

MARKET BULLETIN

REF: Y4567

Title	Distribution Costs, Broker Remuneration and Additional Charges
Purpose	Consolidated Guidance
Type	Event
From	Tom Bolt Director, Performance Management 020 7327 6700 tom.bolt@lloyds.com
Date	22 February 2012
Deadline	
Related links	

Lloyd's has previously provided guidance to the market concerning some of the legal and regulatory considerations regarding distribution costs, broker remuneration and additional insurer charges. In particular, the Director, Performance Management wrote to the chief executive of every managing agent on 31 March 2010 and on 11 April 2011 to highlight the significant regulatory risks associated with additional insurer charges. Lloyd's also set out its reporting requirements in connection with additional insurer charges in market bulletin Y4392 on 28 April 2010.

Broker remuneration arrangements continue to evolve with new remuneration structures being developed all of the time. Lloyd's does not seek to interfere with the agreement of commercial arrangements in the market but the development of new remuneration arrangements means that the associated legal and regulatory risks also continue to evolve.

The purpose of this bulletin is therefore to stress Lloyd's ongoing commitment to ensuring that managing agents are able to meet the very highest standards in their dealings with brokers for the benefit of Lloyd's policyholders. It is also to set out in one place Lloyd's guidance and requirements for managing agents in this area.

Given the importance of these issues, managing agents should ensure that a copy of this bulletin is provided to all its board members (including non-executive directors) and the content of this bulletin should be considered at a board meeting.

1. Bribery Act

The Bribery Act 2010 (the “Act”) is now in force and all managing agents must make sure that they are aware of the implications of the Act (and the associated guidance issued by the Ministry of Justice). In summary, the Act provides that it is both an offence to offer, promise or give bribes (active offences) and to request, agree to receive or accept a bribe (passive offences). The Act also introduced corporate liability for failing to prevent bribery.

It is ultimately a matter for the board of each managing agent (taking its own external legal advice where appropriate) to ensure that any arrangement that a managing agent enters into does not breach the terms of the Act.

The consequences of breaching the Act are very serious and any criminal charges would be a matter for the Serious Fraud Office (rather than Lloyd’s or the FSA). Currently, due to the lack of relevant precedent, the precise application of the Act is not always easy to determine. Accordingly, Lloyd’s expects managing agents to adopt a very cautious and rigorous approach to compliance having regard in particular to the following matters.

Ordinary brokerage

The payment of brokerage within the usual range is a long-standing commercial practice that has consistently been upheld by the courts as compatible with brokers and insurers fiduciary duties. Accordingly, Lloyd’s has been advised and has concluded that it is inconceivable that agreement or payment of brokerage would lead to prosecution where the amount agreed is an ordinary amount within the usual range for the type of business in question and where the amount has been fully disclosed to the client.

Additional fees charges and commissions

Payment by the insurer of additional fees, charges or commissions (or brokerage outside the ordinary range) to a broker which acts for a policyholder including under a line slip (rather than as agent for underwriters under a binding authority) raises concerns that the additional payment might be seen as inducing or influencing the broker to place business with the insurer contrary to the broker’s client’s best interests or which might otherwise cause improper performance by the broker of its duties. This is particularly the case where the additional payments are calculated by reference (whether directly or indirectly) to the amount of business underwritten by the insurer or by reference to the profitability of the business.

Considerable care therefore needs to be taken before any such additional payments are agreed having regard to the underlying commercial reality of the arrangement in question rather than merely to how it is represented or described.

Accordingly, Lloyd's expects each managing agent from 1 March 2012 to ensure that, as a minimum, each of the following questions has been considered before additional payments are agreed to –

- a. no matter how the additional payment is described, is the real commercial motivation to agree to the additional payment to secure underwriting business or the opportunity to quote for such business? If so, the additional payment should not be agreed to without the managing agent obtaining its own legal advice which specifically addresses the commercial motivation for the additional payment.

In no circumstances should additional payments be agreed which are contingent upon the profitability of business being entered into or which are contingent upon receiving target volumes of business which represent a very high risk under the Bribery Act;

- b. where the additional payment is said to be in return for any services provided to the insurer (whether for administrative services, provision of management information or otherwise) –

- i. are the services of real additional value to the managing agent and demonstrably commensurate with the additional payment? If not, the additional payment should not be agreed to or arrangements should be negotiated in good faith so that the value of the service is objectively and demonstrably commensurate with the additional payment;
- ii. are the services fully defined and set out in a contractually binding agreement which would meet equivalent FSA outsourcing requirements (see SYSC 13.9) and (a) allow proper monitoring and control of the services, (b) allow access to the managing agent's internal and external auditors to review the provision of the agreed services and (c) make the broker legally responsible for providing the services and accepting liability for failure to do so. If not, the additional payment should not be agreed to without the managing agent obtaining its own legal advice;

- c. has the broker agreed to provide clear disclosure to its clients in respect of each contract of insurance placed for each client of (a) the amount of the additional payment and (b) of any services for which they are paid? If not the additional payment should not be agreed to;

- d. can the broker demonstrate that it has appropriate and proportionate processes and procedures to ensure that it and its staff will continue to perform their fiduciary duties to their clients in all of the circumstances? If not, the additional payment should not be agreed to.

Where a managing agent does consider that it is appropriate to agree additional payments the managing agent must keep a clear record of how it reached that decision.

It is important that each managing agent agreeing to additional payments satisfies itself that the payment is appropriate rather than relying the fact that other managing agents or insurers may have agreed to enter into the same or similar arrangement.

Where an additional payment has been agreed not at managing agent level but at group level, then the managing agent should consider the above questions when considering a proposal to recharge any of the additional payment to the syndicate.

2. Reporting to Lloyd's

A managing agent which has entered into an arrangement with a broker which involves additional payments must continue to notify the Performance Management Directorate of these arrangements using the following email address: distributioncosts@lloyds.com

Managing agents must also continue to report to the Performance Management Directorate all new arrangements before they are entered into and must account for all amounts booked in that quarter using the form attached to the Market Bulletin of 28 April 2010.

Going forward these reports should include -

- a. all additional payments however described (other than ordinary brokerage) whether or not the additional payment is provided for on the slip or on a line slip¹; and
- b. details of additional payment arrangements which have been entered into at group level but where some or all of the payment is to be recharged to the syndicate.

If a managing agent is in doubt whether an additional payment should be reported please contact Lloyd's to discuss.

3. Further advice and information

Further advice on these issues has also been provided by the LMA. This includes the letter from the Chief Executive of the LMA (1 December 2010) and the written advice from Reynolds Porter Chamberlain LLP to the LMA (28 July 2011) on broker remuneration.

Any queries relating to the contents of this bulletin, including the notification requirements, should be addressed to Mark Stockton in the first instance (mark.stockton@lloyds.com or Lloyd's extn 5419).

¹ Accordingly Instruction Note (b)(1) in the Annex to that bulletin no longer applies