Hold Covered Agreement or Binder?

As compliance officers we are often asked to explain the difference between a hold covered agreement and a binder agreement.

For example, if a client contacts an intermediary to provide additional insurance cover when an insurer is closed for business, such as over weekends and public holidays, to enable the intermediary to confirm that cover is in place it is necessary for the intermediary to have the authority to ‘bind’ the insurance company immediately.

A binder agreement must be entered into between an insurer and an intermediary when an intermediary has the authority to perform one or more of the binder functions referred to in Section 48A of the Short Term Insurance Act; the first function being “enter into, vary or renew a policy”.

On the face of it, it would mean that to accommodate a client in the example above, an intermediary would need to have entered into a binder agreement with the insurer.

However, the FSB recognised this problem when drafting the Regulations and Section 6.5 states:

Despite regulation 6.2(1), an insurer may conclude a hold-covered binder agreement with a mandated intermediary or a non-mandated intermediary, if-

(i) that agreement provides for the entering into policies on an interim and limited-in-time basis only; and

(ii) the legal liability of the insurer under such policies lapses after a maximum period of 96 hours in respect of personal lines business and 30 days in respect of commercial lines business, unless the insurer, in respect of each policy, confirms its legal liability under that policy in writing prior to the expiry of such period; and

(iii) no fee for the services rendered under the hold-covered binder agreement is payable to the mandated intermediary or non-mandated intermediary by the insurer.

In analysing this, it will be seen that there are some distinct differences between hold covered agreements and binder agreements, and these we explain hereunder:

1. A hold covered agreement attracts no fee from the insurer. It stands to reason that if the insurer is paying a fee to the intermediary, it will be necessary for the intermediary to have a full binder agreement.

However, if that fee payable to the intermediary (such as for outsourced services) has no bearing on the activity of granting cover to a client, this will not prohibit the issue of a hold covered agreement.

A problem arises when the insurer pays a fee purely for the issuing of a policy which is linked to a hold covered agreement, but this is not dealt with here.
2. A hold covered agreement does bind the insurer, but on terms to be agreed by the insurer in respect of each particular case. It therefore stands to reason that the insurer may decline cover after it has had the opportunity to assess the risk.

Where terms are decided upon ‘upfront’ for a portfolio of clients, such as when an intermediary has a ‘scheme’, the intermediary will have to enter into a full binder agreement with the insurer. This will allow the intermediary to add clients at any time, as well as renew policies on expiry.

If a scheme of this kind includes conditions whereby the intermediary has to obtain approval from the insurer for each individual risk prior to policy or certificate issue, it can fall within a hold covered agreement, but this type of condition is unusual. The most common practise is for the intermediary to issue a certificate or policy on pre-agreed terms and conditions, and to advise the insurer of new clients at a given future date.

3. There are some very restrictive time constraints imposed on hold covered agreements. In respect of personal lines policies, the insurer has to be informed within 4 consecutive days. There is no provision for ‘business days’ or ‘business hours’, so this allows for long weekends only. If a longer period is required, an intermediary will have to enter into a binder agreement.

A 30 day time constraint applies to commercial lines business, the longer period being required because commercial risks are generally more complex in nature than personal lines risks.

There are a number of definitions used in the various pieces of legislation relating to the rendering of financial services. For the purpose of hold covered agreements, personal lines insurances means “short-term insurance business in respect of which the policyholder is a natural person”. All other policies will be deemed to be commercial lines business.

The final consideration is whether or not a hold covered agreement has to be in writing, and if so what would have to be included.

Although it is not specifically mentioned in the Regulations, nevertheless all FSP’s are subject to the requirements of Section 8 of Board Notice 106 of 2008 which states “An FSP that utilises any third party to render administrative or system functions in relation to the rendering of financial services on its behalf must have in place a detailed service level agreement, specifying the agreed services, time standards, roles and responsibilities and any penalties that might be applicable.

Consequently, there can be no doubt that a hold covered agreement must not only be in place, but must address every aspect of the authority including limits, procedures and the timeframes involved.