Summary of broker fees payable by clients in the short term insurance sector

By Barry Taylor, chairperson of the FIA Short Term Executive Committee and Peter Atkinson, National Technical Portfolio Manager, FIA
28 February 2016

A recent communication from one of the major compliance providers regarding the charging of a fee to clients has resulted in a flood of queries on this.

The historical situation

The charging of a "broker fee" to clients was based on Section 8(5) of the Short Term Insurance Act which read:

(5) An independent intermediary shall not charge, in addition to any remuneration contemplated in section 48, any fee which is payable by a policyholder, unless the amount thereof is disclosed expressly and separately to the policyholder by the intermediary.

This needs to be read in conjunction with Section 48(1) of the Short Term Insurance Act dealing with intermediary remuneration, which read:

(1) No consideration shall be offered or provided by a short-term insurer or a Lloyd's broker or a representative of such insurer or broker or any person on behalf of such insurer or broker or accepted by any independent intermediary, other than someone who has entered into an agreement contemplated in subsection 2, for rendering services as intermediary, and otherwise than in accordance with the regulations.

(Subsection 2 dealt with Binder fees, while the regulations to the Act set out the maximum commission levels of 12.5% for motor business and 20% for other business.)

In general this was probably abused to a certain extent in that many brokers simply referred to it as a “broker fee” or “policy fee” without bothering to define what it was being charged for. (The FIA has advised that the description should be made clearer by calling it a “broker advice fee”, “broker risk management fee” or “broker additional services fee”.)

The FSB has indicated on several occasions that there are tight boundaries around the charging of a fee under Section 8(5). These conditions are summarised below:

The fee must:

a) Be specifically agreed to by the client in writing;
b) Be disclosed;
c) Not be a duplication for which remuneration has already been paid (commission or binder fee);
d) Be reasonable for the service/s provided; and
e) There should be no barrier to exit from this fee on the part of the client.
Insurers / UMAs are allowed to collect this fee on behalf of the broker along with the premium and pay it over to the broker. However as the fee is an arrangement between the client and the broker, it is not the insurers/UMA’s domain to question the amount of this fee.

The mention of commission in “c” above means that one has to then refer to the definition of intermediary services for which commission is paid. This reads:

“Services as an intermediary” means any act performed by a person –

a. the result of which is that another person will or does or offers to enter into, vary or renew a short-term policy, or

b. with a view to –

(i) Maintaining, servicing or otherwise dealing with;
(ii) Collecting or accounting for premiums payable under; or
(iii) Receiving, submitting or processing claims under a short term policy.

However, this definition was deleted by section 109(l) of Act No. 45 of 2013.

A further complication existed in that the definitions in the Long-term and Short-term Insurance Acts, as well as the definition in the FAIS Act, are not consistent. In the FAIS Act, advice is expressly defined, but not in the Insurance Acts.

**The current situation**

Section 8(5) has effectively been removed from the current Short Term Insurance Act although the implementation of this change has not yet been effected.

The entire Short Term Insurance Act is, in any event, in the process of being replaced by the new Insurance Act which is currently being processed. As this Act is part of the prudential legislation falling under the auspices of the Reserve Bank through Treasury, it is not surprising that no similar clause is contained in the Insurance Bill, as the matter of intermediary remuneration is a conduct issue rather than a prudential issue.

The issue is part of the RDR discussions still under way.

Below is an extract of the FIA’s response to the FSB on what constitutes the various services performed by intermediaries. (We have not had any direct feedback from the FSB on this as yet.)

**Core intermediary functions**

This assumes that the intermediary does not have any binding or outsourced capabilities and is modelled on the work flow of the normal day to day activities of an independent intermediary and also assumes the status as being one of a “non-mandated” intermediary as defined in the binder regulations.

The suggested basis of remuneration is in brackets.

Read “policyholder” for “client” in the context of commercial business.

A. “Enter into”

- Marketing – lead generation and sourcing of potential policyholders (Business acquisition cost)
- Establish policy holder risk profile and insurance requirement (Policy holder consulting - Broker fee)
This ranges from detailed risk assessments and risk data collection and interpretation for large market clients to a simpler questionnaire approach for smaller enterprises and individuals.

For larger policy holders, the process is bespoke and directly quantifiable for each policy holder. For smaller policy holders the risk, market and product intelligence is proactively researched, assembled and presented for the needs of various market niches against which individual policy holder’s needs are mapped – here the process is not directly quantifiable for each policy holder but is nonetheless applicable and key.

Whether for a large or small policy holder, the outcome of this phase is an identification of the policy holder’s insurance needs for which an insurance (risk transfer) solution can be sought and intermediated.

Should further general risk consulting activity result from this phase it will be conducted outside of the auspices of the STIA (Broker fee)

- Consult markets (Broker fee)
- Recommend solution to policyholder (Commission)
  Advice and recommendations re insurance solution/s (Commission)
  **Note:** If the policyholder’s response is negative which results in no “entering into”, there is no remuneration for the intermediary unless specifically agreed to prior to undertaking the exercise. This would normally only apply to large commercial/corporate business. (Broker fee)
- Receive policyholder instructions by way of a written proposal to “enter into” (Commission)
- Implement policyholder instructions:
  - Instruct insurer/s (Commission)
  - Confirm instructions to policy holder (Commission)
- Policy /Contract issuance by product provider (Commission)
- Intermediary verifies correctness of policy documentation and dispatches to policyholder (Commission)
- Premium collection by intermediary on premise that the intermediary is appointed as “collection agent” (Outsourced function). **Note** this function extends to the "Vary / Maintain" and "Renew" sections below. The issue of whether this is an outsource function or part of intermediary services will be a discussion point in the RDR debate.

**B. “Vary / Maintaining”**

- Policyholder instructions to change or amend policy details throughout the period of insurance (Commission)
  - Instruct insurer (Commission)
  - Receive and authenticate documentation and dispatch to policyholder (Commission)

**C. “Renew”**

- Review of the policyholder’s needs (processes as per A above)
- Consult markets (Broker fee)
- Recommend solution to policyholder (Commission)
  Advice and recommendations re solution/s (Commission)
  **Note:** If the policyholder’s response is negative which results in no “entering into”, there is no remuneration for the intermediary unless specifically agreed to prior to undertaking the exercise. This would normally only apply to large commercial/corporate business. (Broker fee)
- Receive policyholder instructions by way of a written instruction to “renew” (Commission)
• Implement policyholder instructions:
  Instruct insurer/s (Commission)
  Confirm instructions to policy holder. (Commission)
• Policy /Contract/Renewal confirmation issuance by product provider (Outsourced service)
• Intermediary verifies correctness of policy documentation/renewal documentation and dispatches to policy holder (Commission)

D. “Intermediary Service.”
• Policy service - ongoing service and advice relative to the policy / product "entered into" throughout the period of insurance (Commission)
• Claims service – core function (Commission)
  ○ Receipt of notification of incidents and claims from policyholders
  ○ Notification of claim intimations to insurer/s
  ○ Intermediation between policyholder and insurer to facilitate claims evaluation leading to approval and settlement in terms of the policy, including:
    ○ reviewing the appropriateness and adequacy of the benefits paid in line with the policy;
    ○ transmission of claims proceeds from insurer to policyholder, and
    ○ general claims advice from time to time in relations to the policy.

Services eligible for a broker fee from the policyholder over and above commission

• Policy holder risk profiling and insurance needs analysis, including
  ○ Risk and insurance strategy meetings and / or the research and development of risk and insurance approaches for niche and affinity groups (Annex A, A)
• Risk management advice
• General advice outside of product specific advice
• Loss control advice and surveys
• Risk financing consulting
• Claims intervention to policyholder such as appointment and coordination of external experts to facilitate settlement
• Management of policyholder self-insurance arrangements including aggregate excess/deductible structures
• Management of policyholder claims floats (self-insurance arrangement)
• Facilitating of non-insurance value add products

The future situation

At this stage we cannot be certain as to how this will turn out. The regulators have not indicated that they are against fees being charged to clients and, indeed, this fits in with their thinking around the splitting of the intermediary’s income into commission from the insurer for introducing the business, fees from the insurer for additional administrative functions performed by the intermediary and a fee from the client for the advice component.

As it stands we believe that a fee for services outside of the definition of intermediary services is permitted – otherwise what would have been the purpose of Section 8(5) of the Short Term Insurance Act?

Content originator:
Peter Atkinson, National Technical Portfolio Manager, FIA
Tel: 011 694 3100; Fax: 011 726 7508; Mobile: 083 627 5026
E-mail: peter@fia.org.za; Web: www.fia.org.za
Issued to FIA Members on 4 March 2016