



**SUBMISSION BY LLOYD'S UNDERWRITERS**

**TO**

**THE INDUSTRY PRACTICES REVIEW COMMITTEE OF THE  
CANADIAN COUNCIL OF INSURANCE REGULATORS AND  
THE CANADIAN INSURANCE SERVICES REGULATORY  
ORGANISATIONS**

**RELATIONSHIP BETWEEN INSURERS AND SALES  
INTERMEDIARIES CONSULTATION PAPER**

3 August 2005

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Dear Mr, Paglia,

I am writing in response to the invitation of the Canadian Council of Insurance Regulators (CCIR) to offer comments on the Industry Practices Review Committee Consultation Paper on Relationships between Insurers and Intermediaries. The comments below represent the views of the Society of Lloyd's ("Lloyd's"). In preparing this submission, we have also consulted with Lloyd's Market Association who represent Lloyd's managing agents.

Lloyd's Underwriters have been licensed in Canada since 1932 and are now one of the country's largest commercial property and casualty insurers. Lloyd's operates under a unique structure, recognised under provincial legislation, in which underwriters do not maintain separate branches overseas but trade from London, accepting business from the many jurisdictions in which Lloyd's hold licences only through the intermediary of brokers and agents. Over 400 Canadian firms are currently authorised to produce business to Lloyd's Underwriters.

Lloyd's appreciates the opportunity CCIR has offered through the consultation for stakeholders to participate in its policy formation process, and the steps CCIR's members have taken through the initial survey towards a risk-based approach to any legislative or regulatory change.



Nicholas Smith

## General observations

The consultation paper outlines various policy options that CCIR's members are considering adopting by means of legislation or regulation. CCIR has explained that these options are responses to its finding that: "some current business practices may contribute to a perception of or actual conflicts of interest in the marketplace. At issue is the appearance to a reasonable, informed third party that bias exists in the course of providing advice to consumers due to a conflict of interest or potential conflict of interest."

Lloyd's believes as a matter of principle that new legislation or regulation must always be underpinned by a solid rationale. Legislative changes are often, as in this instance, proposed as solutions to particular problems, but whilst society may benefit from the solution, it will inevitably also impose costs due to the need to adapt existing behaviours and procedures. CCIR has also enumerated (in section 4 of the consultation paper) a number of public policy objectives that have guided the development of the policy options outlined in the paper. Lloyd's believes these objectives are sound, particularly the final one ("competitive market – fostering a healthy and efficient insurance industry"). Often, policy is adopted on the basis of the benefits it theoretically confers without due consideration of the costs.

Lloyd's believes that CCIR should attempt thoroughly to evaluate the cost to society of any perceived conflict of interest in the current (unreformed) situation as against the cost to the industry of making the changes before proceeding with any legislative or regulatory changes. Whilst Lloyd's notes that CCIR has identified the problem to be addressed in terms of "the appearance of bias ... due to a conflict of interest or potential conflict of interest," it has not quantified how widespread that appearance is nor identified the audiences to which it is being made manifest, nor its cost society.

Lloyd's would observe that the existence of conflicts of interest in insurance transactional relationships is not a new phenomenon. Such conflicts are already subject to regulation through the law of agency, and the fiduciary duties to his principal which it imposes on an agent. Within the Lloyd's market, the Lloyd's Act 1982 prevents managing agents being a controller, subsidiary, holding company or related company of a Lloyd's broker whilst managing agents are required to include in their syndicate business plans all related party insurance transactions that they intend to enter into during the year to which the plan relates. As a matter of general principle, therefore, Lloyd's believes that conflicts can be addressed by agents making suitable disclosures to their principals rather than by legislation of the type discussed in the consultation paper. This is why Lloyd's, in common with many other insurers, voluntarily adopted the 'Insurance Bureau of Canada's Code of Consumer Rights and Responsibilities' in respect of Lloyd's Underwriters Canadian Business and recognised consumer rights in this area.

Finally as a general comment, Lloyd's supports proposals that ensure that clients are provided with suitable product information both before and after contract. However, if the impetus for legislation or regulation is the conflict of interest, then any changes should be confined to situations or relationships where that conflict may arise. Lloyd's does not believe that there is any conflict between insurers and policyholders where they are dealing with each other through the intermediary of a broker or agent who is acting on behalf of the policyholder and that there is no

need to impose, in that scenario, additional compliance burdens on insurers (outside, of course, any illegal practices). In addition, Lloyd's does not believe that conflicts exist for intermediaries who are involved in an insurance transaction but who do not have an agent-principal relationship with the policyholder as they act as intermediaries between the insured's representative and insurers.

Lloyd's comments on this and the subjects raised in the consultation paper are presented below. Lloyd's has responded in general on the various subjects and attempted to address those questions raised in the paper that are pertinent to its mandate.

### 1. Codification of the priority of the client's interest

Lloyd's supports any proposal that makes clear that a broker's primary obligation is to his principal (ie his client). However, Lloyd's is unclear what practical effect any legislation would have over the law of agency that already imposes fiduciary obligations on an intermediary acting on behalf of a client.

Lloyd's has a particular concern over the implications of such a legislative change for the 40% of its Canadian business that is distributed through intermediaries holding delegated underwriting authority as "coverholders." Due to the structure of Lloyd's, it is very expensive for small and medium-sized risks to be placed individually in the market, and delegated authority contracts provide a cost efficient means of distributing these products to Canadians. In these circumstances, the coverholder acts as agent for the members of particular Lloyd's syndicates with authority to enter into contracts of insurance with policyholders subject to certain terms, conditions and exceptions. Accordingly, any proposal would need to take into account the fact that the coverholder owes agency law duties to the members of the relevant Lloyd's syndicates. If any proposed legislation did not take this into account then some Lloyd's businesses may rethink their appetite for delegated authority Canadian Business and lead to a reduction in the availability of cover to Canadians.

### 2. Restricting performance-linked benefits offered to intermediaries

It is common for Lloyd's coverholders to be remunerated by way of contingent profit commissions. Lloyd's believes that this can be a suitable and appropriate means of remuneration for such business, providing an incentive to the intermediary to manage the underwriting he conducts on behalf of the relevant members correctly. Lloyd's notes that profit commission is not guaranteed: it depends ultimately on the claims experience of a contract, which intermediaries are unable directly to influence at the moment they recommend a particular transaction to their client. Lloyd's notes that, in the United Kingdom, the Financial Services Authority (FSA) has not sought to ban specific types of inducements such as volume overrides, market services agreements and profit sharing arrangements. Instead, it has a rule to prohibit any unfair inducements. In particular, the FSA requires that an intermediary must take reasonable steps to ensure that it does not offer, give, solicit or accept an inducement likely to conflict with the duties the intermediary owes to its customers. This would be similar to the principle based approach outlined in the consultation paper.

With regard to performance-linked benefits generally, and noting that certain forms of inducement are already illegal or constitute breaches of fiduciary duty, Lloyd's is not persuaded that there is a case for regulation. Concerns in this area can best be addressed by suitable disclosure by an intermediary to his client.

### 3. Enhance transparency of compensation, ownership and other financial interests

Lloyd's agrees with the consultation paper's view that disclosure is an important method by which conflicts of interest, or potential conflicts of interest, can be addressed. For that reason, Lloyd's has voluntarily adopted the IBC Code of Consumer Rights and Responsibilities in respect of Lloyd's Underwriters Canadian Business. Lloyd's also believes that such disclosure reflects the agency obligations that a broker owes to his client.

Lloyd's is unclear as to the need to mandate particular forms of disclosure by insurers where the business has been placed on behalf of the client by an intermediary that is acting for the client. In that case it is difficult to see where there is a conflict of interest between the insurer and the policyholder.

In addition, the particular disclosure obligations suggested for insurers outlined in Appendix 1 provide some practical difficulties for Lloyd's as a market comprised of 62 syndicates of underwriting members rather than a single company with a single set of practices. If this proposal was to be taken forward, it would need to be determined exactly how this can be achieved in the context of a market. It is suggested that the relevant information should be disclosed on an insurer website, but the Lloyd's website was not established to provide the type of detailed information outlined in Appendix 1.

Lloyd's believes that the potential burden of complying with these requirements considerably outweighs the benefits. Since insurer-intermediary conflicts became the object of attention last fall, Lloyd's has received not one call in its Canadian office asking for such information. Further, Lloyd's believes that policyholders are well aware that intermediaries are remunerated by insurers, and notes that many intermediaries already have policies in place (by regulation or on a voluntary basis) that explain how and by whom they are remunerated. The value of supplementing this information by a secondary level of detail provided by insurers is questionable:

- a policyholder will naturally look to his agent for such information in relation to his particular transaction and any insurer website will, at best, provide only general information.
- where, as is often the case for Lloyd's business, the transaction has been placed through a chain of intermediaries, the website can only describe the total of remuneration not what has gone to each intermediary as this will be unknown to the underwriters.
- much of Lloyd's business emanates from businesses who can be presumed to have a reasonably sophisticated knowledge of the workings of the insurance business
- much business is also placed with Lloyd's as part of a programme involving several insurers: it is unlikely that a policyholder wishing to find out the nature of any conflicts of interest will consult the websites of each individual insurer for general information rather than ask his broker for data about his particular transaction.

- It takes no account of the procedures individual insurers may have in place to manage conflicts. In the case of Lloyd's, there are already in place risk management procedures that relate to the management of the financial relationships between Lloyd's managing agents and Lloyd's brokers and other intermediaries. For example, by Lloyd's Act 1982 (and in particular sections 10-12) Lloyd's managing agents are prevented from being Lloyd's brokers or being associated with Lloyd's brokers. In summary the provisions in Lloyd's Act prevent managing agents being a controller, subsidiary, holding company or related company of a Lloyd's broker. In addition, managing agents are required to include in their syndicate business plans all related party insurance transactions that they intend to enter into during the year to which the plan relates. Managing agents also need to obtain Lloyd's prior consent if they wish to establish a dedicated service company which will undertake insurance business on behalf of the syndicate managed by the managing agents.

None of Lloyd's global regulators requires the disclosure by insurers of the information envisaged by Appendix 1. The imposition of this additional compliance burden could adversely affect some Lloyd's businesses appetite for Canadian Business

#### Scope and applicability

The consultation paper outlines that CCIR is cognisant that there are different types of intermediaries, and comments in some detail on the difference between "independent intermediaries" and tied agents. Lloyd's believes that a further difference that CCIR needs to consider is that between intermediaries that deal with policyholders directly and those such as coverholders which act in an insurance transaction in a wholesale or managing general agent capacity after being approached by the policyholder's intermediary. Much of Lloyd's business originates through such chains of brokers, and many of its coverholders do not deal directly with policyholders.

Although these intermediaries will often be independent (in the sense that they are not tied agents and have no ownership ties to insurers), they will not have the same relationship with a client as the intermediary acting directly for it, and therefore the nature of any conflicts (if any) will be different. Generally, intermediary regulation in Canada does not recognise the distinction between intermediaries acting directly for policyholders and those acting in a managing general agent/wholesaler capacity, but Lloyd's believes that it is important that this is taken into account in CCIR's deliberations. Lloyd's is aware that the National Association of Insurance Commissioners has recognised this distinction in their 'Compensation Disclosure Amendment To The Producer Licensing Model Act'. As item 1 of Appendix 1 refers to disclosure by "independent intermediaries who deal with the general public," it may be that this distinction is already in CCIR's mind.