

Binder agreements are an established feature of the Short Term insurance industry. A binder agreement is simply an outsourcing agreement between an insurer (principal) and a third party (broker, administrator or underwriting manager). The insurer mandates the binder holder to perform certain functions for and on behalf of the insurer in connection with administration of insurance policies and claims.

Michael Blain, CEO of Centriq Insurance, explains that while the Long Term Insurance Act did not previously contain provisions on binder agreements, the Short Term Insurance Act did, however its wording presented a number of interpretation difficulties. “The Insurance Laws Amendment Act 27 of 2008 (ILAA) levelled the playing field by introducing the concept of binder agreements into the Long Term Insurance Act and also sought to address the previous difficulties encountered with regard to binder agreements,” says Blain. A new set of regulations governing binder agreements are being drawn up by the Financial Services Board (FSB) in consultation with the short term and long term industry stakeholders, where after the changes introduced by the ILAA will become effective. The first draft of the new binder regulations is expected to be announced towards the middle of the year.

Blain notes however that while there have been various high-level engagements with industry role players around this legislation, there are still a number of contentious issues that need to be addressed. The proposed new section 48A of the Short Term Insurance Act and section 49A of the Long Term Insurance Act are aimed primarily at tidying up the regulatory regime applicable to binder agreements between insurers and other parties who act on behalf of the insurer. Blain says that while the legislation is clear on a number of issues surrounding binder agreements, a definitive set of regulations needs to be introduced around best practice when it comes to roles and responsibilities, conflict of interest, remuneration and full disclosure.

Points that were brought up in the FSB’s 2010 regulatory workshop included:

- The functions and powers of the third party are not always sufficiently clear including termination provisions.
- Instances where the third party further delegated certain functions without the knowledge and permission of the insurer.
- Possible conflicts of interest emerge when services as an independent intermediary and services in terms of a binder agreement are rendered by the same person.
- Risk that termination of binder agreement may result in unregistered insurance business.

Blain adds that broker remuneration quickly became an issue due to the fact that a strict interpretation of the current legislation prohibits a broker from earning a fee from the insurer for rendering these services over and above the commission they earn for the sale of an insurance product.

In addition, Blain says that profit shares awarded to brokers have also been frowned upon as a contravention of the law and commission regulations set out in the Short Term Insurance Act. “Therefore,” he says, “the way in which binder relations are enacted needs to be thought out carefully.”

Blain poses the following questions:

- Is there a conflict of interest at heart if an independent intermediary is issued with a binding authority from an insurer?
- Will the FSB allow for broker binders with disclosure, and how far will these be allowed to go in terms of authority and remuneration?
- What disclosures will need to be made to consumers and policy holders around these binder agreements and remuneration?

A key question Blain asks is whether or not independent intermediaries should be able to participate in binder agreements at all? Blain states that in all likelihood this would in fact be seen to be an inherent conflict of interest, as an independent intermediary should be a completely neutral party that acts in an advisory capacity only, with no real or perceived bias towards specific insurers.

A tied agent on the other hand, according to Blain, should be able to enter into binder agreements with full disclosure to the policy holder. A tied agent, he says, is an outsourced agent of an insurance company, and does not act as an independent advisor. The FSB however is questioning whether or not tied agents should be allowed to interact with the public as they might then start to act as a broker. Blain comments that he sees no problem with direct public interaction by tied agents (in the same way that direct insurers deal directly with the public), as long as proper disclosures are in place to allow the public to understand who they are dealing with and in what capacity so that they can make an informed decision.

Blain believes that in today's business world, with the number of insurers shrinking along with economies of scale, outsourced agreements allow for more choice and provide insurers with better distribution options that have unique structures. "This will also be beneficial to the consumer," he says.

According to Blain, there is a clear distinction between binder holders (tied agents) and independent intermediaries. Independent intermediaries, he says, should ideally charge a fee to the client, and not receive commission or any other remuneration from the insurer. Their sole role should be to advise and educate consumers regarding financial services and products. Binder holders may take the form of intermediaries performing administration services for one or more insurers while also acting as a sales or distribution channel. Alternatively, binder holders may act solely in an underwriting or administration capacity where sales and distribution is via independent intermediaries or tied agents. As this can be confusing to consumers, it is essential that clear and meaningful disclosure is made to the consumer regarding roles, responsibilities and any real or potential conflicts of interest.

Blain says that traditionally, insurers have lacked in their administration capabilities specifically in terms of customer relationship management - a job he feels that brokers can do better. Insurers have focused on their relationships with the brokers, who have in turn, improved the art of customer-facing administration. Therefore, he believes that intermediaries are well placed to perform certain administration functions. The question is whether this is an inherent conflict of interest if these

administration functions are for and on behalf of an insurance company or product provider. Surely an intermediary performing administration services should earn a fee for doing so, within limits?

Blain also raises the point that this situation has led to a power battle between insurers and brokers as to who actually owns the customer. "This is a situation that has led to insurers being forced to up their game."

Other relevant points discussed at the FSB's regulatory workshop included the Insurance Laws Amendment Act, which states that "A written agreement is required, setting-out the functions and the powers of the binder holder". In addition, Blain says, the Amendment Act states that a "binder holder must meet disclosure standards and keep proper records; they may not delegate, assign or sub-contract and there are limitations in place around the form of remuneration for services to avoid conflicts of interest."

In addition, circumstances under which a binder agreement will lapse and steps that must be taken to protect the interests of policyholders as well as clear accountability and responsibilities, such that the insurer is the owner of policyholder information/documentation and remains liable for claims and compliance with the Act, were also stated in the Amendment Act.

With regards to the drafting of regulations, a task team including various industry representatives was established to identify the different types of binder agreements, clarify certain binder functions, and determine who should be eligible to become a binder holder as well as identifying which elements of a binder agreement should be included or prohibited in the regulations. Remuneration aspects for different types of binder holders were also on the agenda.

Blain says that once the new regulations are finalised, there is likely to be a transitional period for existing arrangements to be brought in line with new binder regulations. However, at the end of the day, Blain believes that there are many grey areas when it comes to binder relationships, with many schools of thought on the matter.

Blain points out that while the FSB is not against the principle of outsourcing, it is cautious around the governance of binder relationships and the risk management thereof. "We don't want legislation that stifles innovation and growth, but rather legislation that provides practical best practice principles that will sustain the growth and future of the industry," he says. "If the new regulations enable innovative business models, the industry will thrive, but if they restrict the ability of various role players to innovate and outsource activities, we'll have to rethink our business models and distribution strategies carefully and this may stifle growth and employment," Blain concludes.