

News flash

WHO PAYS THE FERRYMAN?

Transparency, conflicts of interest and disclosure of commissions – does any one care?

You should! Because although the FSA initially rejected the implementation of a regime of mandatory commission disclosure, that is not the end of the matter and the FSA is seeking comments on its current proposals, which could impact on the way you do business. The deadline for comments to the FSA on the current discussion paper is 25 June 2008¹.

A number of large brokers have already put in place systems that provide for mandatory disclosure of commission, but the FSA does not consider this addresses its concerns. In summary, it is concerned that customers do not know they have a right to request this information and even if they are aware of their rights, most do not know what to do with it. This gives rise to a lack of transparency in the insurance market as regards the services offered by brokers, and the commission paid for them. How are customers to know if they are getting a good deal? How can they compare the level of service being offered if they do not have the information or know what to do with it? The FSA's aim is to lead to a more efficient market.

You now have an opportunity to comment on the possible solutions. To help, [Megan Howe](#) and [Elizabeth Simpson](#) look at the identified concerns and the potential solutions being proposed.

FSA's concerns

- 1 Customers appear to be poorly informed by intermediaries about the full cost of services offered, the extent to which the market is being searched and the capacity in which the intermediary is acting.
- 2 There is a lack of consistency in the form in which customers are receiving commission information, preventing like-for-like comparisons of service and cost.

- 3 Uncertainty as to the remuneration arrangements which must be disclosed.
- 4 Management of conflicts of interest arising from intermediaries' commission arrangements/relationships with third parties - what capacity is the broker acting in? How does the broker manage any conflicts of interest which arise due to his status? And to what extent does the commission the customer is paying for relate to the work the broker is doing?

The CRA International Report: Commercial Insurance Commission Disclosure: Market failure analysis and high level cost benefit analysis (December 2007)² found that the main failure in relation to mandatory commission disclosure was in relation to medium-sized firms (annual turnover between £0.5m and £100m). Due to the lack of transparency, customers of those firms (a) were likely to be paying higher commissions; (b) were frequently unaware of their right to ask for commission information; and (c) rarely exercised their right to do so even if they were aware.

The report estimated that the cost of mandating commission disclosure would be an initial £87m and £34m ongoing 

1. FSA Discussion Paper 08/2 – Transparency, disclosure and conflicts of interest in the commercial insurance market
2. <http://www.crai.com/publications/listingdetails.aspx?id=5794&terms=commercial+insurance+commission+disclosure>

- ▶ – equivalent to 0.5% and 0.2% of the gross written premiums respectively. These costs would be split between the insurers, who would bear 45% of the total, and intermediaries who would bear around 55% of the costs. It was estimated that regional intermediaries – smaller firms in particular – would bear a disproportionate share of the costs.

According to the report, approximately half of customers already receive commission disclosure, but 80% of the remaining customers would be unlikely to use the commission information if they received it. In fact, only 5% of the total value of commercial insurance (based on gross written premium) would benefit from mandatory commission disclosure, i.e. able to compare levels of service and commission to make an informed choice as to which intermediary to retain. Therefore, on its own, mandating commission disclosure would not be justified on cost-benefit grounds.

So what's the answer?

A number of potential solutions have been identified to address the concerns and to achieve a more competitive and efficient market –

- 1 More rigorous supervision and enforcement of existing rules and principles – this would include further guidance on what is expected by the FSA, more targeted supervision and additional reporting requirements about remuneration arrangements and business models likely to create conflicts of interest.
- 2 Enhanced 'on-request' regime – improve the transparency and comparability of disclosure requirements relation to remuneration, services and status, for both 'on-request' and voluntary disclosure.
- 3 Mandatory commissions disclosure – introducing measures as above, but, in addition, require commission disclosure to be made automatic, rather than on request.
- 4 The FSA is also conducting further research and investigations into other solutions that could be implemented in order to assist the market. The issues to consider are: (a) whether standardised commission disclosure templates or pro-formas would be necessary to ensure that commission

information is provided in a consistent manner; (b) whether a common set of definitions or principles for defining certain types of remuneration arrangements or services would help to achieve greater standardisation; and (c) improving management of conflict of interests. Disclosure of commissions may help to ensure that the broker knows what work it is doing for the customer, and thereby prevent any conflicts to the work being conducted.

How do these affect you?

Whatever solution is adopted, it is likely brokers will have to put in place systems to ensure that clients are receiving full information before conclusion of the insurance contract.

If the FSA decides that mandatory commission disclosure is appropriate, the fear amongst smaller broker firms is that they will be forced out of the market due to the additional costs incurred in implement the new rules.

But even if disclosure is not mandatory, intermediaries will be required to provide information to their customers (when requested) in a standardised format. Brokers will therefore need to ensure that they are able to deal with this demand and provide the information needed.

Next Steps

The FSA's deadline for feedback on the current discussion paper is 25 June 2008, and it hopes to provide a formal consultation in the fourth quarter of 2008 if it is decided that rule-changes are necessary. Details of Discussion Paper 08/2 can be found at www.fsa.gov.uk/pubs/discussion/dp08_02.pdf.

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We can put together a seminar/talk or panel discussion on the issue above, or any of the issues featured in our publications to be held at any of our offices, or yours. If you are interested, please contact any one of our lawyers or David Simon at david.simon@robinsimonllp.com.

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