

Regulatory Bulletin

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FROM: Director, Regulatory Division

LOCATION: 58/NC1

EXTENSION: 5355

DATE: 6 September 1996

REFERENCE: 047/96

SUBJECT: **BROKERS' COMMISSIONS**

ACTION: **BROKERS AND UNDERWRITERS TO NOTE CONTENT**

DEADLINE: **IMMEDIATE**

A market bulletin of 1 May 1995 entitled "Grossing Up" (Ref. X770) reminded brokers of their duties to assureds. The attached statement of those duties is intended to build on existing best practice and to provide further guidance in respect of the negotiation of brokers' commissions. Brokers should note the new procedures for risks presented for signing through LPSO which will apply after 30 September 1996.

Any questions on the statement should be addressed to James Manning (extension 5823) or Greg Shepherd (extension 5866). Policy Department, Regulatory Division.

This bulletin is being sent to all Lloyd's brokers, active underwriters, managing agents and market associations.

David Gittings
Director, Regulatory Division

DUTIES OF LLOYD'S BROKERS

INTRODUCTION

The fiduciary duties of Lloyd's brokers are a matter of agency law. Many of the obligations of brokers to proposed policyholders are set out in both the Lloyd's Code of Practice and the IBRC Code of Conduct. This statement is intended to develop the guidance given in those documents, and to build on existing best practice. specifically in respect of broker commissions.

The primary function of a Lloyd's broker is to procure a contract of insurance or reinsurance between a proposed policyholder and insurer or reinsurer as the case may be. In fulfilling that function, the broker must have regard to the best interests of the proposed policyholder and avoid acting in any way which is detrimental to those interests. [In particular, to represent to a proposed policyholder or a producing broker that the premium he is to pay is greater than that shown on the slip is, without the proposed policyholder's informed consent, contrary to the general law of agency which obliges the broker to put the interests of its principal above all other considerations and also requires that an agent may not make a secret profit. Furthermore, placing insurance or reinsurance on a basis which increases or potentially increases the broker's remuneration against the interests of the proposed policyholder without his knowledge is not in keeping with the broker's agency duty.

These principles apply irrespective of whether the broker is instructed directly by the proposed policyholder or via an intermediary.

1. "Grossing Up"

Grossing up is a practice whereby the gross premium (i.e. including commission) agreed between broker and insurer (or reinsurer) is less than the premium which the broker notifies the proposed policyholder is payable. The difference in the two amounts remains in the hands of the broker, and the proposed policyholder is left unaware that he is paying a greater sum than has been agreed by the broker on his behalf with the insurer (or reinsurer).

Such a practice, without the informed consent of the proposed policyholder, is wholly unacceptable. Furthermore, any action which may have the consequence of misleading the proposed policyholder as to the premium payable may result in disciplinary action being taken against a broker.

Where the Lloyd's broker is the agent of the underwriter(s) on whose behalf authority to bind business has been granted, any commissions under such binding authorities must be agreed by those underwriter(s) on whose behalf the broker is acting. In such instances the position must be made clear to the policyholder or producing broker and any conflict of interest must be disclosed.

2. "Net Equivalent" Clauses

In the past, certain slips have contained wordings which have allowed the broker to adjust the gross premium while the underwriter receives the same net premium (for example, contracts with an "or net equivalent" clause).

A broker using such a clause where the consequence is to increase in any way the gross premium payable is acting inconsistently with his duties to the proposed policyholder unless the proposed policyholder has given his informed consent. Accordingly, and as a safeguard against potential abuse, the LPSO will reject slips presented for original signing after 30 September 1996 where commission is expressed as a net equivalent and may be varied by the broker, unless the commission appearing upon the slip is expressed as a specific sum or maximum amount which can only be reduced.

The actual gross premium charged to the proposed policyholder must be disclosed to LPSO in all cases where premium taxes apply or where a risk is subject to US regulatory reporting. It is underwriters' responsibility to determine the taxable gross premium on each appropriate risk and this obligation must be discharged accurately.

Should a broker negotiate the premium with the underwriter on a net basis (e.g. if the broker is remunerated on a fee basis by the policyholder) the commission must be stated on the slip as nil.

3. Preparation of Insurance/Re insurance Documentation

Brokers must have regard to the interests of a proposed policyholder in conducting insurance or reinsurance business and to the preparation of documentation in the course of conducting such business. The Lloyd's Regulatory Board would expect the amount shown as the premium on any evidence of insurance issued by a Lloyd's broker to mirror the premium agreed by the underwriter and shown on the relevant slip. Any upward variation in the amount shown as premium on a covernote may be viewed as evidence of a failure to adhere to the principles governing the relationship between the broker and proposed policyholder and may lead to disciplinary action.

RESPONSIBILITY AND MONITORING

It is the responsibility of the Board of each Lloyd's broker, acting through the compliance officer on a day-to-day basis, to ensure that the company has internal control systems in place adequate to ensure compliance with this statement.

This bulletin applies to Lloyd's brokers regardless of where the business concerned is being placed.

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