

It always comes down to a matter of trust

Brokers may not be legally required to give the best advice

Although insurance agents have a 'duty to act with reasonable care' towards their clients, they have no obligation to advise clients in regard to policy coverages, terms and conditions, or to ensure that their clients have the most appropriate coverages to protect valuable assets and guarantee business continuity.

In fact, there are several legal cases in the U.S. proving the importance of ensuring that your insurance broker or agent is your fiduciary.



In *Sewell v Great Northern Insurance*, the U.S. Federal Court determined that the company's agent, Professional Lines Insurance (PLI) Brokerage Inc, did not have a duty to advise its client on the most appropriate insurance coverages required to meet their needs. PLI Brokerage had no fiduciary duty to its client because it was the agent of the insurer – and as there was no special relationship between the agent and the client beyond those of an 'ordinary, reasonable prudential agent', fiduciary was assumed as an additional responsibility.

In another U.S. case, *Cameron School Board v State Farm Fire and Casualty Co*, the Federal Court Judge ruled that insurance agents do not have any duty to identify their clients' needs, tell them when they are underinsured or inform them of additional coverages that may be available from different insurers.

To guarantee that your business always has the most appropriate coverages at the best possible cost, you must first ensure that you have a trusted relationship with your preferred agent or broker. If not, you may be paying tens of thousands of dollars more for insurance than you need and be receiving substantially inferior coverage.

More than 90 percent of businesses in the U.S., Australia, New Zealand and Europe do not adequately understand their relationship with their insurance advisor. Calvetti, Ferguson & Wagner assists its clients in establishing the most appropriate relationship with their preferred insurance professional to meet their

business' immediate risk management needs. While many businesses are now more aware of the need for transparency and disclosure and the conflicts of interest that exist in the commercial insurance market, they still misunderstand the need to establish the fiduciary duty (entrustment) due from their preferred insurance advisor.

Most businesses feel comfortable with their current insurance arrangements because they have a good relationship with their broker and have received prompt service in the past. However, most have never considered whether they are actually getting appropriate, independent advice. Unfortunately, most discover that they were under, or inadequately insured, after it is too late and a major, uninsured event occurs.

Is your agent your fiduciary?

The United Kingdom Financial Services Authority (UK FSA) identified five "best practice" guidelines for business insurance customers:

- Customers should have clear and comparable information about the commissions that intermediaries receive;
- Customers should have clear and comparable information about the services intermediaries are providing;
- Customers should have clear information about the capacity in which an intermediary is acting;
- Customers should be alerted to their right to request commission information; and
- Customers should be made aware where there is a chain of intermediaries.

The UK FSA believes that if these guidelines are met, the insurance buying process will be sufficiently transparent for buyers to access the information they need to make informed decisions. However, this will not be sufficient by itself to establish the special relationship needed for your broker to be responsible to "notice the omissions in the application, correct the errors or ambiguities in the Policy" as noted in *Sewell v Great Northern*.

The UK FSA welcomes "the development of a market-led solution". However, we have yet to see this 'solution' developed and implemented in any global commercial insurance markets. Until such a solution exists, all businesses, large and small should have a properly negotiated broker service level agreement

(BSL) that includes entrustment provisions and appropriate key performance indicators (KPIs).

Who is paying your broker?

Many business insurance customers also underestimate the power of fees in their broker relationship. The London-based Association of Insurance and Risk Managers (AIRMIC) states, "There is a pressing need for clarity and a resolution of what constitutes acceptable practice. There is a need for automatic, mandatory disclosure of the source and amount of any broker's remuneration received from the market so that buyers know how their money is being distributed and can make their own assessment regarding any potential for conflicts of interest. There should be total clarity about whether the intermediary is acting on behalf of the buyer or the insurer and that it is no longer acceptable for brokers to work for both parties during the same transaction."



In most countries, especially the U.S., Australia and New Zealand, brokers continue to believe that it is acceptable to work for both the insurer and client, and claim they have difficulty understanding the potential for conflict of interest. Skeptics might say that the conflict is blurred by money.

Brokers typically receive a 15 percent to 20 percent commission. In the UK and Europe, some of them also want insurers to pay an additional 2.5 percent commission, which will eventually be passed on as an additional cost to clients.

Brokers also sometimes charge their clients a fee. In some countries, including the U.S. and New Zealand, these fees can be 'camouflaged' into the premium so the client is not aware of the fee amount being charged over and above the actual premium. This camouflaged add-on-fee, as seen in one example of broker exploitation, can be as high as \$1.4M added on to a \$2.6M actual premium.

Dirk Verbeek, UK Chairman and CEO of Aon Risk Services International, said the 2.5 percent additional commission is justified for the services a broker provides in a rapidly changing marketplace heavily dependent on expensive technology.

Critics of the 2.5 percent commission counter that the additional commission is an effort for brokers to buy time to sort out their business models, previously dependent on 'contingent commissions' (profit share and volume bonuses paid by insurers) at the expense of clients and carriers.

The most important thing for businesses to understand is that all commission paid to brokers comes out of the insurer's profits. If the insurer is not prepared to absorb that cost, it is passed along to the client in the form of higher premiums.

In Europe, brokers still receive payments from insurers and have shown no signs of giving up this income stream. Their attitude is probably best summed up by Sarah Turvill, Chairwoman of Willis International, who said regarding the additional 2.5 percent commission, "The insurer can find 2.5 percent somewhere...If there's more money to be gotten, if you don't ask, you won't get it."

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