LEGAL FOCUS

In Holland, the selling of car cover just got trickier

BERRY JONK-VAN WIJK and MAURICE ESSELING, of Houthoff Buruma, say the ability of dealers to sell motor insurance in The Netherlands has been curbed

CAN insurers and insurance agents use the services of car dealers to sell car insurance, right? In The Netherlands, the answer is "yes, but only to a very limited extent".

This is the consequence of the Financial Services Act, which came into force on January 1, 2006, and a recent confirmation of the policy of the Financial Markets Authority (AFM), the Dutch authority that supervises the conduct of financial service providers.

The objective of the Dutch government was to ensure financial service providers act responsibly when dealing with consumers. The Act lays down rules on advising on and offering financial and insurance products to consumers. Rules on intermediation are also imposed. These rules, mostly of conduct, do not just benefit consumers – providers of insurance to companies are also required to comply.

The aim of the Act is to set qualitative standards, which are cross-sectoral and relate to reliability, expertise, administrative and internal controls, financial security, transparency and duty of care. The Act implements Directive 2002/92/EC of the European Parliament and of the Council of December 9, 2002 on insurance mediation.

Under the Act, anyone advising on or providing financial and insurance products, or acting as an intermediary, requires AFM authorisation. To be authorised by the AFM, an applicant has to demonstrate compliance with the statutory requirements. Anyone providing these services without authorisation risks a fine and other penalties. The AFM can also impose fines and other penalties on financial services providers who have conducted business with the offending financial services provider.

An exemption from this requirement may be granted in a special case by the AFM. A few exceptions and exemptions are also set out in the Act. The most important statutory exemption is for insurance intermediation. This exemption is based on the European Union (EU) insurance mediation directive.

Insurance intermediaries are exempt from the authorisation requirement only if ALL of the following apply:

(a) The insurance product requires knowledge only of the coverage offered by the insurance;

(b) The insurance is not a life insurance product and does not provide coverage for liability (unless it is a travel insurance and coverage for liability is provided as additional coverage);

(c) The principal job of the intermediary is not insurance intermediation;

(d) The insurance is supplementary to the provision of goods or services by the intermediary; and

(e) The annual premium does not exceed €500 ($635) and the maximum term of the insurance, including extensions, is five years.

Statutorily exempted

Most insurance products offered on a retail basis in The Netherlands meet these requirements and are therefore statutorily exempted from application of the Act.

This exemption generally does not apply to car insurance products. Car insurance usually includes liability coverage. Car insurance premiums usually exceed the threshold of €500 per year. A term of more than five years is also not unheard of. In other words, if a car dealer provides car insurance intermediation or offers advice on car insurance, the car dealer will almost certainly need AFM authorisation.

But what do they mean by "intermediation" and "advice"? With regard to insurance products, intermediation means all services an intermediary offers with respect to entering into insurance contracts or providing assistance concerning the administration and execution of insurance contracts.

"Advice" means recommending one or more specific insurance products to a particular customer. Both definitions are rather wide in scope and are sure to capture the insurance-related activities of a car dealer.

The AFM recently confirmed that a car dealer is considered to be acting as an intermediary when the dealer does nothing more than provide an insurance agent with the contact details of a car purchaser, information about the current market value of the car purchased, and the number of years without a claim.

The AFM does not regard mere "lead generation", ie, just providing contact details about a customer to an insurance agent, as intermediation.

This means that where the insurance-related activities of a car dealer consist of more than just passing on contact details, the dealer will need AFM authorisation and will have to comply with all the other requirements in the Act.

To do that, the car dealer will require the relevant diplomas, professional liability insurance, a complaints-handling procedure, subjection to the jurisdiction of a dispute committee, and compliance with special obligations relating to providing information, and more.

It is not very likely that a car dealer will be able and willing to meet these requirements. A car dealer in The Netherlands would be best advised – in order to avoid AFM sanctions – to refrain from engaging in activities that may be regarded as intermediation or advice within the meaning of the Act.

Insurers and insurance agents would be best advised not to arrange for an unauthorised car dealer to act as an intermediary or to give advice within the meaning of the Act. By doing so, insurers and insurance agents risk being sanctioned themselves. These sanctions include fines and possibly even the loss of their own authorisation.

The Act does offer two interesting alternatives for insurers and insurance agents. It is still possible under the Act to arrange for a car dealer to do more than just generate leads. The Act recognises the concepts of "tied insurance intermediary" for insurers and "affiliated entity" for both insurers and insurance agents.

A "tied insurance intermediary" in principle offers intermediation for a single insurer only. The insurer is fully liable for the intermediary, in the sense that the insurer must ensure that the intermediary complies with everything in the Act. The insurer must also notify the AFM of the tied insurance intermediary.

An "affiliated entity" is an entity that operates under the authorisation granted by the AFM to a legal entity having full legal capacity. The legal entity must have sufficient authority to compel the affiliated entity to act in accordance with the Act. The legal entity must have sufficient resources to provide expert support. The legal entity must also be authorised to represent the affiliated entity when applying for the authorisation.

These arrangements have disadvantages. For instance, except for the obligation to have authorisation, tied insurance intermediaries and affiliated entities must meet all the other requirements of the Act. For car dealers, this is not always possible even with the support of the insurer or the insurance agent.

Furthermore, insurers and insurance agents who become involved in these arrangements become responsible for the car dealer's compliance with the Act. Moreover, it is still uncertain whether an "affiliated entity" may be used in an insurance context at all. The EU insurance mediation directive recognises the concept of "tied insurance intermediary", but not that of "affiliated entity".

To sum up, insurers and insurance agents may only make very limited use of the services of car dealers in The Netherlands when selling car insurance. They can rely on car dealers to generate leads, but not much else.

The alternatives of "tied insurance intermediary" and "affiliated entity" have drawbacks. At the very least, they require insurers and insurance agents to enter into contracts with the car dealers so that they can exert influence on the working methods of these dealers. The rules in this Act will soon be incorporated into an omnibus, cross-sectoral Act that regulates the market. This Act, the Financial Supervision Act, is scheduled to come into effect on January 1.

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LEGAL BRIEF

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Avoid the soft option

IT is often easier to delegate. However, it must be done properly and recent Financial Service Authority (FSA) enforcement cases in the UK have demonstrated that, while senior managers may delegate or outsource tasks or duties, they cannot avoid taking regulatory responsibility for them.

The Davis case: Mr Davis was the chief executive officer and director responsible for the accounts and finance functions of a mortgage and general insurance broker. There was no finance director. Instead there was one accounts clerk, who undertook all the accounting functions. The accounts clerk had no accounting qualifications, received no training other than a handover by the previous job holder and was subject to no formal reporting regime or management oversight.

Some problems arose under these arrangements: in particular, some insurance premiums received by the firm were not passed on to the insurer, but were instead banked by the firm to meet other costs and liabilities. Some customers were left without any cover.

In July 2006, the FSA published a Statement of Misconduct against Mr Davis. The FSA stated that it regarded the failures as very serious, as customers had been exposed to considerable risk and it would have fined Mr Davis around £50,000 ($95,000) if he had been able to pay it. This is the first occasion on which the FSA has disciplined a senior manager of a mortgage and general insurance broker.

The Rainbow Homeloans case: In June 2006, the FSA fined Rainbow Homeloans Limited (RHL), a sub-prime mortgage broker, £35,000. In June 2006, the FSA found that RHL had failed to apportion significant responsibilities, in particular responsibility for compliance oversight, among its senior management. The firm had relied to an inappropriate extent on the services of an external consultant for compliance-related matters and ensuring the fair treatment of customers.

During an FSA supervision visit, RHL's directors could not produce any of the firm's compliance reports or provide any information about its compliance record. The case illustrates the importance of record-keeping and ensuring that senior management are aware of their regulatory responsibilities.

Lessons learned – delegating effectively: In both of these cases, problems arose not because delegation or outsourcing took place, but because of the circumstances surrounding them. Particular attention needs to be paid to the following:

- Ensure that senior management responsibilities are properly apportioned and clearly documented before delegation takes place.
- Be clear on what is being delegated. Document the responsibilities and how senior management will monitor and supervise the delegation.
- Ensure that the person to whom the work has been delegated is competent for the task, properly trained and is not over-loaded by other duties.
- Senior management must expect that the FSA will examine how delegated or outsourced responsibilities are working in a firm, and must be properly prepared to comment on this at a supervision visit. Directors must be prepared to demonstrate their personal knowledge of key areas, for example what steps a firm is taking to prepare for Solvency II or how a firm has applied a risk-based approach to develop systems and controls against internal fraud.

Conclusion: Delegation by senior management is not a soft option. The FSA is increasingly prepared to hold senior management accountable for ensuring that a firm complies with its regulatory obligations. However, good documentation relating to systems and controls, and an investment of time by senior management in preparing for FSA scrutiny, can help to reduce the risk of adverse FSA action.

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