would take into account when deciding which power to use.

The Authority recognises that as it continues to develop its regulatory framework, the supervisory approach described above will also need to be kept under review.

For conduct of business and corporate governance requirements in particular, there are a number of factors that need to be considered when determining how the Authority's supervisory approach may evolve to best evaluate how regulated entities comply with requirements established in the updated framework and to ensure that the desired outcomes are achieved. Effective assessment of the quality of insurance intermediation to a large extent requires supervisory consideration of policies, processes and procedures that relate to individual customer relationships and transactions.

A supervisory approach developed to identify and monitor conduct risk issues is likely to require enhancements, when compared to a prudential model of regulation for example. In particular the Authority expects to develop its approach in the following areas:

- Focus on business models, strategy and culture – as noted earlier in this paper, current standards place an expectation that the fair treatment of customers is an integral part of regulated entities' business models and culture. The Authority will continue to expand its supervisory activities to assess these areas.
- Focus on customer outcomes and a principles based approach – the evaluation of conduct risks often does not lend itself to a rules based approach to supervision. While the Authority will enhance its framework by developing prescribed requirements and guidance where appropriate, consideration will also need to be given to how the Authority develops its supervisory process to assess and monitor outcomes for customers.

Examples of how the Authority may develop its supervisory approach to address include:

- Building understanding of conduct risks through expanded scope of data collection and greater use of market intelligence;
- Formalising conduct themes into the Authority's existing risk based supervisory approach;
- Ongoing monitoring of compliance with conduct regulations and guidance as regulatory enhancements are introduced;
- Thematic reviews of customer outcomes; and
- Increasing the focus on corporate governance for intermediaries.

4 Summary of discussion points

For ease of reference, the discussion points raised throughout this paper are repeated here:

Discussion point 1

The Authority welcomes views on developing rules in relation to financial resources, and encourages existing registered general insurance intermediaries to share examples of practice in this area in order that the Authority can evaluate current market practice to the approach adopted in other jurisdictions.

Discussion point 2

The Authority considers the current project as an appropriate opportunity to review exemptions to registration under the current framework, to consider whether the exemptions available remain current and consistent with international standards.

In this regard, the Authority is interested in feedback from the industry to help formulate its views in this area, particularly if the industry is aware of firms utilising the exemptions currently available.

Discussion point 3

The Authority is interested in further feedback from the industry regarding the services being provided by off Island intermediaries to IOM residents on a cross border basis.

Discussion point 4

In addition to general feedback on the professional knowledge and experience, integrity and competence within the industry currently and the issues raised within this paper, the Authority is interested in specific comments from intermediaries on the degree to which the outlined suggestions are consistent or in conflict with existing practice.

Discussion point 5

The Authority invites feedback on the proposal to extend the CGC to intermediaries, including where it is felt application may be impractical or require further guidance.

Discussion point 6

The Authority is interested in feedback from intermediaries on practice adopted around disclosures currently made to customers prior to a contract being concluded, and how developments in insurance law around customer disclosure of material facts, such as through CIDRA, have modified such practice.

Discussion Point 7

The Authority invites feedback on the proposal for enhancements to the requirements in relation to conflicts of interest, including whether additional guidance would be welcomed by the industry and, if so, on what areas it would be required.

Discussion point 8

It is assumed that the majority of intermediaries already have TOBAs in place. The Authority invites feedback on the proposal to introduce a requirement for a TOBA to be signed by the customer prior to an insurance policy being entered into. The Authority is interested in hearing detail of intermediaries' current practice in this area, especially in terms of situations where this is not possible and how the customer is given adequate disclosure of the above information in such circumstances.

Discussion point 9

The Authority invites feedback on the proposal for enhancements to the requirements in relation to clients' money. It would be useful if respondents could inform the Authority of the frequency with which they hold clients' money in the normal course of business.

Discussion point 10

The Authority is seeking the views of the sector on the issues with the PII requirements as they currently stand, and any suggested improvements to these.

Feedback on these specific discussion points along with any other feedback to this document should be provided by email, by 23 December 2016, to:

Paul Ellison - ACII
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Appendix 1 – ICP 18

ICP 18 Intermediaries

The supervisor sets and enforces requirements for the conduct of insurance intermediaries, to ensure that they conduct business in a professional and transparent manner.

Introductory Guidance

18.0.1 Most of the standards under this ICP apply to intermediaries in a functional capacity (i.e. as individuals providing intermediation services to customers). In some cases, the standards' requirements apply to the intermediary as an organisation; where this is the case, this is made clear in the corresponding guidance. Where insurers' direct sales staff solicit, negotiate or sell insurance as employees of the insurer, the standards apply to the insurer.

18.0.2 Individuals or firms which simply refer (or "introduce") potential customers to an insurer or insurance intermediary, without carrying out intermediation, are excluded from the scope of these standards. Also excluded from the scope of these standards are persons, such as tax advisers or accountants, who in conducting another professional activity provide:

- advice on insurance cover on an incidental basis in the course of that other activity, or
- information of a general nature on insurance products (without advising on the choice of insurance product provider) provided that the purpose of that activity is not to intermediate an insurance or reinsurance contract.

18.0.3 Insurance intermediaries may also perform functions supplemental to intermediation, many of which may be described as outsourced functions of the insurer. These supplemental functions may include underwriting, premium collection, administration, management of insurance claims, loss adjusting and claims appraisal. These functions are excluded from the IAIS definition of insurance intermediation^[37] but may be subject to other ICPs and standards relating to business conduct.

[37] However, in some jurisdictions these supplemental functions are included in the definition of intermediation. See Glossary.

18.0.4 Intermediation systems and practices are closely linked with jurisdictions' tradition, culture, legal regime and the degree of the development of insurance markets. For this reason, regulatory approaches to intermediation also tend to vary. Such diversity should be taken into consideration in implementing this ICP and related standards and guidance material in order to achieve the outcome of fair treatment of customers.

18.0.5 Insurance intermediation involves the interface between insurers and actual or potential policyholders. Effective assessment of the quality of insurance intermediation to a large extent requires supervisory consideration of policies, processes and procedures that relate to individual customer relationships and individual transactions. Where insurance intermediation (including intermediation activity of an insurer's direct sales staff) is carried out by intermediaries which are part of a group, supervisors are expected to apply these

standards to all the entities within the group that conduct insurance intermediation business. Where intermediaries participate in a group or financial conglomerate, the application of appropriate policies and procedures on insurance intermediation across the group should result in the fair treatment of customers on a group-wide basis, even if legal provisions in some jurisdictions set requirements that are potentially lower than those used by the group.

18.0.6 The supervisor should consider the application of these standards and guidance material taking into account that there are various business models ranging from sole traders to large enterprises, including specialist wholesale or reinsurance intermediaries.

18.0.7 The nature of the customers with which an intermediary interacts and the complexity of the products offered are also relevant. Private customers have different needs in terms of consumer protection than larger businesses; life products with an investment element are typically more complex than general personal lines products.

18.0.8 In order to take into account the nature, scale and complexity of the business in applying this ICP and standards, the supervisor may wish to take a functional approach, focusing on the activity carried out by the intermediary, to ensure consistency and prevent the opportunity for regulatory arbitrage.

Types of Intermediaries

18.0.9 Intermediaries fall into two categories. They act either primarily on behalf of the customer or primarily on behalf of the insurer.

- Where the intermediary acts primarily on behalf of the insurer, the intermediary sells products for and on behalf of one or more insurers, they are often referred to as “agent” or “producer”. Intermediaries may act for a single insurer (sometimes referred to as “tied”) or represent several. The products they can offer may be restricted by agency agreements with the insurer(s) concerned.
- Where the intermediary acts primarily on behalf of the customer, the intermediary is independent of the insurer(s) whose products he sells. Often referred to as “broker”, or “independent financial adviser”, they are able to select products from those available across the market.

For the purposes of these standards and guidance, where it is relevant to distinguish between the intermediaries described above, the former are referred to as “agents” and the latter are referred to as “brokers”.

18.0.10 Some supervisors do not distinguish between agents and brokers in legislation and instead focus on the activity performed. It may be possible for an intermediary to have different status depending on the customer relationship and the product or service being offered.

18.0.11 Intermediary operations range from large international firms to local sole traders. Intermediary firms sometimes operate as independent enterprises or divisions of insurers or other financial institutions, or as part of non-financial organisations.

18.0.12 Insurers use various distribution channels to market and sell insurance products. These can include a variety of partners such as car dealerships, post offices, retailers and travel agents who offer insurance in respect of the primary goods and services in which they trade. In many cases this activity will represent intermediation on the respective insurance products.

18.0.13 Bancassurance describes the relationship between a bank and an insurer whereby the bank's distribution channels are used to sell insurance products.

18.0.14 Intermediaries are generally remunerated through fees or commissions, which may be paid by the insurer, deducted from funds invested in a policy or charged directly to the customer, depending on the circumstances. Where insurers' direct sales staff carry out insurance intermediation as employees of the insurer, they may be salaried as well as receive any applicable commission.

Intermediaries' Role in Promoting Public Trust and Confidence in the Insurance Sector

18.0.15 Insurance plays an important role in society. In most insurance markets, intermediaries serve as important distribution channels of insurance. Their good conduct is essential to promote confidence in insurance markets.

18.0.16 It is in the interests of supervisors, in promoting fair, safe and stable insurance markets, that the public has trust and confidence in the insurance sector. Insurance intermediaries' interface between consumers and insurers gives them a key role in building and justifying this public trust and confidence.

18.0.17 Intermediaries' duty to the public interest has also been considered by some professional bodies and other interested organisations. With a view to enhancing the professionalism of insurance intermediaries, they encourage, amongst other things, the obtaining of professional qualifications, continuous professional development, ethical behaviour, the fair treatment of customers and better communication with the public including thought leadership. Such measures are aimed at enhancing public confidence in insurance intermediaries through raising professional standards, and many of these are discussed further in this guidance.

Intermediaries' Role in Promoting Financial Awareness

18.0.18 Intermediaries can promote consumer protection by assisting consumers to make better informed decisions about the products that they buy. At the heart of consumer protection are asymmetries of information between financial services product providers and the public to whom the products are sold. The adoption of good conduct of business practices by insurers and insurance intermediaries helps to ensure that customers are sufficiently informed on the insurance products they buy before concluding a contract.

18.0.19 The enhanced financial awareness of consumers is a further means of ensuring that consumers are aware of the products available to them and understand their purpose, how they work and their key features, including cost. This understanding helps consumers to compare products and to purchase insurance products that meet their needs.

18.0.20 The promotion of financial awareness is likely to benefit, in particular, consumers in jurisdictions where consumer protection standards are weak or levels of financial literacy are low. It is also especially important when dealing with more complex financial products, particularly those with an investment element.

18.0.21 Insurance intermediaries are not the only stakeholders in promoting the financial and risk awareness of consumers; governments, supervisors, social interest organisations and insurers have a significant interest and role to play in consumer protection. Nor are insurance intermediaries the only means of improving financial education. Other stakeholders, using various communication channels including the media, are also able to play a significant role. Nevertheless, intermediaries' face-to-face dealings with their customers and marketing of products to consumers place them in a position to contribute to strengthening the financial awareness and education of the public on risk and insurance matters. Supervisors may therefore wish to encourage insurance intermediaries to promote the financial awareness of consumers on insurance products.

18.0.22 A variety of means may be used by insurance intermediaries to promote financial awareness, such as:

- taking advantage of face-to-face meetings to explain features of products in which customers may be interested, which may be particularly important where their interest is in complex or long term contracts;
- providing references to specific websites or other reference material which gives relevant information, or publishing such material themselves;
- making available or suggesting other sources of financial tools such as on-line calculators which estimate premiums or coverage levels; or
- participating in educational initiatives such as training seminars.

18.0.23 In undertaking financial education initiatives, intermediaries should ensure that the personnel used to undertake the relevant activity have sufficient knowledge for this purpose and that material or tools provided are up to date and free from error to the extent practicable. Such initiatives may target specific audiences, such as vulnerable groups, and are likely to benefit from a user-friendly approach.

18.0.24 Improved understanding by consumers of the terms and benefits they can expect from insurance products may also lead to a reduction in complaints against intermediaries or the insurers whose products they sell.

18.0.25 Intermediaries' initiatives to promote financial awareness, where conducted with professionalism, may be seen as a public service and help to enhance both their own reputation and that of the insurance sector.

Application of ICPs to Intermediaries

18.0.26 Whilst this ICP is specific to the supervision of intermediaries, other ICPs that apply, generally or in part, to the supervision of intermediaries as well as to the supervision of insurers are:

- ICP 19 Conduct of Business

- ICP 21 Countering Fraud in Insurance
- ICP 22 Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT).

18.0.27 The supervisor should have adequate powers to conduct supervision of intermediaries, including powers to issue rules and take enforcement action.

18.1 The supervisor ensures that insurance intermediaries are required to be licensed.

18.1.1 In some jurisdictions other terminology or processes, such as “authorisation” or “registration”, are used in place of “licensing”. For the purposes of this ICP these terms are collectively referred to as “licensing”.

18.1.2 The supervisor may choose to license intermediaries at the entity level or the individual level, or both. Where insurers’ direct sales staff carry out insurance intermediation as employees of the insurer, these activities may be covered by the insurer’s licence or may require separate intermediary licensing.

18.1.3 Where licensing is at the entity level the supervisor may consider whether the entity has in place procedures to ensure that the individuals who conduct insurance intermediation under its responsibility meet appropriate standards of professionalism and competence. The supervisor may also wish to set its own requirements for approval of individuals, within an insurance intermediary, who conduct intermediary business.

18.1.4 Certain types of insurance business involve greater complexity and risks and hence require more skill and experience, including the provision of advice, in their intermediation. In view of this, the supervisor may wish to specify in the licence the types of insurance intermediation which the insurance intermediary is permitted to undertake, taking into account, for example, the intermediary’s proposed business plan and areas of expertise.

18.1.5 Prior to issuing a licence, the supervisor should require an application, together with additional information which may include items such as:

- A copy of the insurance intermediary’s Conduct of Business Rules or confirmation of agreement to Conduct of Business Rules published by the supervisor
- Details of ownership, including all relevant information necessary to provide a full understanding of the insurance intermediary’s ownership and control
- The proposed method of capitalisation
- A business plan, including details of proposed business and financial projections
- Information on personnel, in particular on key functionaries
- Successful due diligence in respect of key functionaries
- Details of any significant third party service providers
- Details of the proposed auditor, where applicable
- Details of professional indemnity insurance cover, including amount and limitations, or comparable guarantee
- Business continuity plans

- If incorporated, relevant information on incorporation such as memorandum and articles of association and certificate of incorporation
- Details of policies, procedures and controls in key areas such as:
 - Compliance
 - combating financial crime (including AML/CFT and fraud)
 - new business
 - client money
 - complaints
 - conflicts of interest.

The supervisor may require additional information to complete the licensing process, upon request.

18.1.6 The supervisor may decide to set minimum financial resource requirements, for example to discourage market entrants with insufficient financial resources to withstand shocks. Where this is the case, such requirements might take into account risk factors such as the nature of the business to be intermediated, whether the intermediary operates client accounts, the level of professional indemnity insurance and the level of operating expenses, to ensure that an appropriately risk-based financial resource requirement is set.

18.1.7 In specific and limited circumstances, the supervisor may choose to make exceptions to certain licensing requirements. The supervisor should ensure that any such exceptions do not encourage regulatory arbitrage or increase the risk to consumers.

18.1.8 The supervisor should consider what licensing requirements, if any, are applicable to intermediaries operating on a cross-border basis from outside the jurisdiction. These requirements should be transparent to consumers, as well as to intermediaries, so that they can make an informed decision when choosing to deal with intermediaries from other jurisdictions.

18.1.9 The supervisor may wish to consider the possibility of issuing periodically renewable licences. An advantage of doing so would be to ensure periodic reassessment of compliance with the regulatory licensing requirements.

18.2 The supervisor ensures that insurance intermediaries licensed in its jurisdiction are subject to ongoing supervisory review.

18.2.1 The supervisor should ensure that initial licensing conditions, as applicable, and ongoing regulatory requirements are maintained subsequent to the licence being issued.

18.2.2 In addition to monitoring ongoing compliance with licensing conditions and other regulatory matters, the supervisor may require that any breaches in licensing conditions or other matters of regulatory concern are reported promptly.

18.2.3 In general, the analysis of complaints against insurers and intermediaries is a valuable source of information in identifying poor conduct in the area of intermediation.

18.2.4 Ongoing supervision may include both reporting to the supervisor (off-site monitoring) and on-site inspection, as necessary. Further information on this topic is available in ICP 9 Supervisory Review and Reporting, but may require adaptation to make it appropriate for the specific nature of intermediary business. The supervisor may specify information to be provided for off-site monitoring purposes, including information to be reported routinely or on an ad-hoc basis, for example (but not limited to):

- Financial statements, audited where applicable, or other certification of the financial soundness of the intermediary
- Auditor's management letter, where applicable
- Confirmation of professional indemnity cover (including exclusions or limitations) or comparable guarantee
- Information on the sources of and placement of business
- Summary of movements on client money accounts, where applicable
- Changes in key functionaries and significant owners.

18.2.5 On-site inspections may consider areas such as:

- Corporate governance and internal controls
- Procedures and controls for combating financial crime
- Review of client money accounts where applicable
- Review of customer files
- Review of complaints
- Review of disclosure to customers and terms of business agreements (TOBAs)
- Review of documentation of advice given and the reasons for that advice.

18.2.6 Where appropriate, the supervisor may also use regular formal meetings with intermediaries as a means of supplementing these off-site and on-site procedures. In addition, where appropriate, the supervisor may also use on-the-ground testing, such as "mystery shopping", to evaluate whether intermediaries' policies and procedures have transferred into fair outcomes for customers.

18.2.7 Where applicable, the supervisor will need to apply supervisory review procedures to insurance intermediaries at the level at which licensing takes place (i.e. at the entity or individual level) or at the insurer level. Reporting requirements in respect of an insurer's direct sales staff would be the responsibility of the insurer.

18.2.8 In conducting ongoing supervision, the supervisor may wish to consider the advantages of a risk-based approach in which greater attention is focused on areas which may be of higher risk, for example:

- where intermediation includes the provision of advice
- intermediation on long-term or complex products or those with a significant investment element
- in respect of less sophisticated customers.

Indirect Supervision

18.2.9 A means of supervision used in some jurisdictions is to supervise intermediaries indirectly through the supervision of the insurers. In applying an Indirect approach, the supervisor will need to take into account the extent to which such an approach achieves effective supervision. Regardless of the approach, it is ultimately the supervisor's responsibility to ensure that intermediaries are effectively supervised.

18.2.10 An Indirect approach may be more appropriate for the agent model than the broker model, as under the agent model the intermediary may act under an agency agreement with the insurer.

18.2.11 Indirect supervision can relate to circumstances where the insurer relies upon an intermediary to perform processes on its behalf. For example, insurers are expected to obtain appropriate documentation regarding their customers to demonstrate that appropriate customer due diligence and/or fact-finding procedures have been carried out. Insurers will be assessed on the adequacy of the processes carried out and documentation obtained, including where the insurer relies upon intermediaries to perform this work and supply the documentation required.

18.2.12 The supervisor should require insurers to conduct business only with intermediaries who are licensed and to verify that the intermediaries under such arrangements have the appropriate knowledge, ability and financial circumstances with which to conduct such business.

18.2.13 The supervisor may also require insurers to have transparent mechanisms to handle complaints against such intermediaries and report breaches of regulatory requirements by intermediaries. This might include identifying whether particular intermediaries or particular matters are the subject of regular or frequent complaints. Documentation on this will enable insurers to report "recurring" complaints to the supervisor where such complaints may be relevant to an assessment of the intermediaries' reliability.

18.2.14 Under this approach the supervisor should ensure compliance by insurers in supervising intermediaries through its on-site inspection and off-site monitoring of the insurer.

Self-regulatory Organisations

18.2.15 A self-regulatory organisation (SRO) is a non-government organisation that exercises some degree of supervisory oversight for an industry or profession. The supervisory functions of a self-regulatory organisation can contribute to the supervision of intermediaries through the regulation of its members and requirements for professional standards.

18.2.16 Where an SRO is involved in the supervision of intermediaries, the supervisor should ensure that the SRO meets appropriate standards before being allowed to exercise authority. The supervisor should maintain oversight of the self-regulatory system by verifying that its functions are being performed adequately and that its standards are sufficiently robust and take appropriate action to deal with any shortcomings.

18.2.17 An SRO's regulatory and professional requirements may not address all the aspects of the supervision of insurance intermediaries in which the supervisor has an interest. Therefore, where an SRO shares some of the supervisory responsibility, the supervisor should nevertheless not abdicate its overall responsibility for supervision as a result of the operation of such as system.

18.3 The supervisor requires insurance intermediaries to possess appropriate levels of professional knowledge and experience, integrity and competence.

Professional Knowledge & Experience

18.3.1 It is important that individuals working as insurance intermediaries have adequate professional knowledge to carry out their responsibilities. Professional knowledge can be gained from experience, education and training. Importantly, to be able to demonstrate that a certain level of professional knowledge has been achieved, it is preferable that this is supported by the attainment of relevant professional qualifications.

18.3.2 Professional qualifications underpin the quality of work carried out by professionals, including insurance intermediaries. The supervisor thus has an interest in ensuring that insurance intermediaries have policies and procedures which encourage individuals to achieve relevant professional qualifications.

18.3.3 The supervisor may also wish to ensure that individuals responsible for insurance intermediation activities have professional qualifications and experience appropriate for the business which they intermediate. More complex products or customer needs will require higher or more specialised qualification and experience. The qualifications and experience of individuals should also be appropriate for the type of intermediation being carried out, whether as agent for a specific insurer or acting as a broker primarily on behalf of the customer. Once professional qualifications have been achieved, it is important that individuals who continue to work as insurance intermediaries keep their professional knowledge up to date. Certain professional bodies require their members to spend a specified minimum amount of time on continuous professional development.

18.3.4 The supervisor may consider recognising the qualifications of specified professional bodies. Where a jurisdiction has no such professional body, consideration could be given to encouraging or recognising qualifications obtained through professional bodies in other jurisdictions. The supervisor might also consider recognising international qualifications where these are considered to be equivalent to, or exceed, a jurisdiction's qualifications.

18.3.5 Intermediaries should also be knowledgeable regarding the status of the insurers whose products they sell. For example, they should be aware of the jurisdiction(s) in which the insurer is licensed, whether they are placing business with a branch or subsidiary company, the financial status and credit rating of the insurer and the applicability of any policyholder protection schemes to that insurer's products.

Integrity

18.3.6 It is essential that insurance intermediaries act with integrity and high ethical standards. These relate to qualities of the individuals concerned, such as: being honest, trustworthy and open being reliable, dependable and respectful not taking unfair advantage not accepting or offering gifts where this might imply an improper obligation.

18.3.7 The supervisor may wish to ensure that individuals acting as intermediaries are subject either to internal policies and procedures, or to the ethical standards of professional bodies, that require integrity.

18.3.8 The supervisor may also wish to lay down their own expectations through the publication of a code of conduct with which intermediaries are required to comply. Codes of conduct should be complementary to the relevant legislation and may address any aspect of dealings between insurance intermediaries and their customers.

18.3.9 Intermediary firms should operate procedures to assess the integrity of those acting as intermediaries on its behalf. Such procedures would be expected to include pre-employment checks as well as ongoing requirements. Pre-employment checks would include, amongst other things, checks for any criminal convictions and on employment history.

Competence

18.3.10 The supervisor should ensure that the individuals carrying out insurance intermediation do so only in respect of business for which they have the required competence.

18.3.11 The supervisor will expect insurance intermediaries to implement policies and procedures to assess the competence of the individuals undertaking intermediation work. Assessment would be particularly important in the case of new employees or where staff are assigned different or more challenging responsibilities. Competence should also be monitored as an ongoing process for all relevant staff. This may include actions such as:

- observed interviews with clients
- review of client files
- internal interviews
- coaching.

18.3.12 The supervisor's powers to conduct on-site inspections (including file reviews and interviews of selected staff) also provide the opportunity for the supervisor to assess competence during the course of supervisory examinations.

Role of professional standards

18.3.13 Where these exist, SROs and professional bodies can be instrumental in promoting professional standards in cases where they issue standards or codes with which their members are required to comply. The standards required by SROs or professional bodies whose members are insurance practitioners might include areas such as:

- acting with high ethical standards and integrity
- acting in the best interests of each client

- providing a high standard of service
- treating customers fairly.

18.3.14 Members who are found to be in breach of the professional standards of the organisation may be subject to disciplinary procedures such as suspension of or exclusion from membership.

18.3.15 The supervisor may wish to confirm that where there is reliance on the membership of a professional body, that body has an effective disciplinary scheme in force. The supervisor may nevertheless decide not to depend on such professional processes entirely and to retain the right to deal with issues of individuals' professional conduct directly.

18.4 The supervisor requires that insurance intermediaries apply appropriate corporate governance.

18.4.1 Insurance intermediaries should be subject to minimum corporate governance requirements. The governance requirements may vary, depending upon the nature and scale of the intermediary and the complexity of its business, and may be subject to general company law. The requirements may therefore differ between different intermediary organisations. However, the minimum corporate governance requirements for each intermediary should be sufficient to provide for sound and prudent management of the business and to protect the interest of stakeholders.

18.4.2 Good governance may be promoted through the supervisor, as well as other authorities and organisations publishing guidance, for example a Code of Practice to insurance intermediaries on their obligations in respect of governance-related matters, setting out expectations in areas such as:

- achieving and maintaining standards on suitability of persons
- ensuring appropriate standards for conduct of business
- ensuring that the making of key decisions is subject to sufficient discussion at Board level or with key functionaries as appropriate
- ensuring adequate human resources to conduct the business
- ensuring an appropriate level of internal controls of the business
- maintaining adequate files and records and ensuring their availability for inspection
- maintaining appropriate controls over outsourced functions
- compliance with all relevant legislation, including non-insurance legislation such as in respect of anti-money laundering, fraud etc.

18.4.3 In setting governance requirements the supervisor may need to consider the application of such requirements to sole traders and small entities operating as insurance intermediaries. Due to their small size, sole traders and small businesses will have difficulty in meeting, or be unable to meet, various requirements expected of larger entities. Key areas where requirements may prove difficult to meet could include internal controls, segregation of duties, compliance functions and maintaining training and competence requirements. Whilst this and other IAIS standards relevant to insurance intermediaries are expected to be applied taking into account the scale, nature and complexity of the business, the supervisor will need to be satisfied that a minimum standard is achieved.

18.4.4 Insurers are responsible for the governance of their direct sales staff and are subject to the requirements of ICP 7 Corporate governance.

18.5 The supervisor requires insurance intermediaries to disclose to customers, at a minimum:

- **the terms and conditions of business between themselves and the customer;**
- **the relationship they have with the insurers with whom they deal; and**
- **information on the basis on which they are remunerated where a potential conflict of interest exists.**

18.5.1 This standard is concerned with the disclosure of matters relating to intermediaries themselves. Requirements to disclose information on insurance products offered to customers is covered by ICP 19 Conduct of Business.

18.5.2 In setting disclosure requirements, the supervisor may find it relevant to take into account that there are differences in:

- the nature of different insurance products;
- the level of sophistication of different customers; and
- the way in which different types of insurance are transacted (for example,
- differences between commercial and personal (retail) lines).

These may influence the nature and timing of disclosures to some extent.

18.5.3 Expectations of timing and detail of disclosure may therefore differ according to the circumstances. The supervisor will wish to ensure that disclosure requirements provide adequate protection to customers as appropriate, taking into account these factors.

Terms of Business

18.5.4 A terms of business agreement may be a convenient means by which an insurance intermediary can provide important information to a customer and satisfy many of the disclosure requirements. Such a document might include information such as:

- by whom they are licensed and supervised
- whether they act as agents or brokers
- the services provided, including whether they offer products from a full range
- of insurers, from a limited range or from a single insurer
- charging arrangements
- cancellation rights
- notification of complaints
- client money arrangements, including treatment of interest
- client money arrangements, including treatment of interest
- confidentiality of information provided
- relevant laws
- information on the basis on which they are remunerated.

18.5.5 Insurance intermediaries should be expected to provide information on terms of business to customers and to do so prior to an insurance policy being entered into. Where there is an ongoing business relationship between an intermediary and a customer, or in the case of policy renewals, once terms of business information has initially been provided, the intermediary should review whether reiterating this information is necessary. Further information on terms of business might only be necessary where there are changes to the terms.

18.5.6 When insurance cover needs to be arranged immediately it may not be possible to provide documentation of terms of business at the point of arranging the contract. In such situations the information may be provided orally and followed up with written documentation within a reasonable period of time.

18.5.7 The supervisor may consider it best practice, and hence recommend or require, that a copy of the terms of business, signed by the customer, is retained as part of the insurance intermediary's records. Where insurance is intermediated over the internet, the customer can be required to acknowledge the terms of business before a policy can be proceeded with. Electronic records could be retained by the insurer.

Intermediary Status

18.5.8 An insurance intermediary's status will provide information to a customer on the extent of products from which recommendations are made and provide an indication of potential conflicts of interest. Where the insurance intermediary is only able to select products from a single insurer or from a limited range, the customer 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.

18.5.9 It is therefore particularly important that insurance intermediaries provide customers with information on their relationship with the insurers with whom they deal, specifically whether they are independent or an agent, legally or in practice, with one or more insurance companies and whether they are authorised to conclude insurance contracts on behalf of an insurer or not.

18.5.10 Potential conflicts of interest can arise if an intermediary is part of a wider insurance group or if the intermediary has a financial interest, such as a shareholding in an insurer or insurance group. Such relationships should be disclosed to customers.

18.5.11 This information may be provided as part of a terms of business agreement or separately. Because of its importance this information might also be highlighted verbally to the customer.

Remuneration

18.5.12 Insurance intermediaries are generally remunerated by way of fees and commissions:

- Fees paid directly by the customer;

- Fees or commissions paid indirectly by the customer, e.g. by way of deduction from premiums or funds invested; or
- Fees or commissions paid by the insurer.

18.5.13 Information on charging structures can be important information to customers, depending on the types of insurance involved. For example, for insurance products with an investment element, information on any fees or other costs deducted from the initial amount invested, as well as on fees or commissions deducted from the investment thereafter will be important. For non-life insurance and pure life insurance products, where fees are not paid directly by the customer, such information may have less of a direct impact but may have a bearing on the independence of any advice that is provided.

18.5.14 The circumstances under which potential conflicts of interest exist, which would require disclosure of the basis on which intermediaries are remunerated, are outlined in the discussion on conflicts of interest in ICP 19 Conduct of Business and applies to all types of intermediary. However, the supervisor may allow exceptions where the risk is low and potential conflicts of interest are adequately managed.

18.5.15 The supervisor may also require that customers are provided with further information on fees and commissions upon a customer's request, including the level of fees and commissions. The intermediary should make the customer aware of his/her right to request information on fees and commissions. Communication should be clear and not misleading. In view of the impact of fees and commissions upon insurance not misleading. In view of the impact of fees and commissions upon insurance products with an investment element, the supervisor may choose to require that disclosure of fees and commissions is provided to customers prior to policies being entered into in respect of all such products.

18.5.16 Information on charging may be provided as part of a terms of business agreement, or separately. As fees and commissions vary by product and between product providers, they may need to be provided separately for each product recommended, often by inclusion in product documentation. Because of their significance to some types of product this information might also be highlighted verbally to the customer.

18.5.17 Some forms of remuneration of insurance intermediaries may potentially lead to a conflict of interest; an intermediary may be tempted to recommend a product which provides higher fees or commissions than another. The supervisor will wish to ensure that robust procedures are in place to identify and resolve conflicts of interest and ensure that customers' best interests are served. Conflicts of interest may be managed in different ways as relevant to the circumstances; for example, through appropriate disclosure and informed consent from customers. Where they cannot be managed satisfactorily this would result in the intermediary declining to act. In cases where the supervisor may have concerns about the ability of disclosure to deal adequately with conflicts of interest, the supervisor may consider requiring other options to manage such conflicts. Examples from some jurisdictions, in place or under consideration include:

- prohibitions on certain types of financial interest
- structural changes to the retail distribution model, such as by prohibiting the
- payment or receipt of commission on investment products in favour of a

- fee-based approach.

These issues may also be covered in the ethical codes issued by self-regulatory organisations.

18.5.18 The supervisor should be aware of the use of non-monetary benefits, so called “soft” commissions, offered by insurers to intermediaries. These may include less tangible inducements such as professional support or corporate entertainment at sporting or cultural events. Such inducements may lead to conflicts of interest and are less transparent than fees or commissions and also need to be managed or prohibited as appropriate.

18.6 The supervisor requires an insurance intermediary who handles client monies to have sufficient safeguards in place to protect these funds.

18.6.1 In the course of carrying out its business, an insurance intermediary may: receive monies from a client for the payment of premiums to an insurer receive monies from an insurer in respect of claims or refunded premiums for onward payment to a client.

18.6.2 Some jurisdictions may have specific legal requirements in respect of the cash flows where monies are transferred via an intermediary from the customer to the insurer and vice versa, including in determining whether the customer or the insurer is at risk in respect of such funds.

18.6.3 Where funds are held at the risk of the client, they may be referred to as “client monies” or “client’s money”. The intermediary should be expected to have adequate policies and procedures in place for the safeguarding of such funds in the interests of their customers.

18.6.4 Where the insurance intermediary acts as agent for the insurer, these funds may be considered “monies held at the risk of insurers”. In these circumstances the insurer is responsible for such funds held by agents on its behalf.

18.6.5 In setting requirements for insurance intermediaries in respect of the safeguarding of client monies, the supervisor may wish to consider recommending, amongst other things, that the following are adequately covered in their client money policies and procedures:

- the use of separate client accounts clearly distinguishable from the intermediary’s own bank accounts;
- ensuring that client accounts are held with licensed banks within the jurisdiction, or specified other jurisdictions;
- disallowing monies other than client monies within the account, except in specific circumstances such as to achieve or maintain a minimum balance, to receive interest, or to receive commission due to the intermediary;
- ensuring that monies are paid into the account promptly;
- ensuring that adequate financial systems and controls are maintained, including authorisation of payments from the account;
- ensuring that adequate books and records are maintained and subject to audit;
- ensuring that reconciliations are performed on a regular basis and reviewed;
- ensuring that discrepancies on the account are followed up promptly and resolved satisfactorily;

- ensuring, for each client, that payments from a client account are not made before sufficient monies paid into the account have cleared, thus ensuring that any balance held in respect of each client is not negative; and
- the treatment of interest.

18.6.6 In the interests of safeguarding clients' money, it will be important that client accounts cannot be used to reimburse creditors of the insurance intermediary in the event of its bankruptcy.

18.6.7 The supervisor may wish to ensure that, where insurance intermediaries operate client accounts, the terms and conditions of such accounts are disclosed to their customers, including whether funds held in such accounts are at the risk of clients or at the risk of the insurer.

18.7 The supervisor takes appropriate supervisory action against licensed insurance intermediaries, where necessary, and has powers to take action against those individuals or entities that are carrying on insurance intermediation without the necessary licence.

18.7.1 The supervisor needs to be able to take action against the insurance intermediary as licensee (i.e. as either an entity or an individual) where appropriate, for example where the intermediary fails to meet licensing or other regulatory requirements or where consumers may otherwise be at risk. This might occur, for example, where:

- Required information is not provided to customers
- Policies and procedures are inadequate (particularly where this results in inadequate due diligence work)
- Internal controls, file keeping or documentation are inadequate
- Conflicts of interest are not adequately identified or managed
- There are concerns over business continuity.

18.7.2 Supervisory action should apply at either the entity level or individual level, as appropriate. It may be corrective or involve sanctions and could include:

- Requiring the implementation of enhanced policies and procedures
- Restricting business activities
- Removing key functionaries
- Suspending or barring specific individuals from engaging in intermediary business
- Suspending, revoking or not renewing the licence.

18.7.3 Supervisory action may also include action against insurers in the case of direct sales or where an insurer knowingly cooperates with an intermediary which is in breach of its regulatory requirements.

18.7.4 In some circumstances it may be appropriate to apply sanctions indirectly through insurers, for instance where action is taken to remove certain conflicts of interest.

18.7.5 The corrective action or sanctions imposed would be expected to be appropriate to the shortcomings. Minor offences might be dealt with through oral or written communications

with management and then followed up, whereas more significant deficiencies which result in a risk to customers might warrant immediate or more significant action.

18.7.6 The supervisor would be expected to ensure that due process rights for an intermediary (or insurer where relevant) to appeal supervisory action are in place.