Mitigating conflicts of interest in the distribution chain

The distribution chain has attracted the Regulator's interest for some time now and it gets a specific mention in their 2018 Business Plan.

The FCA's business plan

The business plan states *"Market access and choice can be restricted due to long and complex distribution chains, as well as a lack of transparency in market practices in wholesale markets."*

The FCA has been carrying out an initial review of the wholesale market sector. There are two aspects here, one is to gain a much better understanding of how this particular sector works in the general insurance environment (it differs completely from Wholesale operations in other sectors) and how the sector works for the benefit of the client.

Why the FCA are interested

The FCA's interest began in 2017 when it assessed whether insurance brokers use their bargaining power to get clients a good deal, whether any conflicts of interest exist and how an insurance brokers conduct affects competition. The conflicts issue is the one to really consider here.

1 Conflict of interest

The wholesaler market has developed substantially over the years with the growth of Managing General Agents (MGAs) and we have seen both insurers and insurance brokers enter this market owning or establishing such bodies.

The FCA will want to see that they can still demonstrate independence and not be influenced by having to contribute to insurance brokers or insurance companies bottom line.

The insurance broker is required to offer the client suitable advice and so must be able to demonstrate how the product and the selected insurer meets that suitability test. Not forgetting how the product meets all of the clients demands and needs.

Do not forget the new rule under the Insurance Distribution Directive of "acting in the customers best interests".

The FCA report detailing their findings is due later in 2018.

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2 Distribution chain value

Also, this year will see the continuation of the initial work on distribution chain value.

This follows on from the work they did on Delegated Authorities and Appointed Representatives which showed that the value of insurance products and related services could be eroded through the distribution chain, particularly when fees are added at various stages which the client ultimately bears.

They are looking to see what evidence there is of potential customer detriment by the application of numerous fees (Wholesaler, MGA, Insurance Broker for example) which increases the overall cost of the insurance disproportionately.

They may want to see how any fees are arrived at, the methodology used in determining the amount and what work is carried out for such a fee and also how this compares with the market place.

They will also look at how distribution chains can be organised, potentially looking at Networks and how they may influence costs or perhaps those consolidators who may try to influence earnings through buying power.

Also, how visible is the fee disclosure, is the customer fully aware of the breakdown of the premium?

The FCA will report their findings and set out any next steps in the second half of 2018.

Practical steps brokers can take:

Whilst not prejudging the review outcomes, brokers should be considering:

- MGAs / Wholesalers - How do these benefit the client, what is the rationale for the relationship and is there any pressure to give volume business? This may be the case where either party has a financial stake in the other, leading to pressure to add to the “bottom line”.
- Consolidation deals - How do these benefit the client, is an insurance broker being rewarded simply because they are placing volume business with a particular market?
- Non-standard commission arrangements – How do these benefit the client and how has the commission amount been arrived at and can it be demonstrated that the insurance broker is being paid an amount commensurate with the work carried out?
- Charging fees – How do these benefit the client and how has the level of fee been arrived at, like commission, is it commensurate with the work being carried out by the party levying the charge?
- Third party add ons – What value do they add, is the charging transparent and how much detail is given to the client to make an informed decision as to whether they requires these?
- Appointed Representative/Introducer Appointed Representative/Introducer arrangements – What is the rationale for the appointment, how does it benefit the client? What rationale is there in place for any income sharing? Does it reflect the work carried out by the principal and the risk that they carry?
- Online B2C facilities managed by brokers - Is it clear that there is no advice, how transparent are fees? Are all steps of the customer journey clearly explained with appropriate documentation?

Conclusion

The key to much of this, is being able to show robust documentation showing what steps you have considered, how any conflict is managed and how the matter is of ultimate benefit to the client and that there is no possibility of customer detriment.

About the author

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John has more than 30 years' experience in the world of general insurance, working for some of the largest UK brands. During this time he held senior leadership roles with responsibility for a wide range of activities including SME deals and sales development, acquisitions, business development, marketing, learning and development, propositions and online trading.

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