

From Hector Sants
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6 December 2006

Our Ref:

Your Ref:

Dear Chief Executive,

COMMISSION DISCLOSURE FOR COMMERCIAL CUSTOMERS

We are writing to Chief Executives and those individuals responsible for apportionment and oversight at general insurance intermediaries who conduct mediation for commercial customers. This letter summarises some of the findings of our conflict management study which we carried out during the second half of 2006. And, in particular, we outline current market practice when commercial customers ask general insurance intermediaries to disclose commission they receive for an insurance contract.

We recognise that managing conflicts is much broader than just commission disclosure, so we will feedback our other conflict management findings from this study in the December General Insurance newsletter.

Our main findings for disclosing commission are:

- The majority of firms have adopted guidance issued by the London Market Brokers' Committee and the British Insurance Brokers' Association. To that extent, most firms we visited included a standard clause in their Terms of Business Agreements which reminds clients of their right to request information about any commission received in the placing of business, prior to the conclusion of the contract.
- Few commercial intermediary clients request commission disclosure although some have sought a positive declaration from their intermediary that it is not being remunerated under a profit share arrangement or any other similar arrangement.
- Few intermediaries have made consequential changes to their systems and controls to comply with the relevant Insurance Conduct of Business Rule (ICOB) rule – ICOB

4.6.1R. So we found a widespread lack of formal process among intermediaries as to what remuneration would be disclosed to a commercial client on request, with not all intermediaries including all forms of remuneration. Such a failure to disclose fully when asked by a commercial customer would be a breach of ICOB 4.6.1R.

Because of this, we remind firms in Appendix 1 (attached) of their obligations under ICOB 4.6.1R and relevant guidance. We expect all firms to disclose commission to commercial clients on request. When doing this, we also expect intermediaries to disclose all commission paid to an associate (including disclosure of commission paid to any affiliated companies and Appointed Representatives). They must also disclose commission from profit share arrangements or any other similar arrangements including commission earned from premium finance companies. A failure to do so would be a breach of ICOB 4.6.1R and may result in us taking Enforcement action.

We also expect the following actions to take place at all firms:

- Boards should establish and maintain procedures to ensure that the firm has the systems capacity and controls to respond to a commercial client's request for information about any commission received in connection with an insurance contract (including payments to associated firms, arrangements for sharing profits, for payments relating to the volume of sales, and for payments from premium finance companies when arranging finance).
- Boards should ensure that proper records are maintained, sufficient to show and demonstrate that the firm has complied or has the capacity to comply with ICOB 4.6.1R.

We announced on 2 October 2006 that in 2007/8 we will undertake an objective market failure analysis and corresponding Cost Benefit Analysis (CBA), covering both transparency to the customer and to the market. This work will enable us to gather detailed and balanced evidence of the extent to which a lack of transparency is leading to customer detriment and/or impairing market efficiency, and whether mandating commission disclosure to commercial customers will lead to benefits that outweigh the costs of introducing it. Only – and only – if both the market failure analysis and CBA tests are met and the market has still not come forward with any industry-led solutions, will we consider whether regulatory intervention is the best way forward.

Our findings will inform our thinking on the wider question of whether to mandate commission disclosure.

Finally, we will publish a copy of this letter on our website on 12th December 2006.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Hector Sants', written in a cursive style.

Hector Sants

APPENDIX

ICOB 4.6.1R

- Before the conclusion of a *non-investment insurance contract*, or at any other time, an *insurance intermediary* that conducts *insurance mediation activities* for a *commercial customer* must, if that *commercial customer* asks, promptly disclose the *commission* that he and any *associate* of his receives in connection with the *non-investment insurance contract* in question, in cash terms or, to the extent it cannot be indicated in cash terms, the basis for the calculation of the *commission*, in a *durable medium*.¹

ICOB 4.6.2G

- **ICOB 4.6.1 R** does not replace the general law on the fiduciary obligations of an agent. In relation to *contracts of insurance* the essence of these obligations is generally a duty on the agent to account to his *principal*. However, in certain circumstances, the duty is one only of disclosure. Where a *customer* employs an *insurance intermediary* by way of business and does not remunerate him, and where it is usual for the *insurance intermediary* to be remunerated by way of *commission* paid by the *insurer* out of *premium* payable by the *customer*, then if the *customer* asks what the *insurance intermediary's* remuneration is, the *insurance intermediary* must tell him. **ICOB 4.6.1 R** is additional to this requirement in that it applies whether or not the *insurance intermediary* is an agent of the *commercial customer*.

ICOB 4.6.4G

- The disclosures required by **ICOB 4.6.1 R** should be made in a manner that is clear, fair and not misleading, as required by **ICOB 2.2.3 R** (Clear, fair and not misleading communication).

ICOB 4.6.6G

- **ICOB 4.6.1 R** does not require the disclosure of *commission* throughout the distribution chain between the *insurer* and *commercial customer*; but it does require disclosure of *commission* paid to any *associate*, regardless of whether the *associate* is part of the distribution chain.

ICOB 4.6.7G

- ¹In considering any disclosure of *commission* under **ICOB 4.6.1 R**, an *insurance intermediary* should include all forms of remuneration from any arrangements he may have for remuneration in connection with the *non-investment insurance contract* (including arrangements for sharing profits, for payments relating to the volume of sales, and for payments from premium finance companies in connection with arranging finance for a *non-investment insurance contract*).

ICOB 4.6.8G

- ¹An example of a situation where the *commission* could not be stated in cash terms under **ICOB 4.6.1 R** is where the *insurance intermediary* is remunerated under a profit share arrangement or any other similar arrangement under which the *insurance intermediary* may receive a non-fixed amount not specific to any particular *non-investment insurance contract*. The *commission*, to the extent it cannot be indicated in cash terms, should instead be indicated by showing the basis of its calculation.