AIDA EUROPE CONFERENCE IN ZURICH
22, 23 October 2009

Working Party "Distribution of Insurance Products"
Chairman: Prof. Dr. Ioannis Rokas

Thursday, 22 October 2009

Present:

Prof. Dr. Ioannis Rokas
Prof. Dr. Pierpaolo Marano
Dr. Kyriaki Noussia

Guests:

Cerini Diana
Caldas Luis Filipe Simoes
Favarger Martine
Concalves Fereira Da Silva
Jonk-von Wijk Berry
Lauxtermann Martijn
Sjoerd Meijer
Gespraecher Lars
Aldona Ungh
Nikos Papachronopoulos
Demirakou Maria

I. Welcome to the Members of the Distribution of Insurance Working Party and Greeting to the Swiss Section of AIDA, host of the Working Party meeting; outline of the targets of the Working Party.

Dr. Rokas in his capacity as the chairman of the Distribution of Insurance Products Working Party and chairman of the meeting welcomed the members of the Working Party and the other attendants of the meeting and expressed thanks to the Swiss Section of AIDA for organization of the meeting. Dr. Rokas briefly summarized the history of the Distribution of Insurance Products Working Party and outlined its future targets and activities. By this, he communicated his intention to publish a book within 2010 which would contain the minutes and the papers of the four WP sessions and would be presented during the forthcoming AIDA World Congress in Paris in 2010. He mentioned that there would be the opportunity to make (up to five short) presentations during World Congress in Paris 2010 and called anyone who might be interested in making a presentation to submit their paper to Ms. Anna Parachou by the end of February 2010.

He then went on to focus on the substance of the WP session.

II. Reports and Discussions

1. Report

Prof. Dr. Ioannis Rokas: Alternative types of insurance intermediaries

Prof. Dr. Ioannis Rokas presented a case study of the different insurance intermediary regimes that exist in the insurance practice and present slight variations. Specifically, he identified three major categories of insurance intermediaries: a) the General Representative, b) the pseudo-agent and c) the bank acting as intermediary in the bancassurance context.

At first, Prof. Rokas mentioned the case of General Representative. In particular, he said that the General Representative distributes insurance products and has or at least should have the same rights and obligations as the insurance intermediaries. He further analyzed the case of pseudo-broker, whereby a person appears as a broker acting in favor of the insured, while he is in fact an agent who serves the interests of the insurer. This gives rise to conflicts of interests and casts doubt over the protection of the insureds. In this regard, Prof. Rokas acknowledged that the opposite scenario, which occurs when somebody appears as an agent while he is actually a broker, could also be considerable. Finally, he described the role of intermediary in the bancassurance channel. In this regard, he referred to a recent decision of the Cour de Cassation. The facts of the case had as follows: a Bank offered one of its clients a life insurance. The insurance contract contained a term, according to which the insurance would be effective unless the insured exceeds the 60 year old – age limit. When the insured became 62 years old and asked for a payment under the insurance, the Bank referred to said term and refused to pay. The Court found that the bank had a duty to specifically alert (through express/ explicit language) the insured of such a term. It should have therefore notified the insured of the above 60 - year old limitation of the insurance cover. The Bank violated its fiduciary duty towards the insured. Since the Bank had not made such an explanation to the insured, the Court found it liable to pay insurance money to the insured. Prof. Rokas attributed the increased duty of the Bank towards the insured to the fiduciary bond which exists between the Bank and its client and is established by the mere fact that the insured entrusts their money to the Bank.

Prof. Rokas found the divergence that characterizes the same activity, i.e. distribution of insurance products, remarkable and tried to identify the rationale behind the different existing regimes.

Discussion

Prof. Diana Cerini gave the example of another decision of the Cour de Cassation in the context of collective insurance that a stricter duty to the Bank on the grounds of the fiduciary relationship with its client.

2. Report

Prof. Dr. Pierpaolo Marano (Richean Le/ Peter Kochemburger):"A comparison between the regulation of brokers' conflicts of interests in EU, China and US"

Prof. Rokas gave the speech to Prof. Marano who made a comparative analysis of the brokers' conflicts of interests in the US, China and Europe. At the very beginning, Prof. Marano mentioned that the presentation is based on a paper he had written with Prof. Kochemburger (US) and Prof. Le (China). He would present the paper on their behalf as well.

Prof. Marano concentrated on two main points by his analysis: a. the broker/ agent relationship in US and China and b) the institution of contingent commission as well as the conflicts of interest generated there-under (under a and b). Regarding a), Prof. Dr. Marano mentioned that the widely recognized categories of insurance intermediaries in the US are those of brokers and agents. He said that, while it is quite clear that the brokers act on behalf of (and in favor of) the insureds and the agents on behalf of (and in favor of) the insurers, it comes to misunderstandings on the part of the policyholders. This is because there are features which blur the boundaries between the agents and brokers and make the differentiation difficult.

Prof. Marano presented then the Chinese perspective. He said that the distinction between brokers and agents exists also in China with slight variations. The brokers are organized only as corporations (thus, the notion of an "individual broker" is absent in China), while the agents could be both natural and legal persons. In the latter case, there is a cap for individuals, which is not the case with the corporations. Conflicts of interest are generated in the context of dedicated and non-dedicated agents. Prof. Marano made the general remark that in China the same conflicts of interest arise as in the US; these are mainly related to factors which could affect the loyalty of insurance intermediaries. Prof. Marano mentioned as a typical case of conflicts of interest the example of "dedicated" vs. "non-dedicated" agents. The dedicated agents represent one insurer exclusively, while the non-dedicated ones act on behalf of multiple insurers-clients. In China, the car dealers and the banks tend to be non-dedicated agents. The "non-dedicated" status of an agent allows them to twist clients.

Prof. Marano analyzed subsequently the institution of contingent commission. This also gives rises to conflicts of interest, since it relates to the motivation of profit. As a matter of fact, such conflict could be dealt with in two ways: a) the disclosure or b) the complete banning of such commissions.

With respect to the US perspective, Prof. Dr. Marano mentioned that no State has banned so far the contingent commissions. Instead of this, States have rather opted for the disclosure of the existence of contingent commission. The disclosure approach to contingent commissions has been adopted in China as well.

Prof. Marano referred also to the European approach, in particular to Article 12 IMD which requires a written statement, disclosing information about the percentage of payment to such an extent that would make a full and fair analysis of the payment possible. At the same time, he pointed out that the US and China regime could serve as a potential lesson for Europe towards the following direction (or within the following meaning). In his opinion, Europe should draft a version of

a revised directive which would provide for the treatment of arising conflicts of interest, the application of disclosure and the definition of contingent commission. Since the current directive does not regulate these issues, MiFID's regulations regarding commissions could be applied. He finally mentioned the example of FSA report that has adopted the disclosure solution and commented that the lesson derived for Europe from the above analysis could be towards "more disclosure instead of banning".

Discussion

Dr. Noussia asked Prof. Marano what he meant under the formulation "twisting the clients" as well as what was the practical outcome of his analysis. Prof. Marano mentioned that the major brokers try to find a substitute to contingent commission, which could lead to a segmentation of customers. Regarding disclosure, he said that different practical implications could arise. Thus, the disclosure could be either mandatory or take place only after a respective question on behalf of the insured. He further commented that the enforcement of law in China, which constitutes a new capitalist, is not the same as in the US. Dr. Noussia stated that it is the application and not the enforcement of law which differs. Prof. Marano said that the enforcement might be different. Then, Dr. Noussia referred to the possibility to apply multiple standards. Prof. Marano finally elaborated on the examples of car dealers and banks and noticed that the effect depends on the extent of trust.

Another attendant pointed out that the focus should be on the interest of the activity. By this, this person stressed upon the fact that the banks and car dealers tend to sell credit. Thus, it is important to consider the implications of the competition, since the market is very competitive. Prof. Marano replied that he was not sure that the contingent commission would be only a problem of competition. He identified two major insurance markets: i) business and ii) retail insurance. Since the retail insurance is interested in the final price, the law of contingent commission is not important in this regard. In business insurance, the largest companies do not need to be protected, because they have risk management mechanisms in place that they understand the dangers of contingent commission. It is only in the medium-sized entrepreneurship where the competition argument might be of importance. This is because in medium-sized businesses, the function of risk management does not suffice to understand the dangers attached to the commission. Thus, an analysis of the market should take place each time.

Prof. Rokas commented that the problem regarding brokers' commission is not new; it is actually quite an old one. In England, the broker was obliged to disclose his compensation only after he had been specifically asked. The main concern in this context is who would actually be able to pose such questions. Prof. Rokas pointed out that there are nowadays sophisticated compensation patterns. Afterwards he gave the speech to Dr. Noussia.

3. Report

Dr. Kyriaki Noussia: "Ongoing information duty of brokers" (after the conclusion of the contract"

Dr. Noussia made a presentation on the "On-going information duty of brokers" (after the conclusion of the contract). She commenced her analysis by presenting the generally-acknowledged role of the broker as an agent of the insured. By this, she mentioned different kinds of authorization (explicit, implicit authorization and authorization by estoppel), upon which the broker could act with binding effect on behalf of the insured. She further mentioned the general rule that the broker is responsible for the advice he has given to the insured.

Dr. Noussia said that the broker might owe a duty of care towards the insured. In this context, she referred to the *HIH vs. LTJ* case. She first described the facts of the case. In that film finance case, *HIH* undertook the coverage of the risk that the investor would fail to recoup its investment in films within a specified period. Back-to-back reinsurance was placed by *LTJ* with a number of reinsurers. Risk management reports were provided to *LTJ* which subsequently distributed them to the insured, *HIH* and the lead reinsurers. These reports clearly indicated that, on each of the arranged slates, fewer films than originally intended were ultimately produced. Eventually, a poor performance of the films took place, and claims were raised against the insurers and reinsurers. *HIH* paid the claims, but was unable to recover by its reinsurance as the reinsurers successfully argued that the insurance and reinsurance contracts contained warranties as to the number of films to be made and the reduction in the number of films constituted actually a breach of warranty. *HIH* turned then against its broker, *LTJ,* alleging breach of duty of care. The Court of Appeals found that there was a post-placement duty of care of the broker to alert its client as per any potential issues of coverage that could arise from making of fewer films than specified. In a memorable phrase, it said that *LTJ*'s role in this regard was not limited to being a "mere postbox" for information. In this way, it affirmed a breach of the duty of care on behalf of *LTJ*.

Dr. Noussia said that this decision is very significant, since it could lead to the affirmation of a general post-placement duty of care on behalf of the brokers. By this, she referred to the decision of the Court of Appeals which found that the brokers' duty of care did not apply to that specific case exclusively, but it could be generalized to enclose other cases as well. She then made some refinement considerations regarding the duty. Dr. Noussia finally made the remark that the decision exemplifies both the US and the UK respective positions.

Discussion

Prof. Rokas commented that the acknowledgement of such duty changes the scrutiny and might raise causation issues which are related to the indemnity. He posed the question "How far should the broker's liability reach?", and he remarked that the liability of the insurer should not be replaced by the liability of the broker.

Dr. Noussia referred to the possibility of an assignment of punitive damages due to the broker's contributory negligence.

Mr. Valentini set out a tri-partite classification of insurance intermediaries from a European law perspective: i) the independent intermediaries, ii) those who have

contacts with the insured and iii) the intermediaries - agents and wanted to know if/ how this duty should apply to these categories of intermediaries.

Dr. Noussia said expressed her opinion that the above duty should be extended to all relationships and all levels.

Ms. Cerini asked which event would trigger this duty. In her view, this should be judged on a case-by-case analysis and would be a matter of competition, since the position of the intermediaries is considerably varied.

III. Closing Remarks

Mr. Rokas expressed his thanks to all the WP attendants. He repeated his request (call for papers) for the World Congress in Paris and declared the end of the WP session.

Minutes prepared by Maria Demirakou