

MANAGING THE RISKS THAT ARISE WHEN BROKERS APPOINT AGENTS

It is common for a broker to appoint another entity, as its agent, to facilitate the introduction and/or handling of insurance business. In this bulletin we look at the risks presented by those agents who are appointed “down the chain” to produce business, rather than those appointed to place it.

Agencies can be an important means of developing or consolidating a broking business, and, if they work properly, can be of significant commercial value. However, the broker can potentially face substantial legal liabilities arising out of the agency, as it can be held responsible for wrongdoing by its agent. The risk is higher where the agent uses the broker’s name and/or documentation and those dealing with the agent believe they are dealing with the broker. What is more, passing any such loss back to the agent may not always be easy and a broker may well face considerable practical or jurisdictional difficulties if the agent is insolvent or uninsured, or is located overseas.

We consider a number of steps which may be taken to reduce the risk faced by the broker.

A. BEFORE APPOINTING AN AGENT

You will want to satisfy yourselves that any agent you appoint is properly authorised and competent to perform the services which you require, and that the risk of any potential damage which might be caused, including to your reputation, is reduced to a minimum.

1. Have you taken appropriate steps to check that the potential agent is compliant with the laws and regulations affecting its handling of insurance/reinsurance business? This may include obtaining local legal advice if your potential agent is located overseas.
 - It is particularly important to establish your agent has the required regulatory authority, including any corporate or individual licenses which may be needed. The use of an unauthorised intermediary is likely to prejudice the validity of activities carried out on your behalf and may mean that any business placed through, or introduced by, that intermediary is void or voidable leaving clients uninsured and likely to look to you for redress. You may also face regulatory issues yourself if you appoint an unauthorised agent. A search of any applicable regulatory register should assist in identifying the proposed agent’s status.
 - If considering appointing an overseas agent, you should establish whether there are any legal restrictions or prohibitions on your ability to appoint an agent. Local legal advice should be able to assist here, and on any other obligations which might be imposed upon you by law or regulation.
2. Have you satisfied yourself of the proposed agent’s financial well-being? This is important in any trading relationship, but in an agency relationship any concerns about solvency issues should be very carefully weighed up as they may indicate not only poor financial management but also a potential inability to meet legal obligations which could increase the risk you face. You may wish to check with credit agencies as well as request the agent’s accounts.

3. You would be wise to establish that the agent maintains sufficient E&O cover of its own. Do you have a copy of the agent's current E&O policy showing the security used and that the scope of cover provided is adequate for the type of business being conducted? The existence of adequate cover with reliable security will reduce the chances of you being pursued to pay for your agent's wrongdoing.

The reputation of your firm is paramount and needs to be protected. Association with a firm or a person who does not observe the same standards of professionalism as you can easily damage that reputation.

4. Have you asked the proposed agent whether it has ever been involved in legal proceedings, and if so, to give details? If these investigations give rise to any concerns about the proposed agent's financial or regulatory standing, you will want to consider carefully whether you wish to enter into an agency relationship. If evidence of involvement in criminal proceedings is revealed, it is unlikely that you will want to proceed with the arrangement. The Managers will be happy to discuss any particular issues or concerns with you.
5. Are you satisfied with the business standards of the proposed agent? Have you visited the agent's offices to establish whether they appear to be managed effectively?
 - At any visit, you should seek the opportunity to speak with both senior and junior members of staff to assess their knowledge of the professional areas in which they work. You should also assess the competence of key staff by checking relevant professional qualifications. You may in some circumstances wish to consider obtaining references.
 - Establish what training procedures are in place for staff and whether these are sufficient to provide staff with the knowledge they need to effectively carry out their responsibilities.
 - Ask to review a sample of working files to assess the standard of work currently being carried out. To facilitate this, you may be asked to sign a confidentiality agreement. The Managers can assist you with this.
 - Find out how complaints are handled. Are you satisfied that responsibilities in this area are taken seriously, and that potentially damaging issues are dealt with professionally?
6. Ask the agent if it is prepared to provide you with details of any matters it has previously notified to its E&O insurers. These may highlight management weakness or other areas of potential exposure for you. A reluctance to do so, in the absence of an acceptable reason (conflict of interest, confidentiality etc) may be of concern.
7. The final appointment of an agent should be approved by your Board.
8. You also have new responsibilities of your own to consider under the Bribery Act 2010 which came into force on the 1st July 2011 and which includes a new offence of "failing to prevent bribery". Whilst you may feel that it is impossible for you to prevent any such activities by an agent who is not subject to your supervision (and who may well be located overseas) it will be prudent, in light of this new legislation, to review the following points (in addition to considering any current anti-bribery guidance

issued by the Ministry of Justice) with any proposed agents, to lessen the risk of your being exposed if that agent has poor anti-bribery controls:

- Do senior managers in the agent's offices have a good understanding of the need to control bribery and corruption risks?
 - Have adequate anti-bribery controls been put in place?
 - Does the agent have good monitoring and audit of third party relationships and payments?
 - Is any specific training provided to the agent's staff on the control of bribery and corruption risks?
9. Provided that you are satisfied with the position, it will be sensible to document the information provided in this respect and to check from time to time that it remains accurate.

B. THE TERMS OF THE APPOINTMENT

If you are comfortable that the proposed agent is a party with whom you consider you can be associated you need to make sure that the terms of the appointment are formally recognised by way of a written agency contract. Until you have this contract in place you should not refer to another entity or allow it to refer to itself as your agent or representative as you may, against your wishes, create a legally binding agency relationship and unintentionally assume the responsibilities which will flow.

10. Always ensure that the contract addresses the following:
- The scope of the agency, particularly limits on the activities the agent can carry out on your behalf. This may include specifying which individuals are to be allowed to act as agents, geographical limits, exclusivity etc.
 - Strict procedures to be followed by the agent when dealing with insurance business on your behalf, for example, the processing of premium, claims and the issue of policy documentation etc.
 - Appropriate restrictions on the agent's ability to use your name and logo.
 - How you will exercise control over, and monitor, the actions of your agent. You may well want to agree some key performance indicators which will be monitored during the period of the agreement.
 - An adequate procedure to ensure that you are informed of complaints in order that you can monitor issues as they arise and ensure steps are taken to quickly remedy any concerns about the agent's conduct.
 - Access to any documentation held by your agent.
 - Preferably, an indemnity requiring the agent to fully indemnify you for all losses you may suffer as a result of the agent's wrongdoing. This indemnity should, ideally, be approved by the agent's E&O insurer.

- Termination of the contract. You should retain the right to terminate the arrangement immediately if you have concerns about the conduct of your agent. The contract should clearly specify how the agreement can be terminated. It should also make provision for documentation to be returned to you and set out how clients' insurances will be handled in the event of termination.

C. MANAGING THE AGENCY

The risk to you doesn't cease just because terms have been agreed. It continues for the duration of the contract and needs to be managed by you during that period. You need to have agreed internally what the responsibilities for that management are and where they lie.

11. You should identify who is responsible for the ongoing monitoring, supervision and management of the relationship with the agent. This should be a senior member of staff, probably a Board director. The FSA has, in the past, fined brokers for failing to monitor adequately the activities of agents. Can you demonstrate to the FSA that you have the necessary management information to allow you to do this?
12. You should be able to monitor the key performance indicators agreed with your agent (these could be the number of complaints and the time within which premium and key documents are processed etc). Monitoring these at regular intervals can assist with identifying potential issues early on and ensuring appropriate action is taken.
13. Do you visit, as frequently as is practicable, all your agents' offices to check that matters are being handled in accordance with agreed procedures? Do you have procedures in place to regularly audit sample files of your agent to ensure that professional standards are maintained including the appropriate handling of client monies? Remember, you may be held to account for any advice the agent gives to clients in its capacity as your agent and/or any inappropriate activities which adversely affect them.
14. If action is needed to remedy areas of concern do you have an agreed plan which can be implemented to ensure such action takes place quickly and is followed up to check it has been effective? This might include terminating the agency relationship. If the agency is terminated you should ensure steps are taken to inform all those business contacts who are likely to be affected that the agent no longer represents your business.

D. SUMMARY AND RISK MANAGEMENT MESSAGE

Agencies can be an important and profitable means of developing or consolidating a business. They also represent an additional exposure to risk. The best way to reduce and manage that risk is by taking precautionary steps to identify the status of the potential agent before any relationship is agreed; to set out in writing the agreement reached on the basis of the relationship; and to make sure that means are in place to monitor adherence to that agreement.

If any of the above points highlight areas of potential concern which cannot be satisfactorily resolved then there may be good grounds to consider whether a potential agent should be appointed or whether an existing agency should be discontinued.

These suggestions are intended for guidance purposes and there may well be other issues, including regulatory issues, which you will want to take into account in particular circumstances. However, addressing the above points is likely to reduce potential exposure to an agent's wrongdoing.

This bulletin is for general information purposes only and does not provide a comprehensive or complete statement of the law relating to the issues discussed nor does it constitute legal advice. In addition, by its nature, this bulletin may be superseded by subsequent regulatory or legal developments. Professional advice should be sought where appropriate in relation to any particular circumstances.

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