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Contingent commissions under renewed scrutiny

By SARAH GODDARD

LONDON—The heated international debate over brokers' contingent commissions grew more intense in the London market last week.

Recent U.K. media reports have implied that large brokers, unbeknownst to their policyholder clients, have been using size and market share to strong-arm insurers into entering incentive commission arrangements.

The brokers strenuously deny these assertions.

"Of course we are committed to transparency in all of our dealings with our clients," said a spokesman for Aon Group Ltd. in London.

But less than 4% of U.K. risk managers polled in a survey released earlier this month by the London-based Assn. of Insurance & Risk Managers said that they were aware of incentive payments from insurers to brokers, and none said that they were given full information about contingent commissions.

"The view of risk managers internationally is that this calls into question the principle of 'best advice' and transparency," an AIRMIC statement said. "This is of particular concern in the light of the rules of agency and the code of conduct of the Insurance Brokers Registration Council and the Lloyd's code of practice for Lloyd's brokers."

The U.K. risk managers echo concerns voiced by their U.S. counterparts over whether some forms of contingent commissions could lead to brokers placing their business with an insurer that is not necessarily providing the best coverage for their exposures.

Volume override commissions, under which an insurer pays a broker a pre-agreed commission if

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that broker produces a certain amount of business for the insurer, are a long-standing feature of the insurance market. However, they tend to become more prevalent when rates are cheap and capacity is high—as under the current market conditions.

The issue has gained more attention recently in the United Kingdom, particularly because of comments made by Jardine Lloyd Thompson Group P.L.C. Chief Executive Ken Carter in JLT's recently issued annual report.

Mr. Carter comments, "We are aware of the debate within part of the risk management community regarding incentive commissions paid by some insurers. These incentives in general terms reflect factors such as profitability, premium volume and administrative efficiencies across the entire business portfolio between a broker and an underwriter."

Noting that less than 2% of JLT's 1997 revenue came from these arrangements, Mr. Carter said, "We will operate a policy of transparency with our clients by providing, where requested, appropriate disclosure of incentive commission whilst, at the same time, separately identifying the total remuneration which the group derives from these incentive commissions in future report and accounts."

The JLT statement has prompted other brokers to make similar statements. At the end of last month, Lloyd's of London broker Berry Palmer & Lyle Ltd. issued a letter saying that the broker "does not accept incentive payments from insurers, though we have been offered them on a number of occasions." In addition, "It is our policy to advise our clients of any such remuneration we receive in addition to brokerage or fees, as we are conscious that we are the agent of the insured, even though commission is usually payable by the insurer," BP&L said.

Still, some risk managers in the United Kingdom and in the United States are not convinced that they are being given the whole picture of their brokers' compensation. Buyers question the potential conflicts of interest brokers may face in also receiving payment from insurers.

By law, a broker's principal client is the policyholder. Even so, when the intermediary receives payments for services or business provided to insurers that may jeopardize that relationship with the policyholder, assert some risk managers and insurance executives.

Liz Taylor, a former chairman of AIRMIC, is against a broker receiving any commissions from insurers at all, since it provides little incentive for the broker to act in their client's best interests. She said she is concerned about the lack of transparency these arrangements represent and added she would happily pay a higher fee in return for greater disclo-

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sure.

Commented Scott Lange, director of risk management at Microsoft Corp. in Redmond, Wash.: "If a broker has a better override with one market than with another. . .it would be interesting to see which the preferred market (for a piece of business) is."

Stephen M. Wilder, who completes his presidency of the Risk & Insurance Management Society Inc. this week, agrees with the view that volume override commissions may provide incentives to brokers that are at odds with the best interests of the insurance buyer.

Mr. Wilder, vp-risk management at The Walt Disney Co. in Burbank, Calif., said he expects the issue of broker compensation to be raised at the RIMS conference this week during a debate on consolidation.

"If I pay a broker a fee for services they deliver, that ought to be the only compensation they earn based on my book of business," Mr. Wilder said. "If they are doing work for an insurance carrier which is to my benefit, it should be reflected in my fees."

Earlier this month, Lloyd's director of regulation, David Gittings, issued guidelines to Lloyd's brokers on the regulatory requirements for broker remuneration. In these guidelines, Mr. Gittings reinforces that the broker's responsibility is to the policyholder, though the full extent of the broker's fiduciary obligations "depends on the nature of the individual relationship and the circumstances in which the broker is acting."

The guidelines also say that an agent must disclose to the policyholder "all benefits received or receivable when acting in the capacity of an agent on behalf of his principal. Such benefits may only be retained if disclosed to the principal and with the principal's agreement."

If commissions are within what Mr. Gittings describes as "the usual range of the market," then the broker doesn't need to tell the policyholder unless the policyholder specifically asks. But if they are outside that range, the policyholder must be informed. In addition, a policyholder must be informed by a broker if there is any conflict of interest.

In an interview with *Business Insurance*, Mr. Gittings said, "There is nothing illegal in any of this," referring to the fees for services and volume override arrangements. "It is purely a disclosure issue."

However, Lloyd's broker regulators will analyze the different payments made for different activities in the light of proposed changes in the U.K. government's broker regulation. Currently, the treasury is consulting with the insurance industry on broker regulation, intending to repeal the current Insurance Brokers Registration Act and include brokers within the Financial Services Reform Bill. The consultation period runs until the end of next month, with draft legislation expected in the summer and a bill expected to be presented to Parliament in the fall.

"We are not in the banning mode" over these arrangements, said Mr. Gittings. "We are in the understanding and disclosure mode." BI