Commercial insurance intermediaries

Transparency, disclosure and conflicts of interest

Paper 2017

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1 Introduction

Airmic believes that the successful management of potential conflicts of interest within commercial insurance intermediaries can be achieved only through full transparency and disclosure of those conflicts and associated financial interests. Buyers of commercial insurance are entitled to information on how their intermediary is remunerated, what services are being provided, the agency status of the intermediary at various stages of the transaction, how potential conflicts may arise and how those that do arise will be managed. A summary of this information will be outlined in the Terms of Business Agreement (TOBA) and this should be used as a basis of the discussion between the intermediary and the buyer.

Airmic first addressed this in the 2009 paper 'Transparency, disclosure and conflicts of interest in the commercial insurance market'. This paper summarised the various methods of remuneration for insurance intermediaries and provided a 'disclosure checklist' which Airmic members could use to help identify the potential for conflict arising from the range of activities undertaken by their insurance intermediary.

The insurance market is currently facing a period of change. The prevailing soft market places continued pressure on insurance premiums and intermediary fees. Emerging risks and dynamic risk profiles mean buyers are seeking to obtain innovative and relevant cover at the best price. These changes have led intermediaries to take on an increased role, including helping insurers to analyse the changing risks of buyers, develop new solutions and deliver these to customers. They are remunerated for these additional services accordingly. Throughout, insurance buyers expect complete transparency from their intermediary.

This report updates the 2009 guidance, taking into consideration the changing methods of remuneration for insurance intermediaries. Broker conflicts of interest/remuneration models have risen into the top three concerns of Airmic members with regards to the insurance market (Airmic pre-conference survey 2016). Airmic members advise that they are unclear about the growing range of services their intermediary provides to insurance carriers and how they are remunerated for this.

This paper summarises the current main methods of remuneration of insurance intermediaries by insurers and highlights potential conflicts of interest. Additional guidance on how to improve transparency of remuneration and understand how potential conflicts of interest are identified and resolved is given.

Airmic undertook several interviews with Airmic members, intermediaries and insurers when preparing this paper. Airmic is grateful to all those who contributed.

This paper focuses on the remuneration methods for intermediaries operating within the large commercial insurance market. Alternative arrangements may be in place for intermediaries operating within the SME market.

2 Types of remuneration

This paper focuses on the remuneration of insurance intermediaries by insurers. Fees paid by the client to the insurer are not considered. Commission at the policy level will not be considered either as Airmic members report that this is clearly disclosed either automatically or on request.

When interviewing Airmic partner brokers and insurers, a number of potential sources of remuneration were identified. This paper groups these into three overall 'buckets' of remuneration, which will be considered in turn:

- Insurance services brokerage
- Facility fees
- Fees for strategic partnerships.

Appendix 2 condenses the following information on remuneration methods and potential conflicts of interest into a 'Disclosure checklist' for insurance buyers to work through with their intermediary.

Contingent commissions

Contingent commissions are payable by insurers to intermediaries, dependent on specific outcomes such as portfolio growth or favourable claims experience. The potential for conflicts of interest in these arrangements is clear and therefore the practice of receiving contingent commissions has been discontinued by most major intermediaries across their entire portfolio.

There have been a few limited examples of the return of contingent commissions in some geographies or some classes of business, although Airmic is unaware of such arrangements in the market used by their members. However, insurance buyers are still advised to clarify whether arrangements of this kind apply to any of their placed risks.

3.1 Insurance service brokerage

Insurance service brokerage (ISB), market brokerage or subscription market brokerage (SMB) is a well-established type of remuneration paid to intermediaries. ISB directly relates to premium paid, on top of standard policy commission.

The exact amount paid varies by insurer, intermediary and class of business (ISB may be dropped entirely for some low-admin classes of business). However, typical rates vary between 3% and 3.5%.

This additional sum is essentially a work transfer fee paid by insurers for administration and distribution costs. Specified policy activities, e.g. policy drafting, premium collection and issuing of documents, become the responsibility of the intermediary who is remunerated accordingly.

Disclosure of insurance services brokerage

ISB relates specifically to the risk placed and must therefore be fully disclosed to the insured, on placing slips and in end-of-year remuneration reports, or on request. However, Airmic members report that ISB is not clearly marked separately from the overall commission received. Insurance buyers can ask for ISB/SMB to be specifically identified on a separate line on the slip and on the remuneration statement

Conflicts of interest arising from insurance service brokerage

Insurance buyers should be clear about the amount of ISB charged on each line of business their intermediary has placed and to which administrative services this relates. For example, the fee could be for developing the contract wording. As the insurer is paying this fee, there may be a potential conflict in terms of whose best interest is placed at the heart of the contract. Insurance buyers will wish to understand how such conflicts are managed.

Intermediaries can charge insurers alternative work transfer charges for other services such as claims management. Insurance buyers should understand where intermediaries receive ISB or alternative work charges on their placements and clarify the services undertaken. This can be compared against the scope of services that the intermediary presents to the insurance buyer in order to clarify where the intermediary is acting for insurer, and where the intermediary is acting on behalf or the buyer.

Questions to ask

- How and when is the payment of ISB agreed with the insurer?
- What services are provided?
- Is there a maximum threshold for ISB, e.g. is x% payable on premium, subject to a maximum of £y?
- Is ISB disclosed separately from other fees and commissions?
- Where is ISB charged and where are alternative work transfer charges charged?

3.2 Facility fees

Brokers earn additional remuneration via the facilities they establish and manage. Facilities are prearranged capacity created to provide preferential arrangements for the buyer, intermediary and insurer. Benefits to the buyer may include best-in-class wording, increased capacity, reduced costs, speed of obtaining cover and, occasionally, the benefit of additional services. The intermediary and the insurers participating in the facility benefit from a flow of revenue and lower operating costs. Facilities have traditionally been established for specific industries, niche risks/classes or excess layers. However, there is an increasing tendency for more commoditised facilities to be created.

Where an intermediary has set up a facility, they are likely to be remunerated in the following ways:

1. Annual fees from insurers to participate on the facility panel.

   This relates to the administration costs for setting up the facility and the ongoing marketing costs.

2. Increased commissions on the premium placed within the facility

   The rate of commission varies widely depending on the facility and type of business. Fees are normally a percentage of premium and commissions vary widely. The percentage commission will be higher where the intermediary performs the underwriting for the facility. This commission may be lower if the facility includes an upfront fee.

   Airmic members report that commissions on placements within facilities are typically higher than commissions on placements outside of facilities. These increased commissions are work transfer fees associated with the running costs of the facility, including binding cover and reporting management information on the performance of the facility.

Insurance buyers should take time to understand the structure of their intermediaries' income from facilities. This includes clarifying what portion of the fee relates to administrative services or risk consulting and what relates to commission on premium income.

Disclosure of facility fees

Enhanced commissions relating to the placement of a risk in a facility should be disclosed to the insurance buyer. Airmic members should ensure that the percentage commission and the value this amounts to are clearly highlighted on the remuneration disclosure documents provided by intermediaries. Airmic members can additionally ask if the facility requires an upfront fee from insurers.

Conflicts of interest arising from facility fees

The benefits of facilities for the buyer are largely clear, particularly where the facility is risk or industry specific. However, due to the enhanced commission received from facilities, there is potential conflict of interest that must be addressed to avoid insurance buyers being influenced towards facilities. Additionally, the underwriting authority given to the intermediary can also lead to pricing conflicts of interest, unless carefully managed. Buyers should be aware of the alternative market solutions and request that these are fully considered. Buyers should also be clear on whether intermediaries have a financial interest in the facility, based on underwriting profitability or claims experience.

Insurance buyers however should ask how insurers are selected for facilities and understand the process for changing any insurer on the facility. Additionally, buyers should be made aware in advance if any insurer on a panel will be replaced and for what reason, and challenge this if appropriate.

There is a growing use of facilities across the market, including the use of quota share arrangements. These arrangements are focused on capacity and involve a fixed percentage of a broad range of risks being placed within non-specific facilities. This may have a long-term effect on the level of competition in the market and cause a reduction in traditional underwriting and broking. This is an area that Airmic will continue to monitor. As the use of facilities can limit the extent of the relationship between the buyer and the insurer, buyers should understand the wider impact of this on their insurance arrangements. This can include clarifying what the implications of using facilities are on complying with the Insurance Act, multinational compliance and claims handling, etc.

Questions to ask

- What proportion of the risk is placed in the facility?
- How are insurers selected or not selected to sit on a facility and how is notification given to changes on the panel?
- How are facilities benchmarked against outside market?
- How are the fees derived from facilities structured in terms of upfront fees versus commissions on risks placed, and how will these be disclosed?
- Are the commissions made on placement into facilities subject to any maximum threshold, e.g. is x% payable on premium, subject to a maximum of £y?
- How will any additional indirect remuneration related to the facility be summarised?
- Does the intermediary have any financial interest in the profitability of the facility?

3.3 Fees for strategic partnerships

Intermediaries receive income from insurers via the portfolio services they offer. Variations of this include strategic partnership fees or insurer service plan fees. Fees can be paid at both the global and local level, and are paid typically on an annual basis.

Fees are paid to enable a closer relationship between the insurer and the intermediary, which can include the following:

- Regular structured conversations between the intermediary and insurer, enabling the intermediary to become more familiar with the insurer offering
- A specific insurer advocate within the intermediary
- Market information through surveys and other data reporting (covering both risk and claims information) to enable insurers to develop their offering and provide customer-centric solutions accordingly.

The above services assist insurers in understanding how they are perceived by insurance buyers and in identifying new markets to target. The shared information enables insurers to develop their own risk appetite for new markets, align their strategy, and create new and innovative products that satisfy the needs of insurance buyers.

Disclosure of strategic partnership fees

Fees associated with portfolio services are typically not explicitly linked to volume of business or any individual client account. However, Airmic members have suggested that there may be an implicit link between the fee paid and the volume of the business controlled by the intermediary. The fee paid and the services delivered varies but will be negotiated by the market management team (usually a segregated team within the intermediary) and the individual insurers. Buyers will likely be told that the intermediary has strategic relationships with some markets, but will not be given any details regarding fees paid.

Potential for conflicts of interest arising from strategic partnerships

The nature of these relationships has the potential to create an unconscious bias towards the insurers that the intermediary has agreements with over those that it doesn't, unless managed carefully. Insurance buyers should therefore understand the overarching market selection strategy adopted by their intermediary.

Local arrangements can involve structured and focused discussion around specific portfolios. Therefore, the intermediary can gain an enhanced understanding of the offering of those insurers where a strategic partnership exists. Insurers report that strategic agreements involve the benefit of access across the broking house (beyond the market management team) and therefore this enhanced knowledge can filter down to individual client teams and placing brokers.

Airmic members should understand which insurers their intermediary has strategic partnerships with and what services are provided. They should also be aware of other insurers in the market who may well have products and services that would be of interest and relevance to the insured but about which the broker may be less familiar. This assessment should ideally take place several months before renewal to avoid the issue of offers only being made a few days before cover is provided and preventing the insurance buyer from considering alternative options.

There is no question that these arrangements can drive innovation and development in the market. However, the buyer must ensure that all relevant markets are considered.

Questions to ask

- Which markets are their agreements in place for and are these at a global or local level?
- How is the agreement fee structured, e.g. is it a flat fee?
- Do the individual placing brokers within the intermediary have any financial interest in the strategic arrangements?
- What services are provided as part of the agreement, e.g. data sharing, product development, etc.
- How are other insurers approached when going out to market with an individual risk, and when?

4 Other potential conflicts of interest

This paper has focused on the implications of remuneration from insurers on conflicts of interest in relation to market search and insurer selection. Airmic members should focus on understanding the process their intermediary has followed when presenting their risk and ensure that a fair analysis of the market is undertaken. However, Airmic members should also consider any potential for conflict of interest arising where their intermediary places reinsurance.

Insurance buyers should understand where their intermediary also places any facultative reinsurance associated to their risk. There may be an incentive to place insurance within a market where facultative reinsurance will be required and arranged by the intermediary. The buyer should understand how this potential conflict is managed.

5 Industry supervision

The key Financial Conduct Authority (FCA) requirements for intermediaries in relation to conflicts of interest, remuneration and disclosure are found within the Senior Managers Arrangements, Systems and Controls (s10), Principles for Businesses (Prin 3, 6, 7 and 8) and Insurance Conduct of Business Sourcebook (c4) sections of the FCA Handbook.

The FCA recognises the potential for conflicts of interest within intermediaries and supervises firms accordingly.

This process includes:

- An individual FCA supervisor in place for each Fixed Firm intermediary. Supervisors have complete access across the business to conduct supervision.
- Supervision including assessment of the tone from the top and governance structures in place at the intermediary. Supervision will include regular review of the systems and controls that identify and manage potential conflicts in practice.
- Supervisors are able to review insurer-intermediary and buyer-intermediary transactions.
- A range of regulatory tools that it can use for any intermediary that does not comply with its requirements.
- Individual supervision is reinforced by market-wide thematic reviews and deep dives.

The FCA conducted a thematic review in 2014 – 'Commercial insurance intermediaries – conflicts of interest and intermediary remuneration'. This focused on the SME market as many customers in this space are unlikely to be as sophisticated buyers of insurance as Airmic members. The FCA found that some intermediaries had not constructed the necessary management and control frameworks to effectively identify, mitigate and manage all potential conflicts.

The FCA has not announced any immediate plans to conduct similar work in the major account sector. However, it does report that conflicts of interest can impact on competition and market integrity.

It is worth noting that the European Commission Insurance Distribution Directive (IDD) will come into force on 23 February 2018. This strengthens the requirements on intermediaries in terms of conflicts of interest, including the information that must be disclosed on market search. The FCA will issue its regulatory requirements and the British Insurance Brokers' Association (BIBA) its guidance to complying with the IDD during the course of 2017.

Additionally, the roll-out of the Senior Managers Regime in 2018 will require a named individual in all brokers to be accountable for conflicts of interest.

Appendix 1 Discussing remuneration

Insurance buyers have a right to request commission information and are entitled to information on the commission that an intermediary receives, the services they provide and the capacity in which they are acting (i.e. for the insured or for the insurer).

In the 2009 guidance, Airmic reproduced the BIBA earnings and services letters which insurance intermediaries can use to communicate with customers. Airmic believes that such letters are useful to gain clarity on the exact values of transaction-specific remuneration. However, they can lead to a tick-box mentality with regards to disclosure. A more complete understanding can only come from a face-to-face discussion.

Buyers should drive a discussion on remuneration and its implications with their intermediary:

1	**Initial overview** • Discuss remuneration transparency and conflicts of interest during the tender process • Agree the remuneration terms disclosure process and include these in the service level agreement or terms of business agreement. This document should form the basis of the remuneration and conflicts of interest discussion throughout placement, for the duration of the contract and at renewal.
2	**Annual remuneration statement (for income relating directly to risks placed)** • Receive a complete breakdown of income, broken down by class/type of business • The premium and the separate types of intermediary remuneration (fees, commission, ISB, etc.) should be indicated for each (either as a %, notional value or basis for calculation) • Placements made overseas should be disclosed separately, following the same structure
3	**Additional remuneration overview** • Understand the structure of the intermediary and request an overview of the remuneration received from insurers by the other businesses • Identify if arrangements have any relation to your own transaction and the value of these arrangements • Payments will involve other teams and businesses beyond the client executive/account manager so advance notification will be required
4	**Conflicts of interest** • Clarify how potential conflicts of interest are identified and managed
5	**Market search** • Agree and understand the market investigation process
6	**Internal checks** • Make use of internal procurement and audit teams when reviewing remuneration

Appendix 2 Airmic disclosure checklist

The following is a checklist of issues that insurance buyers can use to structure their conversation with their intermediary, in order to gain more complete transparency of remuneration and services.

This will put the buyer in the position to recognise the potential for conflict arising from the range of activities undertaken by the insurance intermediary.

1 Remuneration and business relationships

Understand if the intermediary receives income from the following sources, in relation to all relevant classes of insurance.

For the items listed below, the amount received from each source can be identified separately. If the earnings vary, a basis of calculation can be indicated, together with an indication of the factors that affect the level of earnings:

- Standard commission at policy level
- Sub-broking income from other intermediaries w
- Facultative reinsurance commission
- Intermediary service income or work transfer charges
- Any income based on volume or profit
- Commission from placement into any facilities
- Other sources of income.

Understand if the intermediary has business relationships with any insurance companies in relation to the relevant classes of insurance. These can include the following services:

- Financial links with insurers
- Long-term consulting arrangements
- Work transfer arrangements and payments, including the management of claims
- Provision of staff training programmes or staff incentives.

2 Market search

Understand how the intermediary carries out the market search for each class of insurance considered. The insured should understand if the search is carried out on one or more of the following bases:

- Full market search
- Limited market search
- Named panel of insurers for this class of business
- Scheme with specific named insurers
- Specific insurer(s) only (named)

The buyer should also understand when potential markets are identified and approached.

3 Placement of insurance

Understand the following for each class of business:

- Whether placement recommendations do not affect earnings, or affect earnings in a particular way
- Any services the intermediary supplies during placement where they are acting as the agent of the insurer.

4 Conflict of interest

The insurance buyer should understand the governance and control framework for identifying and managing potential conflicts of interest, including whether the following features are in place:

- Are insurer agreement fees and facilities negotiated by a consulting/market management team?
- Which arm of the business does this team report to?
- What information on insurer agreements and the services provided is shared with transactional/placing brokers?
- How is the influence of market management teams on insurance placement teams restricted?
- Do transactional brokers need to advise market management teams when they make individual recommendations for insurers outside of ‘strategic partners’ or relevant facilities?
- How are insurers selected to sit on facilities and is there any remuneration criteria?
- How often are facilities tested against the open market?
- What governance structures are in place to review insurer arrangements and the potential conflicts of interest?
- How are remuneration requests dealt with and by what teams?
- How is the regulator (FCA) engaged?

Buyers may also wish to discuss the insurer-intermediary agreements with their insurers. Insurers will be able to provide information as they test these agreements to ensure they are fully compliant with all regulations and are commercially appropriate, whilst being cost neutral to the client.

5 Future disclosures

Agree how changes to the information discussed above will be provided. Information should be shared:

- Automatically at the time of placement/renewal without request
- Provided without further request
- Provided for each line of business/class of insurance
- Provided for each country that cover is provided for.

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