

## **Transparency, disclosure and conflicts of interest in the commercial insurance market**

### **1. Introduction**

AIRMIC believes that management of potential conflicts of interest in the commercial insurance market can only be successfully managed if there is transparency and full disclosure of financial and other interests. AIRMIC welcomes the “Industry Guidance” that has been approved by the Financial Services Authority (FSA) and this guidance represents the position agreed by BIBA, LIIBA, IIB and the ABI.

The industry guidance is a step forward in the process of clarifying the status of intermediaries and the means by which they are remunerated for their professional services. However, AIRMIC believes that the buyers of commercial insurance will require information in addition to the minimum disclosures set out in the industry guidance and referred to in this guidance.

As the FSA identifies, buyers of commercial insurance require information about how their insurance intermediary is remunerated, what services are being provided, the status of the intermediary and how conflicts might arise. Additionally, buyers of commercial insurance require information on how any potential conflicts of interest that do arise will be managed.

### **2. Scope of this AIRMIC Guidance**

Buyers of commercial insurance are entitled to information on intermediary status and remuneration. The request should relate to each separate class of insurance business and be sub-divided into information specific to each country. The industry guidance states that disclosure of the information regarding the status and remuneration of the insurance intermediaries is mandatory on request.

The information should be supplied in a timely manner and include details of other intermediaries (and their remuneration) involved directly in the placement of the insurances. Information should also be provided on whether there are companies involved in the insurance placement that have financial links to the insurance intermediary.

The industry guidance uses the word “agent” to indicate the status of the insurance intermediary. The word agent has a specific legal meaning and the use of that word can be misleading. For example, it is possible that the intermediary may be (in a legal sense) acting as an agent of the insurer, but performing a task and / or acting in a manner that is in the best interests of the insured.

Because of the difficulties that arise from the strict legal interpretation of the word “agent”, the use of that word is avoided in this guidance wherever possible. The main issue that is being addressed in this AIRMIC guidance is whether the intermediary is acting in the best interests of (on behalf of) the insured. To the extent that it is appropriate, the phrase “best interests” is used rather than “agent”.

The disclosure of the source, amount and nature of earnings that the intermediary receives from an insurer will enable the insured (risk manager) to determine whether the intermediary is acting in the best interests of the insured, or whether these earnings and the way they are structured will cause an intermediary to be exposed to a conflict of interest between the best interests of the insured and the total earnings of that intermediary.

### 3. Industry Guidance

The Financial Services Authority (FSA) confirmed in April 2009 that the guidance developed by the British Insurance Brokers Association (BIBA) and others aimed at assisting intermediaries provide clearer and more consistent information to their customers about their capacity, the services being provided and their remuneration has been given “Industry Guidance” status by the FSA.

The development of the guidance followed the publication of Feedback Statement 08/7, *Transparency, disclosure and conflicts of interest in the commercial insurance market* ([http://www.fsa.gov.uk/pages/Library/Policy/DP/2008/fs08\\_07.shtml](http://www.fsa.gov.uk/pages/Library/Policy/DP/2008/fs08_07.shtml)). This FSA document established five outcomes for commercial customers. The outcomes were developed following findings that although intermediaries are largely managing conflicts of interest appropriately, more should be done to improve transparency.

The FSA suggested that commercial customers are often unaware of their right to request commission information, can be unclear as to the capacity in which their insurance intermediary is acting and would benefit from clearer descriptions of their intermediaries’ services.

Intermediary associations will be promoting the industry guidance amongst firms and offering practical advice aimed at helping firms achieve the outcomes for their customers. In 2010/11, the FSA will assess whether firms have succeeded in achieving the customer outcomes and will be regularly monitoring progress in the meantime.

A full copy of the industry guidance can be found on the BIBA website at: <http://www.biba.org.uk/PDFfiles/IndustryGuidanceFINAL.pdf>

### 4. Intermediary Remuneration, Services and Status

A range of disclosure requirements is placed on insurance intermediaries by the industry guidance. These disclosures relate to the source, amount and nature of the earnings of the intermediary. Insurance intermediaries can be remunerated in a number of different ways, as described in a later section of this guidance. Some of the ways of remunerating insurance intermediaries can give rise to a conflict of interest between the interests of the insured and the interests of the intermediary.

Conflicts of interest can arise, in particular, when an insurance intermediary gains more income if the insurances are placed with a particular insurance company. This additional income can arise because of the commission payments, work transfer arrangements and / or other less easily quantifiable incentives.

The scope of services provided by insurance intermediaries can be extensive. This can range from the collection of the underwriting information to the provision of engineering advice, in addition to the more obvious areas of advice on selection of insurance companies, evaluation of insurance coverage and advice on the limits of indemnity that should be purchased.

Given that this range of services can be very wide, it is important for the buyers of commercial insurance to understand the status of the insurance intermediary. The buyer of commercial insurance will take a different view of the advice given by insurance intermediaries, depending on whether the intermediary has the legal status of or is acting as an agent of a particular insurance company.

In support of the provision of the information set out above and to deliver a more competitive and efficient market, the FSA has suggested that at least the following information should be supplied by insurance intermediaries to their commercial customers:

1. the commission that intermediary receives
2. the services the intermediary is providing
3. the capacity in which an intermediary is acting

Additionally, the FSA has suggested that buyers of commercial insurance should be specifically alerted to their right to request commission information and should also be advised if there is a chain of intermediaries directly involved in the placement of the insurances.

## 5. Types of Remuneration

All types of remuneration received by the intermediary need to be disclosed to the insured and the potential sources of remuneration may include the following:

1. standard commission paid at policy level
2. contingent commission, based on performance of the intermediaries accounts and / or individual contracts
3. non-contingent commission that is not linked to performance criteria at portfolio level and / or individual contracts
4. sub-broking arrangements, where more than one intermediary is involved in a placement chain
5. profit share, when the intermediary is entitled to a share of the profits or accounting surplus
6. volume over-rides, where the intermediary is entitled to a higher commission rate, once a target amount of business has been written with the insurer
7. work transfer payments, whereby specified policy related activities become the responsibility of the intermediary
8. Intermediary services income

Additionally, insurers sometimes provide insurance intermediaries with other less easily quantifiable benefits, including:

1. Advanced commissions, by way of a lump sum pre-payment of commission
2. Loans paid back through commission on expected volume of sales
3. Non-repayable payments for marketing, IT investment, etc.
4. Incentives to encourage staff of intermediaries to sell particular products
5. Gifts and corporate entertainment for the staff of intermediaries

## 6. Range of Services

Insurance intermediaries are able to provide a wide range of services to the buyers of insurance. These services are provided throughout the life cycle of an insurance contract and may include the following:

- data collection and the preparation of underwriting reports
- search of the insurance market for suitable insurers
- placement of the insurance contracts and premium collection
- claims handling support
- support services related to the insurance contract
- compliance support, including contract certainty and payment of taxes

The checklist at the end of this guidance provides a more complete list of the range of services that can be provided under each of these headings. It is worth considering support services in more detail, because these services can have a very wide scope. Perhaps the most critical category of support services is that of claims handling, and this is dealt with as a separate topic in the checklist.

Other services may be offered by insurance intermediaries, including professional advice on the adequacy of the insurance cover available, the structure of insurance programs and advice on the overall limits of indemnity that should be purchased. Other services may include the issue of local policies in different territories around the world, as well as advice on loss control, including loss prevention, damage limitation and cost containment.

## 7. Means of Disclosure

Insurance intermediaries should provide sufficient information, so that insurance buyers can identify potential conflicts of interest. Often, the scope of disclosure will be set out in a Service Level Agreement (SLA) between the insurance buyer and the insurance intermediary. Such a Service Level Agreement is referred to in the industry guidance as a Terms of Business Agreement (TOBA).

As well as being aware of the status of the insurance intermediary, the insurance buyer also needs to be aware of the level of (risk-bearing) premium that it is ultimately received by the insurer. The insurance buyer can then evaluate whether the level of fees received by the intermediary is appropriate for the work involved and whether the level of premium received by the insurer is in line with the nature of the risk that has been transferred.

Although the tax situation can be complex, it is also worth noting that insurance premiums attract non-reclaimable Insurance Premium Tax (IPT). Intermediary fees do not attract IPT, although the fees for some types of intermediary services may attract Value Added Tax (VAT). If the insured pays a gross premium that includes commission, the insurance buyer will be paying IPT on the whole premium, including the commission paid to the intermediary. This may result in payment of non-recoverable IPT in circumstances where either no tax or potentially recoverable VAT could have been paid.

## 8. Standard Letters in the Industry Guidance

The industry guidance provides the insurance intermediaries with 2 standard letters for communicating with their customers. These standard letters are reproduced in this AIRMIC guidance as Appendix A and Appendix B. Appendix A reproduces the standard letter set out in Annex 1 of the industry guidance and it is concerned with the reporting to the insured of the insurance intermediary earnings.

In the opinion of AIRMIC, the content of Annex 1 to the industry guidance does not provide sufficient details of the intermediary remuneration. Insurance buyers should seek a more comprehensive account of the source, amount and nature of remuneration available to the insurance intermediary and how this additional income may be generated.

Appendix B reproduces the standard letter set out in Annex 2 of the industry guidance and it is concerned with the services provided by insurance intermediaries and the capacity in which they are operating. It is the view of AIRMIC that an insurance intermediary can not act in the best interests of both the insurer and the insured at different times during the same insurance contract.

If an insurance intermediary is not able to state that they are the legal agent of the insured throughout the whole life cycle of the insurance contract, then conflict of interest is likely to arise. In these circumstances, the insured will need to decide whether the fact that the intermediary is the agent of the insured and the agent of the insurer at different stages of the insurance cycle is acceptable. If the insured decides to accept this split role, more detailed information will be required on how conflicts of interest may arise and how they will be managed.

Appendix C sets out a comprehensive checklist of issues that insurance buyers should ask their insurance intermediaries to explain. This checklist includes the basic information that would be supplied by the standard letters in Appendix A and Appendix B. The full range of information set out in Appendix C is required so that the insured may recognise the potential for conflict arising from the range of activities undertaken by the insurance intermediary.

## Our Earnings

As your chosen insurance intermediary, we earn income in two separate ways.

1. We can earn by charging you a fee for our service. Whenever we charge a fee, that amount will be agreed with you in advance and will be disclosed to you separately to the insurance premium. If we have charged you a fee, this information will have been provided to you already alongside details of the premium.
2. We can earn by receiving a commission payment from the insurance company with which the insurance is placed. This amount will usually be calculated as a percentage of the insurance premium and the percentage will have been contractually agreed with the insurance company. We earn different percentages for different classes of business and from different insurance companies.

The table below sets out details of the commission and any other income we might earn in respect of handling your insurance.

	£
<b>Direct earnings</b>	
1) <b>Commission</b> – we earn the following:	
2) <b>Premium finance</b> – for arranging the funding of your insurance premium, we will earn:	
<b>Possible additional earnings</b>	
1) <b>Profit share agreement</b> - we have an agreement with [insurer name] that if our account with them meets certain pre-agreed volume and profit targets during this year, we will receive an additional payment from them. The value of the arrangement to us cannot be accurately calculated today. However, should our account achieve the income and profit targets set by the insurer, the maximum extra commission we could earn is x%. This could mean us earning up to a maximum extra commission in respect of your policy of £x. <b>If you would like further details on the precise method of calculation of this agreement, please contact [insert name].</b>	
2) <b>Volume commission over ride</b> - we have an agreement with [insurer name] that if our account with them meets certain pre-agreed volume targets during this year, we will receive an additional payment from them. The value of the arrangement to us cannot be accurately calculated today. However, should our account achieve the income targets set by the insurer, the maximum extra commission we could earn is x%. This could mean us earning up to a maximum extra commission in respect of your policy of £x. <b>If you would like further details on the precise method of calculation of this agreement, please contact [insert name].</b>	

*(Reproduced from Annex 1 of the Industry Guidance)*

## **Our capacity and services**

### **Important information**

The following information is in relation to the [enter the contract-specific name] insurance you have asked us to arrange.

### **The capacity in which we are acting**

Sourcing a suitable policy

- We act as your agent
- We act as agent of the insurer

Placing the insurance

- We act as your agent
- We act as agent of the insurer

In the event of a claim

- We will act as your agent
- We will act as agent of the insurer

### **How we made our selection**

- We have carried out a 'fair analysis' of the market in order to identify a suitable product. This means that we have compared products from a sufficiently large range of insurance providers in terms of cover, price, quality of service and other relevant features in order to select appropriate policies for you.
- Our search for a product to meet your requirements has involved a limited number of insurers. We would be happy to discuss with you the scope and outcome of our search. You can ask us, at any time, for a list of the insurers we use.
- To access the insurance product that most suits your needs, we will use another intermediary to help place your business.
- We only offer cover from a single insurer, XYZ Insurance Company Limited in respect of this type of insurance.

### **Our remuneration**

You are entitled, at any time, to request information regarding any commission which we may have received as a result of placing your insurance business.

***(Reproduced from Annex 2 of the Industry Guidance)***

## Appendix C: AIRMIC Disclosure Checklist

### **Introduction to Checklist**

Set out below is a list of issues that an insurance buyer should discuss with the insurance broker or intermediary. This list covers all stages in the purchase and servicing of an insurance contract, although it may not be exhaustive in all circumstances. It includes and consolidates the areas of disclosure outlined in the industry guidance Annex 1 and Annex 2 as set out in Appendices A and B above.

Obtaining this information will provide full transparency and disclosure of all sources of income for the insurance intermediary, across the whole life cycle of the insurance contract. Also, there are questions related to the proposed status of the insurance intermediary and the range of services that may be provided throughout the life cycle of the insurance contract. It will be for the insurance buyer to decide whether the declared status and relationships are acceptable.

This checklist has been constructed as a list of issues designed to ensure that risk managers get appropriate information from the intermediary in relation to each class of insurance / type of business, presented on a country by country basis. However, in many cases, further information will be required either to clarify the answer provided or to supply further details of, for example, additional income that has been acknowledged.

The structure of this checklist is related to the steps involved in the purchase of commercial insurance and the different aspects of servicing of commercial insurance contracts. Additionally, arrangements should be agreed for conflict resolution, where this is necessary.

### **Disclosure Checklist – to be completed by the Intermediary**

#### **1. Remuneration**

In relation to the class of insurance to which this checklist refers, we receive income from the following sources:

- Standard commission at policy level
- Contingent commission based on volume or profit
- Non-contingent commission, not linked to performance
- Sub-broking income from other intermediaries
- Facultative re-insurance commission
- Additional income from line slips
- Intermediary service income
- Volume over-rides
- Advance commissions and loan pay-back arrangements
- Non-repayable payments
- Other sources of income

The amount received from each source is indicated. Where the earnings may vary, a range of possible remuneration is indicated, together with an indication of the factors that affect the level of earnings.

***(AIRMIC Guidance on Remuneration of Insurance Intermediaries)***



## **2. Business Relationships**

In relation to the class of insurance to which this checklist refers, we have business relationships with the insurance companies (as named below) involved in this insurance programme, as follows:

- Financial links with the insurers (including any equity interest)
- Finance provided by any insurer
- Provision of staff training programs
- Provision of staff incentives by insurers
- Work transfer arrangements and payments

## **3. Market Search**

In relation to the class of insurance to which this checklist refers, we undertake a market search on the following basis (more than more answer allowed) and we will supply additional information, as appropriate:

- Acting as your agent
- Full market search
- Limited market search
- Panel of insurers for this class of business, as named below
- Scheme with specific insurers, as named below
- Specific insurers, as named below
- Only offer insurances from the insurer named below

## **4. Placement of Insurance**

In relation to the class of insurance to which this checklist refers, when we place the insurance contracts the following circumstances apply:

- Acting as your agent
- Placement recommendations will have no impact on earnings
- Placement recommendations affect earnings in the following way

## **5. Claims Support**

In relation to the class of insurance to which this checklist refers, we provide claims support services in the following basis:

- Acting as your agent with primary insurer
- Acting as your agent when collecting money from the subscription market

## **6. Future Disclosures**

In relation to the class of insurance to which this checklist refers, we confirm that all of the above information is accurate and completed to the best of your knowledge and that in future we will provide relevant information:

- Automatically at the time of placement / renewal
- Without further request from you
- For each line of business / class of insurance
- For each country in which you operate

***(AIRMIC Guidance on Remuneration of Insurance Intermediaries)***