

# MARKET BULLETIN

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<b>Title</b>	Distribution Costs, Broker Remuneration and Additional Charges
<b>Purpose</b>	Consolidated Guidance
<b>Type</b>	Event
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<b>Deadline</b>	
<b>Related links</b>	

Lloyd's issued consolidated guidance with regard to distribution costs, broker remuneration and additional charges on 22 February 2012 (market bulletin Y4567).

Placement structures and remuneration arrangements in the London market continue to evolve and increase. Whilst Lloyd's does not seek to interfere with the agreement of commercial arrangements in the market nevertheless, it is important that managing agents continue to properly consider the structure and terms of such arrangements to ensure their compatibility with relevant laws and regulations and to meet the very highest standards in their dealings with brokers for the benefit of Lloyd's policyholders.

In view of developments, and following discussion with the LMA and LIIBA, the Franchise Board has decided to take the following steps –

- refresh and reissue Lloyd's consolidated guidance (incorporating the further guidance issued by Lloyd's and the LMA on 26 April 2012). This is attached at annex 1 to this bulletin;
- remind managing agents of the advice obtained by the LMA for its members from Reynolds Porter Chamberlain on broker remuneration. A summary of that advice is available at

[www.lloyds.com/Web/News\\_room/LMA\\_bulletins/xLMA\\_bulletins/LTM11-013-KvdK.aspx](http://www.lloyds.com/Web/News_room/LMA_bulletins/xLMA_bulletins/LTM11-013-KvdK.aspx)

- require that each managing agent reconsiders the application of the guidance to its business arrangements with brokers at a board meeting; and
- reissue Lloyd's reporting requirements for managing agents in connection with additional payments and inform the market that it will carry out sample audits of such audit returns from Q1 2015 to ensure that Lloyd's is accurately capturing both the type and quantum of these payments;

Lloyd's will continue to engage with the FCA in monitoring this issue.

Any queries on the content of this bulletin should be addressed to [distributioncosts@lloyds.com](mailto:distributioncosts@lloyds.com) or your usual Syndicate Underwriting Performance account executive.

## **Consolidated Guidance Distributions Costs, Broker Remuneration and Additional Charges**

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### **Bribery Act**

#### **Introduction**

The Bribery Act 2010 (the “Act”) is in force and all managing agents must make sure that they continue to consider 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 FCA). Lloyd’s continues to expect 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 to continue 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. is the additional payment compatible with the managing agent's obligation to pay due regard to the interests of Lloyd's Customers and treat them fairly at all times?
- c. 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 PRA and FCA 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;
- d. has the broker agreed to provide clear and readily comprehensible 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;
- e. 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. The confirmations and undertakings that a broker provides under the new (2013) model non risk transfer Terms of Business Agreement ('TOBA') (or the new model endorsement to the risk transfer TOBA) including in relation to the Bribery Act, are likely to be sufficient for these purposes.

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 on 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.

*Supplementary guidance with regard to profit commission on line slips*

It is understood that currently some line slips do permit profit commission for the named broker. Profit commission represents a high risk under the Bribery Act. This is because an agreement between a managing agent and a broker which rewards the broker for placing (profitable) business with the managing agent raises clear concerns that the broker may be influenced to place business with that managing

agent even where that is otherwise contrary to its duties to its client. In this regard it is important to bear in mind that under a line slip the broker remains the agent for its client (the insured). (This is in contrast to the position where a broker acts as agent for underwriters under a binding authority, which includes under a “limited” or “prior submit” binding authority.)

However, the legal risks regarding agreement of PC under a line slip are likely to be materially less where the managing agent is reasonably satisfied that –

- a. the broker has expressly stated to its client that it will not be undertaking a fair market analysis when seeking terms for the client (but instead will seek to place the business under the line slip); and
- b. the broker has disclosed, or will disclose, the remuneration arrangements to its client in accordance with the broker’s duties under ICOBS and in accordance with any additional fiduciary duties it owes its client; and
- c. the broker is, when required or requested to disclose the remuneration it receives under the line slip, expressly providing the client with details of the level of the PC and basis of calculation.

In the case where the client is separately paying his broker a fee, and the managing agent is aware of this arrangement, then the managing agent should satisfy itself that the broker is disclosing the remuneration details (including of the PC) in respect of each contract of insurance whether or not the client specifically requests disclosure.

The broker is under an ICOBS obligation always to state to its client whether or not it is operating on a fair analysis basis or only dealing with a limited number (or one only) of insurers [ICOBS 4.1.6R].

In these circumstances, and where the managing agent is satisfied the broker has appropriate processes to comply with its regulatory and fiduciary obligations and adequate procedures under the Bribery Act, the managing agent may decide that allowing PC is acceptable since the concern that the broker might improperly perform its duties to its client to seek best terms would not arise.

*Supplementary guidance with regard to profit commission on binding authorities*

In some cases binding authorities provide for profit commission to be payable to both the coverholder and also to the Lloyd’s broker which placed the binding authority on behalf of its client (the coverholder). Where –

- a. the Lloyd’s broker’s only role is acting for the coverholder in placing the binding authority (and not acting for the ultimate policyholders); and
- b. where the profit commission arrangement for the Lloyd’s broker is included in the binding authority

then there should not be a concern from the Bribery Act. This is because the broker's client (the coverholder) is a party to the binding authority agreement permitting the profit commission.

## Reporting to Lloyd's

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A managing agent which has entered into an arrangement with a broker which involves additional payments must continue to notify the Performance Management Directorate as follows.

1. Managing agents should notify the Directorate of all additional payments however described (other than ordinary brokerage). This includes all such additional payments whether provided for on the slip or on a line slip (other than PCs on line slips in which case the disclosures provided by the Quarterly Broker Remuneration returns will suffice).

These initial notifications should be provided using the following email address: [distributioncosts@lloyds.com](mailto:distributioncosts@lloyds.com). Prior approval or consent is not required.

2. 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 Quarterly Broker Remuneration form attached. This form includes disclosing PC paid under lineslips.

The form contains guidance and instructions regarding the nature of the disclosures that must be made. This form and its guidance may be updated and refined over time and any updates will be communicated to the market. More information on quarterly reporting can be found on the [Business Timetable tool](#) on Lloyds.com.

For the avoidance of doubt these reporting obligations include where the managing agent has decided as a matter of strategy to make payments for services rather than payments that relate to individual insurance contracts. The reports should also cover additional payment arrangements which have been entered into at a 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 [distributioncosts@lloyds.com](mailto:distributioncosts@lloyds.com) or your usual Syndicate Underwriting Performance account executive.