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GOVERNOR

STATE OF MICHIGAN
DEPARTMENT OF INSURANCE AND FINANCIAL SERVICES
LANSING

ANNETTE E. FLOOD
DIRECTOR

March 6, 2014

Re: Insurance Agency Best Practices

Dear Insurance Agencies Doing Business in Michigan:

Please see the attached memorandum from Holly Zhu, CPA, Senior Auditor, Market Conduct Audit Unit of the Department of Insurance and Financial Services regarding Insurance Agency Best Practices, for your review and reference.

Thank you.

Sincerely,

AEF/Annette E. Flood

Memorandum

DATE: March 6, 2014

TO: Insurance Agencies Doing Business in Michigan

FROM: Holly Zhu, CPA, CFE
Senior Auditor
Market Conduct Audit Unit

SUBJECT: Insurance Agency Best Practices

The Market Conduct Section (MCS) within the Department of Insurance and Financial Services (DIFS),¹ proactively monitors the business practices of insurance institutions (including companies, agencies, third-party administrators, managing general agencies and surplus lines carriers) operating in Michigan. The MCS is responsible for conducting audits on insurance agencies and licensees to ensure their compliance with the Michigan Insurance Code (Code).

The MCS seeks to guide licensees on best practices to protect consumers, provide quality service, and to meet statutory requirements. The *Best Practices* identified below are provided as guidance. There may be other practices that would be equally effective. Also, any of the practices in this document that are specific to paper recordkeeping would, of course, be equally effective if converted to fit within an electronic system.

I. Best Practices – Accounting

The Code imposes a fiduciary responsibility upon insurance producers and solicitors for all money received and held in their capacity as licensees. Agencies should adopt reasonable accounting methods to properly account for premium-related transactions. The following five accounting practices are designed to help licensees fulfill their fiduciary responsibilities.

1. A trust bank account separate from the operating account is maintained.

Description: Separating insurance premiums from an agency's operating bank account is the optimal way to safeguard client funds. The following recommendations, in

¹ Pursuant to Executive Order 2013-1, all authorities, powers, duties, functions and responsibilities of the Commissioner of the Office of Financial and Insurance Regulation (Commissioner) have been transferred to the Director of the Department of Insurance and Financial Services (Director).

connection with this practice, will ensure accounting accuracy and minimize the possibility of fiduciary violations and exposure to loss of client funds.

Recommended Procedures:

- Premium funds and operating accounts are separately maintained.
 - Premium funds maintained in a fiduciary capacity are not commingled with the agency's operating account, or the owner's or an employee's personal account.
 - Premium funds are maintained in a Federally Insured Financial Institution.
- In addition to depositing premiums that the agency has collected but not yet remitted to a principal, other deposits into the premium account are limited to the following purposes:
 - To maintain a minimum balance;
 - To guarantee the adequacy of the account; or
 - To pay premiums due but uncollected (when an automated payment method is established with the insurer).
- Withdrawals from a premium account are limited to the following purposes:
 - Payment of premiums to insurers;
 - Payment of return premiums to insureds; or
 - Transfer of commissions to an operating account.
- Withdrawals are not made from a premium account if the remaining account balance would be less than aggregate net premiums received but not remitted.
- A separate cash account such as "Cash – Premium" is used to record deposits and withdrawals related to this premium account.

2. Sufficient controls over premium receipts and deposits are adopted and maintained.

Description: Effective controls over premium receipts and deposits ensure that premiums received in an agency's fiduciary capacity are recorded correctly, deposited promptly, and not easily misappropriated.

Recommended Procedures:

- Premium funds received are recorded in a pre-numbered receipt book in duplicate. For each check received, the payer, the receipt date, the check number, and the amount paid is recorded. For each cash payment, the payer and the receipt date are noted, the "cash" box on the receipt is checked, and the amount paid is indicated. If known, the carrier and the policy number are also specified. The client is provided with a copy, and one copy is maintained for the agency's records. The grand total of receipts is calculated on a daily basis.
- Checks and cash are recorded on a deposit slip that specifies deposit date, payment method, check number, and amount and the deposit is totaled. Any differences between the total on the deposit slip and the grand total in the receipt

book are reconciled. Checks and cash are stored in a locked pouch and transported to the bank.

- After making a deposit, the bank receipt is compared to the total on the deposit slip, and any differences are reconciled. A reasonable level of segregation of duties during the receipt and deposit process is maintained. (Refer to best practice #5 for more details).
- Blank check stocks and signature stamps are safely secured.
- Check signing authority is limited to designated individuals. Also, dual signature authority is established by value of check.

3. Written procedures and controls for reconciliation of premium accounts are adopted and maintained.

Description: Establishing a different ledger of accounts, separate from business operating funds, to journalize premium related transactions, enables agencies to reliably report the financial status of the trust account. Reconciling those accounts periodically ensures effective controls over the premium remittance and disbursement process as well as reimbursement of return premiums to insureds.

Recommended Procedures:

- A set of premium accounts which can include Premium Receivable, Premium Payable, Cash – Premium (to account for premium funds deposited in agency's trust account and to differentiate from agency's operating funds), Return Premium Receivable, and Return Premium Payable are established.
- An overall reconciliation policy requiring all premium accounts to be reconciled at least once every month is established and followed.
- Each reconciliation includes a title, description of the account, and procedures and/or instructions on how to complete the reconciliation.
- Documentation supporting the account balance is included with the reconciliation.
- Any discrepancies noted while reconciling those accounts are investigated and resolved.

4. Reasonable accounting records related to return premiums are maintained.

Description: Appropriate and effective controls over return premiums help an agency meet statutory requirements. Improper recording of return premiums can easily distort an agency's outstanding receivable balances.

Recommended Procedures:

- A report of cancelled policies which identifies the policy number, insured's name, carrier, effective date, cancellation date, unearned premium, etc. is maintained.

- Specific accounts such as Return Premium Receivable/Payable (to capture outstanding net return premiums) and Commission Receivable/Payable (to track unearned commission to be refunded) are established to record return premiums.
- The Return Premium Receivable account is reviewed at least on a monthly basis and follow up with carriers regarding any balance aged over 30 days is performed.
- The Return Premium Payable account is reviewed at least on a weekly basis and any outstanding balance is investigated to ensure timely return to clients and/or finance companies if policies are premium financed.
- A written consent is obtained from customers who agree to use return premiums as credit to make a down payment or other payments on other policies.

5. A reasonable level of segregation of duties is established and maintained.

Description: Segregation of duties is critical to effective internal control since it reduces the risk of both erroneous and inappropriate actions. Whenever one person has control over the entire accounting transaction, there is an opportunity for fraud. In general, the approval function, the accounting/reconciling function, and the asset custody function should be separated among employees.

Recommended Procedures:

- The person who maintains and reconciles the accounting records does not obtain custody of premium funds.
- The person who prepares a listing of premiums received does not make the deposit and does not maintain the accounts receivable accounting records.

II. Best Practices – Records Retention

1. An organized filing system is maintained.

Description: Maintaining an organized filing system will best serve the needs of the agency in complying with market conduct audit requirements and help protect against consumer harm.

Recommended Procedures:

- Copies of application forms, policy declaration pages, policy binders, receipts of premium payments, company and agency invoices, and premium remittance are maintained on a customer-by-customer basis.
- Each client file is organized by policy year.
- Copies of premium finance contracts with signatures are maintained.
- Current client information is maintained, including at minimum: name, address, contact person, phone and email.

- Client records are kept on file for a specified period of time in accordance with advice of the licensee's accountant and/or legal counsel. Note: Market conduct audits involve the review of agency financial and client records that generally address a time period of up to three years prior to the date of audit.

2. Effective policies and procedures for safeguarding customer information are implemented and consistently followed. See Bulletin 2010-21-INS Safeguarding Customer Information.

Description: Each licensee needs to adopt policies and procedures for administrative, technical, and physical safeguards for the protection of customer records and information. The policies and procedures should be reasonably designed to do all of the following:

- Ensure the security and confidentiality of customer records and information.
- Protect against any anticipated threats or hazards to the security or integrity of customer records and information.
- Protect against unauthorized access to or use of customer records or information.

Please also keep in mind that a breach of the security of a database containing personal customer information may subject licensees to penalties under the Identity Theft Protection Act, MCL 445.61 et seq.

Recommended Procedures:

- Old paper records are not thrown away with the trash or left in a vacant office. Documents containing customer information that are discarded in trash containers create the potential for identity theft. Customer information is especially vulnerable to inadvertent disclosure when producers change office locations and records are simply discarded.
- All insurers are consulted and their guidelines on how to store customer records and methods for properly disposing of those records (shredding, offsite storage, etc.) are noted and followed.
- The agency's information security program is reviewed periodically and adjustments made in light of new circumstances (changes in technology, changes in the sensitivity of the customer information, new internal or external threats, etc.). Office staff are trained in the elements of the information security program and the need to safeguard customer information is emphasized to them.

III. Best Practices – Licensing and Other

1. Agency and producer licenses and carrier appointments are maintained as required to conduct the insurance business in Michigan.

Description: Maintaining required insurance licenses and company appointments is critical to remaining in good standing with DIFS. *MCL 500.1201a, MCL 500.1208a*

Required Procedures:

- Licenses required to conduct business in an agency's chosen lines of business must be maintained.
- An insurance producer shall not act as an agent of an insurer unless the insurance producer becomes an appointed agent of that insurer.
- Producers affiliated with the agency must be appointed by the agency's carriers. The appointment must be made within 15 days of the date the agency contract is executed, or the first customer insurance application is submitted.

2. Continuing education requirements are met on a timely basis for all licensees.

Description: The Code requires most licensees to complete continuing education (CE) for the purpose of renewing his or her producer license. *MCL 500.1204a, 500.1204c, 500.1201a*

Required Procedures:

- Licensees are aware of, and comply with, the statutory CE requirements.
- Employing agencies ensure licensees suspended or terminated do not sell, solicit or negotiate insurance.

CE due date and course credits can be verified using the [Insurance Licensee Locator](http://difs.state.mi.us/locators?searchtype=InsAgent) at: <http://difs.state.mi.us/locators?searchtype=InsAgent>. Also, you may refer to the [Continuing Education FAQ](http://www.michigan.gov/difs/0,5269,7-303-13648_60666_77187---,00.html) for additional information regarding CE: http://www.michigan.gov/difs/0,5269,7-303-13648_60666_77187---,00.html.

3. A Designated Responsible Licensed Producer is assigned and maintained.

Description: MCL 500.1205(2)(b) requires an agency license applicant to identify a Designated Responsible Licensed Producer (DRLP) in order to obtain licensure. The purpose of a DRLP is to ensure that each agency has a knowledgeable person designated as responsible for agency compliance with statutory and administrative

requirements. Such a designation is an indication of both agency compliance and trustworthiness. Without a knowledgeable person designated as responsible for compliance under the Code, the trustworthiness of the agency is in question.

Required Procedures:

- DIFS is notified when the DRLP leaves the agency or becomes inactive.
- The agency immediately secures a new DRLP and notifies DIFS.

4. Address and name changes are reported promptly to DIFS.

Description: MCL 500.1238(1) and MCL 500.1206(5) require licensees to notify DIFS of a change of legal name or address within 30 days of the change. Individual licensees must have a residence address that is a physical address. Post Office boxes are permissible for business and mailing addresses.

Required Procedures:

- Individual producer addresses are updated via the Address Change Request (ACR) gateway on the [National Insurance Producer Registry \(NIPR\) website](http://www.nipr.com) at: www.nipr.com.
- The agency address is updated using the FIS 0262 Name or Address Change form.
- An individual producer name change is accomplished by submitting form FIS 0262 and a copy of legal proof of the name change, such as a driver's license or marriage certificate.
- An agency name change (but not an FEIN) is completed by submitting form FIS 0262 and a copy of the agency's amended articles of incorporation/organization, partnership or new dba filing.

5. Appropriate professional liability insurance coverage is maintained.

Description: Appropriate levels of professional liability (errors and omissions) insurance provide insurance agencies with the financial capacity to stand behind their professional services.

Recommended Procedures:

- A level of professional liability coverage sufficient to meet the requirements of the carriers for which an agency or producer has appointments is maintained.
- An errors and omissions policy is maintained.

- Required practice for Managing General Agents - A bond in an amount acceptable to the Director is maintained for the protection of the insurer. *MCL 500.1407*

6. Procedures for resolving consumer complaints are maintained.

Description: A process for receiving and addressing consumer complaints is important to ensure that all complaints are addressed.

Recommended Procedures:

- Procedures for documenting and resolving consumer complaints received directly from consumers or from DIFS are established. A standard method that connects the complaint information to a specific transaction is developed.
- A single point of contact is designated for handling complaints.
- A complaint log is maintained for five to seven years.

IV. Best Practices – Annuity Recommendation and Suitability

Chapter 41A of the Code, “Annuity Recommendation to Consumers”, MCL 500.4151 et seq, sets standards and procedures for suitable annuity recommendations in order to protect consumers and ensure that their insurance needs and financial objectives are appropriately addressed. On January 2, 2013, Public Act 544 (the Act) was signed into law and became effective on June 1, 2013. The Act amended the existing chapter by expanding the legal requirements for annuity purchase, exchange, or replacement resulting from any recommendation made by an insurance producer to a consumer. In addition to requiring insurers to provide product-specific training to their producers, a number of new suitability factors applicable to producers were also added.

1. Appropriate recommendations of an annuity sale or replacement are made based on a consumer’s suitability information.

Description: The Act defines suitability information as information that is reasonably appropriate to determine the suitability of a recommendation including, age, annual income, financial situation and needs. The producer or insurer is required to have a reasonable basis for recommending a product that is based on these factors. (See Chapter 41A of the Code)

Required Procedures:

- Reasonable efforts are made to obtain the suitability information of a consumer prior to recommending the purchase, exchange, or replacement of an annuity.
- Consumers are informed of the characteristics of the recommended annuity product, such as the potential surrender period and surrender charge; potential tax penalty if the consumer sells, exchanges, surrenders, or annuitizes the

annuity; mortality and expense fees; investment advisory fees; potential charges for and features of riders; limitations on interest returns; insurance and investment components; and market risk.

- Producers ensure there is a reasonable basis to believe that the consumer would benefit from certain features of the recommended annuity, such as tax-deferred growth, annuitization, or death or living benefit.
 - In cases of an exchange or replacement of an annuity, a replacement disclosure form is completed that compares the main features of both the existing and proposed annuity product.
- In cases where a consumer voluntarily enters into an annuity transaction without a producer's recommendation:
 - A customer-signed statement is obtained, documenting a customer's refusal to provide suitability information, if any.
 - A customer-signed statement is obtained acknowledging that an annuity transaction is not recommended by the producer, if applicable.

2. Sufficient records for annuity recommendations are maintained.

Description: Appropriate levels of documenting the basis of annuity recommendations ensure that insurance agencies and producers meet client and legal obligations.

Recommended Procedures:

- Sufficient records of the suitability information collected from the consumer are maintained, together with any marketing materials and illustrations used during the point of sale.
- Records are maintained for five years after the insurance transaction is completed by the insurer.

3. Education and licensing requirements are completed and maintained.

Description: The Act imposes specific education requirements on all resident and non-resident producers to ensure that a producer possesses adequate knowledge of the recommended annuity product and complies with the insurer's standards for product training. *MCL 500.4160*

Required Procedures:

- All licensed producers who engage in the sale of annuities have completed a one-time four-hour annuity education course by December 1, 2013. Individuals licensed on or after June 1, 2013 shall not engage in annuity sales until this education requirement is met.

- Producers selling, soliciting or negotiating variable life and variable annuity (VA) products maintain a producer license with the VA line of authority and are registered with the Financial Industry Regulatory Authority.

[Approved education courses](#) can be located on the education webpage at: [http://difs.state.mi.us/ProviderListOpenToPublic/\(S\(Inpeqoavlaa1pd5j3nmgc5le\)\)/search.aspx](http://difs.state.mi.us/ProviderListOpenToPublic/(S(Inpeqoavlaa1pd5j3nmgc5le))/search.aspx); choose Life/Health from the drop-down box as Course Classification and click the search button. Approved annuity courses that meet the training requirements in the new Act will display as Annuities as the course type.

Any questions regarding these Best Practices, or any other situations that may arise, may be directed to the DIFS Market Conduct Section at (877) 999-6442 or DIFS-MarketConduct@michigan.gov.