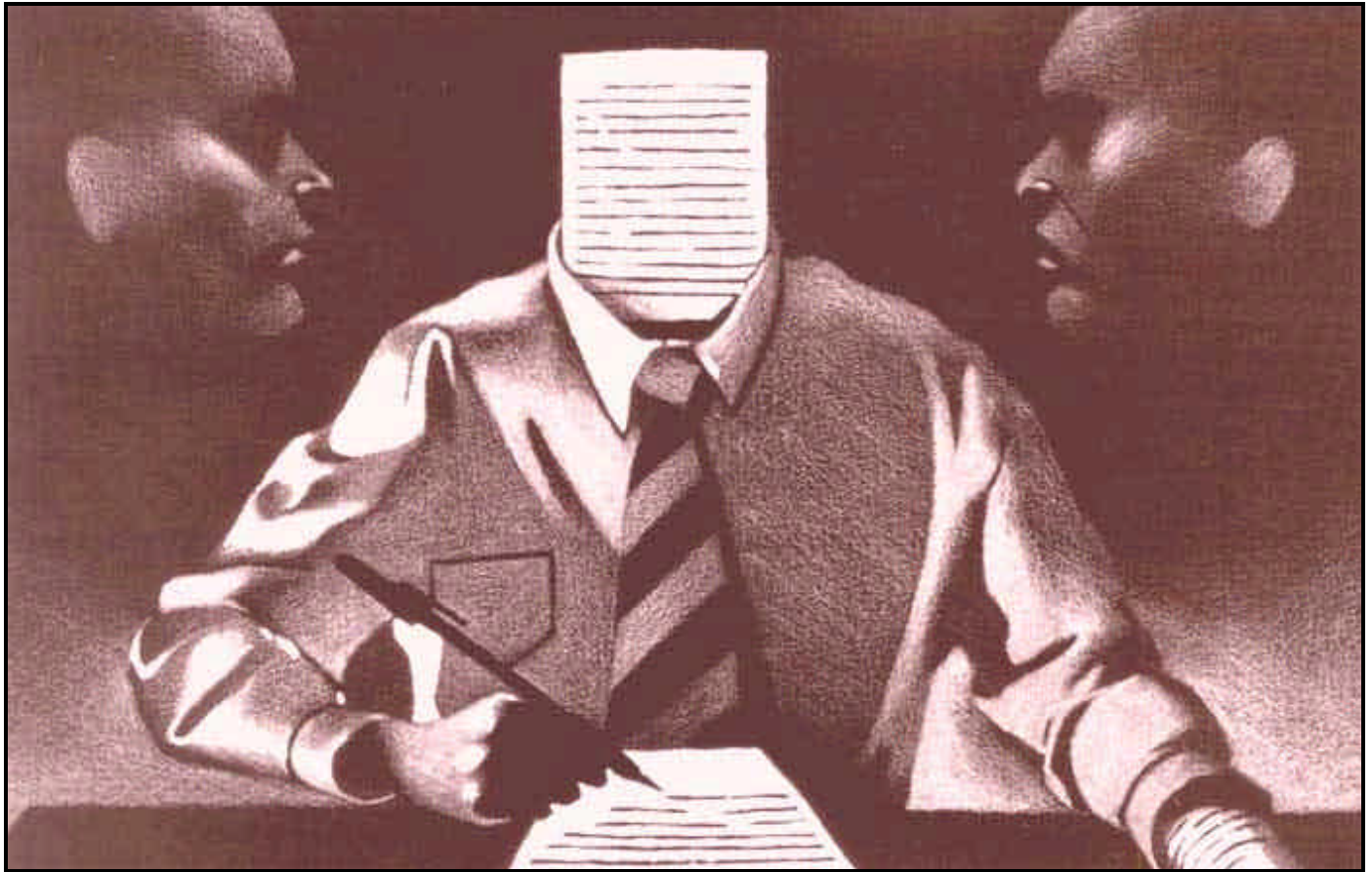


Defining Duties

Set solid standards from the start with thorough third-party insurance agreements

by Michael D. White



Banking and insurance statutes, regulations and guidances define a bank's duties and responsibilities when insurance and annuities are sold to its customers. A bank engaged in the sale of insurance, either directly through its own agents or indirectly through the agents of a third party, must engage in sound management practices when instituting an insurance sales program and be sure that sales activities are performed in a responsible manner.

Keys to responsible selling activities are adequate consumer protections, qualified employees to engage in sales

activities and appropriate sales practices by these employees. Whether it is your bank's own program or one conducted on its behalf by an unaffiliated third party, your bank management must actively oversee the insurance program. Competent personnel must be employed. And there must be internal controls to facilitate both the sales and their oversight.

What are these controls? What should they do? What performance standards and behavioral criteria are set such that these controls can monitor, measure and facilitate the bank's busi-

ness objectives and meet its regulatory duties? How and where should these standards and criteria be established?

Third-Party Agreements

The logical and primary place to begin locating criteria, standards, performance commitments and controls is your bank's agreement with its third-party product, sales and service provider. The parties commit to writing what they agree as a business arrangement. The agreement contractually sets forth important elements of the insurance program, reinforces an agreed

business plan and enhances the enforceability of program-related duties.

Other contractual provisions are included because regulators specifically require or strongly advise them for a well-run bank insurance program. Also built in are the requisite legalisms that bank counsel normally recommend as a matter of contract law and good business sense - representations, warranties, covenants, dispute resolutions and remedies.

Third-party arrangements require that your bank's board of directors make certain that an appropriate review has been conducted of the qualifications of the third party. Moreover, your board must approve the written agreement with the third party.

What's the Agreement?

Your bank's written agreement should describe the duties and responsibilities of each party, with particular reference to the permissible activities on your bank's premises; the use of your bank's space, personnel and equipment; compensation arrangements; and duties and responsibilities of employees. If dual employees are used, they must have written employment contracts, specifying their duties and compensation arrangements.

A good third-party agreement outlines what the two parties will do to market and sell insurance - for example, advertising, marketing and sales material (print, audio, video), referral programs, cost-sharing, and so forth. Critical expectations of performance derived from your business plan can be set forth as an exhibit or appendix to the agreement.

Training is essential to a successful bank insurance program, so the agreement should set forth the training your bank expects of its employees, dual employees and the third party's personnel. Identify what kind of training is to be done, for whom it is done, and who does it. Because it requires insurance expertise, training is usually largely the responsibility of the third party. Licensed sales people need product, sales

Training is essential to a successful insurance program, so set forth your expectations in the third-party agreement.

and compliance training, professional education and continuing education. Unlicensed bank employees need training to understand product benefits, identify qualified prospects, and follow referral procedures and compliance rules.

When it comes to compliance and customer complaints, again it does not matter that a third party is conducting the insurance sales on behalf of your bank. That fact does not excuse your bank from fulfilling these responsibilities. Thus, if a third party is doing the direct selling, your bank's agreement with it should spell out the third party's duties and responsibility to:

- Track complaints;
- Monitor and identify systemic problems;
- Maintain records, such as the number, nature and disposition of complaints; and
- Assure that bank management and state insurance regulators receive complaint information.

The agreement should establish policies regarding use of confidential customer information and third-party regulatory compliance. Provisions should authorize bank monitoring and verification of third-party compliance, as well as authorize access by your bank and banking regulators to appropriate third-party records pertaining to the program and third party's sale of insurance on behalf of your bank. Your bank may agree to a reasonable, reciprocal indemnification provision; but, at the very least, your bank should require the third party to indemnify it for any

liability the third party's activities may engender.

Of great importance generally, and to your bank specifically, is defining the compensation your bank is to receive, its ownership interests in the insurance accounts, conditions for terminating the agreement and the disposition of ownership interests upon termination. The agreement should state under what conditions and how one party acquires the ownership interests of the other, define how the purchase price of that interest is to be calculated, describe a process for selecting who will do the calculation, and spell out how the ownership interest will be secured and transferred.

If your bank is to assert an ownership interest, it is necessary that it have an appropriately licensed insurance agency. Moreover, a licensed agency serves as the legitimate receptacle for all commissions generated by licensed agents of the bank or commissions shared under an arrangement with a third party.

Protecting Your Bank

The best way to protect a bank's immediate and long-term interests in the insurance business a third party will help create is for the bank to ensure its success by properly monitoring, measuring and managing the insurance program. Thus, your bank's agreement with a third party should require regular monthly and year-to-date reports on all aspects of referrals, sales activities and sales results. It should also require regularly scheduled meetings of the two parties to review and assess the program's performance.

One of the reasons that bank regulators establish rules for, and examine and supervise, bank insurance programs is because of the potential risk to the bank's safety and soundness. That is why bank regulators like to see bank insurance programs with written third party insurance agreements.

These contracts establish a base of protection against increased liability with a bank's regulators, customers and

shareholders should something bad happen. Liabilities may arise from noncompliance with banking and insurance regulations and guidelines. There is potential liability arising out of customer disenchantment, errors and omissions, and allegations of unfair trade practices and generally bad market conduct. There also is potential liability from improper sharing of confidential customer information. There is reputation risk deriving from all these, and reputation risk harms shareholder value.

Your bank should establish adequate monitoring procedures to assure that the third party is meeting its com-

pliance standard. Get your bank's own compliance and audit personnel involved in examining compliance relative to the sales operation of the third party on behalf of your bank. Compliance and audit staff should not report to anyone connected with insurance sales management and activities. Compliance reports should go directly to senior management, then, if necessary, on to the board. Audit reports of the compliance program and activities should go directly to the board or a committee of the board.

Your bank should also conduct a review of its own insurance practices to make sure that its existing risk manage-

ment program covers these and other potential risks and liabilities. A bank may need to purchase additional insurance, so be sure it receives a share of commission on any insurance it buys.

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