DELEGATED AUTHORITY AGREEMENTS
ISSUES FOR BROKERS AND MGAs

Griffin has a number of MGA Members and also many Members that operate delegated authority agreements (DAAs), as part of their broking business, on behalf of capacity providers. Recently, partners from DAC Beachcroft LLP presented a Technical Forum on some of the risk areas associated with these DAAs. This bulletin is intended to provide a high-level summary of the matters discussed at the Technical Forum. The PowerPoint slides, as well as a full recording of the Technical Forum, are available on the Member Portal. We recommend that this Bulletin is considered in tandem with those slides and the recording.

DUTIES OF INTERMEDIARIES AS AGENT OF INSURERS

As agent, an intermediary, whether a broker or MGA, will owe fiduciary duties to the insurer as principal. A consequence of this is that the intermediary is obliged to place the interests of the insurer above the interests of all others, including itself. In practical terms, if you are operating a DAA this means you will owe a number of duties to the insurer, including:

- A duty of confidentiality in respect of information that comes into your possession whilst acting as insurer's agent.
- A duty not to make a profit from the relationship other than sums to which you are entitled (commissions, etc).
- A duty to avoid conflicts of interest, which is especially important if you are also acting in a dual capacity as placing broker.
- The standard duties in contract and tort (see 'Red Flags in DAAs' below for further discussion).
- Regulatory duties, including under FSMA 2000 to manage conflicts of interest fairly.
- Personal duties of individual Directors or Employees, as sub-agents of insurers, in certain limited circumstances – for example, if named in a specific Binding Authority.

RED FLAGS IN DAAs

To state the obvious, the DAA records the contractual duties owed by each of the parties. It is essential when the DAA is being negotiated that sufficient attention is paid to those duties as part of the deal being done, before the agreement is signed. Having the duties set out comprehensively and without ambiguity at the outset, will prove invaluable in the event of a dispute at a later date. Some particular issues to look out for in the DAA are as follows:

- The duties and obligations set out should be realistic. If they cannot be fulfilled, a breach of contract claim is likely to follow so don't over-promise.

- The DAA should set out a process to manage conflicts of interest (in particular regarding a declaration where acting in a dual capacity). If it does not do so a breach of contract claim may follow, as may regulatory sanction.

- The DAA should clearly set out the classes of business, limits, laws and jurisdiction, territorial limits, etc, that can be bound and those operating the DAA must understand the limitations of the authority delegated. The parties should agree at the outset whether the authority given is fixed or whether there is any flexibility. If there is some flexibility, how is that managed?

- An indemnity clause is usually included in DAAs providing that one party is compensated by the other party if it suffers loss as a result of negligent acts during the currency of the DAA. This can be a blessing or a curse, depending on the side of the indemnity on which you sit. It can entitle a party to avoid any liability for its errors (absent fraud). Conversely, such a clause may impose obligations on a party beyond those that would otherwise exist at common law and which no PI policy will cover.

- It is essential to check whether the DAA permits sub-delegation before any duties are sub-delegated to a third party. Where it is permitted, the agreement with the third party needs to clearly set out the extent of their authority, in the same way your DAA with the insurer does. You will have less control over the actions of the third party and so will need to be comfortable with how they will handle the sub-delegated business, before finalising any agreement with them.

PRACTICAL PITFALLS

Although a carefully negotiated DAA may make good business sense it also carries some risk. There are a variety of potential pitfalls to bear in mind:

- There is always the potential for misunderstanding the scope of the authority granted. If this results in breaching that authority in respect of one policy only, then at least the problem is contained. However, the nature of DAAs means it is more likely the mistake will be replicated across multiple policies (e.g. insuring commercial premises with residential flats above, when you are only permitted to write commercial property risks) and that can multiply your potential losses.

- The wording of contracts is subject to copyright and so a wording agreed for use under a DAA should not be copied for use on other business. In reality it will be expensive for a party to pursue a breach of copyright claim and so the risk of that happening may be relatively low. Even so, making some changes to the wording to avoid a dispute is likely to be the best course.

- Be aware of your position in the distribution chain and alive to any potential conflict of interest.

- Regardless of obligations under DAAs, there is still an obligation to treat customers fairly. This in particular bites where you are dealing with vulnerable customers and consideration will need to be given as to whether or not the product under the DAA is appropriate for them.

RISK MANAGEMENT MESSAGE

When acting under a DAA:

- Ensure that the scope of authority being delegated, any obligations assumed and the basis upon which you will be remunerated is absolutely clear in the agreement.

- Any DAA should be reviewed by a senior member of your business before it is entered into. The devil is in the details. You need to focus on them when the DAA is negotiated and then comply with them to the letter as long as the DAA remains in force. If in doubt about any aspect of the authority granted check the DAA's terms. It will take a couple of minutes and may be a lifesaver.

- Only name individuals in the DAA where absolutely necessary for its operation. Be alive to the fact that individuals named may assume personal responsibility to the insurer when acting on their behalf.

- When placing business under a DAA operated in-house, the conflict of interest situation is potentially difficult to manage. Larger Members are likely to have the resources in place to ensure that different staff handle the broking and underwriting aspects of the business. However, the resources available to smaller Members may mean it is difficult to put such barriers in place. This may lead to uncomfortable questions needing to be addressed, such as whether it is appropriate to handle the business at all.

- Keep the DAA under review during its operation and if there is any tension between the wording of the DAA and what happens in practice, address this with the insurer. Never rely on the goodwill of the insurer – always get any necessary changes written in to the agreement.

- Think carefully before you sub-delegate any duties. It may make good business sense but you will have less control over the activity carried out on the insurer's behalf.

- Look out for indemnity provisions within the DAA. These may provide some protection, for example where duties are being sub-delegated to a third party. However, more often than not they impose a liability which would not be covered by any PI policy. We are always happy to review any such clauses appearing in DAAs and provide guidance on how they should be amended.

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