



The Insurance Brokers' Standards Council

In Response to the FCA Thematic Review of the
SME Market - May 2014 (TR14/9)

A Discussion Paper for Members of the IBSC Who Are Practising Insurance Brokers (DP1024)

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Please send any opinion or comments to
myopinioncounts@theibsc.org.uk
(quoting reference 'DP1024')

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The IBSC

Click each question in order to give opinions or feedback

How would you define an SME customer?

Have there been any changes to your business model and is this reflected in a formal business plan?

Is it always true that SME customers are not sophisticated buyers of insurance?

How can you assess the insurance knowledge of your Clients?

email: myopinioncounts@theibsc.org.uk

Can you think of examples of how levels of income and favours from insurers might influence an insurance broker in their choice of insurer?

Do you have examples of insurers who offer additional payments for new business?

Do you have examples of insurers offering additional payments to insurance brokers to introduce business which is currently held by a particular insurer?

Do you know of any inducements that an insurer gives or pays an insurance broker which is not commission?

CONFLICTS OF INTEREST

FCA Thematic Review of the SME Market - May 2014 (TR14/9)

Background

The report identifies that “at the start of 2013 there were an estimated 4.9 million private sector business, 99.9% of which were SMEs”.

Insurance Brokers are increasingly taking on functions that are traditionally associated with the insurer in exchange for additional remuneration.

It is also believed that SME customers are unlikely to be sophisticated buyers of insurance and may need similar levels of protection as consumers.

The full review can be found at: <http://www.fca.org.uk/news/tr14-9-commercial-insurance-intermediaries>

The Aim of the FCA Review

To establish how general insurance intermediaries identify and manage potential conflicts of interest where they receive revenue from both their customers and insurers.

To understand whether the flow of revenue from insurers or other sources to intermediaries arranging insurance for SME customers, particularly when acting as agent might:

- Unduly influence the intermediary to recommend an insurer against the customer’s best interest
- Cause an intermediary to improperly perform its duties to the customer

The Purpose of an IBSC Discussion Paper

As with many of the FCA thematic reviews, the regulator wants to understand the expectations of certain customers in terms of the services provided and whether this is aligned to what is actually being provided. We have identified the issues that have been identified as part of this review and set these as a series of questions for Practising Insurance Brokers to consider.

This is issued as an IBSC DP (Discussion Paper) with the sole purpose of giving members some key questions to consider and debate internally, with other insurance brokers, with advisers and with clients and to give each member the opportunity to send their own opinions to us (myopinioncounts@theibsc.org.uk).



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> Do you work with a binding authority where risks are placed without other options being considered?

> Do you act as agent for both the customer and the insurer in the same transaction?

> Do you or does your employer have a financial incentive for placing business with a certain insurer (profit sharing)?

> Do the key benefits identified by an MGA include an increased commission level?

> Does your firm have an MGA and retail arm within the group as a whole?

> Does your firm take a premium finance over-rider?

> Do you offer add-ons?

> Do you offer insurance where the cost is borne by another party (e.g. property owners)?

Do these revenue streams form a significant portion of your firm's profitability?



FCA Expectations

Principle 8 – “Conflicts of Interest” states that a *firm* must manage conflicts of interest fairly, both between itself and its *customers* and between a *customer* and another *client*.

As such, it is expected that customers are at the heart of how firms run their business and the IBSC attaches considerable importance to how Practising Insurance Brokers consider conflicts of interest and take steps to mitigate them.

Client Expectations

The FCA research showed that a large majority of SME customers expected to receive advice from their insurance broker and attached importance to this. They are therefore relying on this advice and expect it to be appropriate. It is perhaps not helpful that some insurers purport to “give advice” and align themselves too closely with the insurance broking profession.

In addition many customers did not appear to fully understand the nature of the service being provided to them.

It is important to note that where an insurance broker increasingly earns commission as agent of the insurer, but still claims to be an ‘independent insurance broker, this increases the risk of the customers misunderstanding of the role of their broker in arranging their insurance.

Lower Risk

Intermediaries who always act as agent of the customer or MGAs who operate solely as agent of the insurer have a lesser exposure as there is no ambiguity in relations with the customer as long as those who are insurers or solely agents of an insurer do not align themselves with the insurance broker by claiming to be part of “the profession”. The fundamental characteristic of a profession is that its members give a client advice

Higher Risk

Firms that operate a mixture of open-market insurance broking activities in conjunction with activities where they act as agent of the insurer are more likely to have inherent conflicts of interest within their business model.

In these circumstances, there is a much greater need for clear controls and management information to address the potential conflicts of interest in the selection and placement process and that all reasonable steps have been taken to mitigate the risk these conflicts pose to the interests of the customer.

Understanding the Conflicts

The concern is that potential conflicts are not always sufficiently understood by the intermediary and therefore steps are not taken to mitigate these.

Click each question in order to give opinions or feedback

Are you able to provide accurate information in relation to:

> The proportion of customers' insurance policies (by value or number) sourced by:

- Open market broking (fair analysis)
- Using a panel of insurers
- Placing with a preferred facility or binding authority after consideration of other options or
- Placing with a single insurer without consideration of other markets

Can you demonstrate how many cases in which you acted:

- As agent of the customer
- In a dual or mixed agency capacity, or
- As agent of the insurer

Management Controls and Information

The FCA research found that in the absence of this type of information it made it difficult to understand how a firm's management could be confident that the conflicts of interest associated with these different approaches and sources of revenue had been identified and therefore could be properly managed.



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When tendering, do you ask insurers to respond separately with details of the product offering and remuneration. Are decisions about the best product made solely on the merits of the product and service levels offered to your client?

Do all statements to the customer of enhancements, additional benefits or more competitive pricing reflect the actual position and evidence that it is appropriate to recommend the product?

Do you rely on a disclosure statement to the customer within your employer's TOBA or do you clearly explain the scope of service being offered (and perhaps not offered) for each specific transaction?

Placement Facilities

The placement decision may not lie with the individual handler where a particular facility has been put into place. You should be able to demonstrate in these circumstances that the client's needs were at the heart of the process for selecting a particular market to underwrite the product together with an audit trail supporting the decision.

The FCA research identified that the regularity of review varied widely between insurance brokers and they stressed the importance of ensuring that each facility continues to be the right choice for the client and that this is documented.

Disclosure

Customer research by the FCA revealed that 68% of SME clients believe that the intermediary is working as their agent and that 82% expect their insurance broker to get quotes from more than 2 insurers. 61% expected them to seek quotes from at least 4 insurers and 27%, from 7 or more markets.

With the change in business model of many insurance brokers, your explanation of services and scope must reflect the actual service provided and your relationship with them.

Do you rely on a disclosure statement to the customer within your TOBA or do you clearly explain the scope of service being offered for each specific transaction?

This might include:

- How the quotation or renewal terms have been sourced e.g. fair analysis etc.
- Whether you are acting as agent of the customer, the insurer or both
- Whether you are taking a fee, commission or both
- Whether you have used an intermediary / MGA for placing the risk

Earnings Disclosure

The number of SME customers requesting details of their insurance broker's earnings remains low. This may be due to a lack of interest in the remuneration however the FCA considers this may be due in part to the expectations regarding commission levels. 72% of SME customers expect this to be 15% or lower.

Concern also remains as to whether the requests are being correctly logged and responded to – client facing staff not always being aware of **all the firm's remuneration** relevant to the particular client requesting the disclosure.



Click each question in order to give opinions or feedback

> Do you offer add-on insurances?

> Is the commission close to that of your core products (e.g. 20-30%)?

> Is the same commission rate charged for all clients buying that product?

> Are these sold on an 'advised' basis and if so, can you evidence the work done to establish these products' compatibility or overlap with the core product?

> Where you offer cover from a single insurer, can you demonstrate that the products chosen were with regard to the client's needs i.e. via a tender or review proves?

Add-On Insurances

It was found that the portion of SME clients buying these products varied widely between the intermediaries taking part in the review and whilst in part reflective of the different business mixes, it also related to the extent to which the intermediary had actively sought to sell these products.

With commission rates also varying widely and in some cases over 50% and as high as 100%, it is clear to see where a conflict might arise



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> Do you charge administration fees and if so, do you have a standard pricing structure which is clearly communicated to the client before cover is placed?

> Do you monitor the application of administration fees?

> Do you offer a premium finance facility?

> Do you add an over-rider to the net rate and if so, if this a formally documented pricing structure?

> Are individuals permitted to choose the gross rate charged to a customer?

> Do you offer the insurers' instalment options where the rate is more advantageous to the customer?

Administration Fees and Premium Finance

With premium finance and administration fee revenues contributing to the revenue and profit of a firm (up to 7% in the review undertaken), there is the potential for a conflict of interest where there is an incentive to use a particular premium finance provider and customers may not be offered cheaper finance alternatives.

The FCA research showed that 79% of SME *customers expected* to be offered the best or cheapest options for premium finance. The same research showed that the majority of the *intermediaries considered* that they were solely offering financing options to the customer and had no duty to act on their behalf or seek the best offer.

The link below takes you to the factsheet published by the FCA in April 2013.
<http://www.fca.org.uk/your-fca/documents/broker-arranged-premium-finance-plans>

Mitigating factors, highlighted by the intermediaries questioned, were the benefits to the customer of including multiple policies under one facility and the competent administration by specialist providers.

Premiums borne by other parties

It was highlighted that property owners' insurance consistently attracts very high rates of commission (generally over 35% and sometimes of 50%) and as cover is frequently placed with a single insurer or small panel, there can be a relative lack of complexity in broking these products.

Concerns were raised by both intermediaries and insurers that these high commission rates exist because the customer buying the product was not the business or individual ultimately bearing the cost of the product. As such, this could result in intermediaries and property owners sharing in high commission levels with the higher premium cost borne by a tenant or lessor.

There is currently a Competition and Markets Authority case underway, which is considering residential property management services.



Click each question in order to give opinions or feedback

Do you outline your services to a client clearly in your Terms of Business or some other document before placing cover for a client?

Should insurers be banned by the FCA from advertising that they “advise” clients?

FCA Expectations

All general insurance intermediaries must be able to demonstrate that conflicts of interest have been effectively mitigated so that placement decisions are always made in the best interest of customers. This particular review relates to SME customers but you should reflect on how you manage any conflicts of interest arising within your own business model.

FCA Rules and Guidance on Conflicts of Interest

Information can be found in the following sections of the FCA Handbook

- SYSC – Chapter 10
- PRIN – Principles 3,6,7 & 8 are of particular relevance
- ICOBS – Chapter 4

