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The Remuneration of Insurance Intermediaries under the revised Insurance Supervisory Act

The partial revision of the Federal Act on the Supervision of Insurance Undertakings of 17 December 2004 aims at revising the legal framework applicable to the remuneration of insurance intermediaries (*Courtagen-Vergütungsmodell*). The bill is designed at transposing the existing legal framework applicable to third party benefits in the financial services industry and the case law developed by the Swiss Federal Supreme Court under the law of mandate to insurance intermediaries. This edition of Advestra Insights analyses the proposed changes to the supervisory framework governing the remuneration of insurance intermediaries by third parties and their potential consequences on the contractual relationship between insurance brokers and policyholders.

1 INTRODUCTION

Insurance intermediaries match the needs of consumers with the offering of insurance companies. In Switzerland, the market and regulatory framework distinguishes between tied agents (*gebundene Vermittler*), who essentially act with one insurance company, and non-tied intermediaries (*ungebundene Vermittler*), who are open to act with several insurance companies. Insurance brokers, who help consumers to select a product from a range of insurance companies willing to underwrite a specific risk, are typical examples of non-tied intermediaries, whereas general agencies of insurance companies are typical examples of tied agents.

In the insurance intermediation industry, brokers are commonly remunerated by the insurance companies through a brokerage fee (or commission) paid upon entering into a new policy, even though they are retained and selected by the client (*Courtagen-Vergütungsmodell*).

Although the consumer does not pay a fee to the broker, the insurance company prices the brokerage fees into the insurance premium charged to the policyholder, who ultimately bears the costs of the compensation paid to the broker.

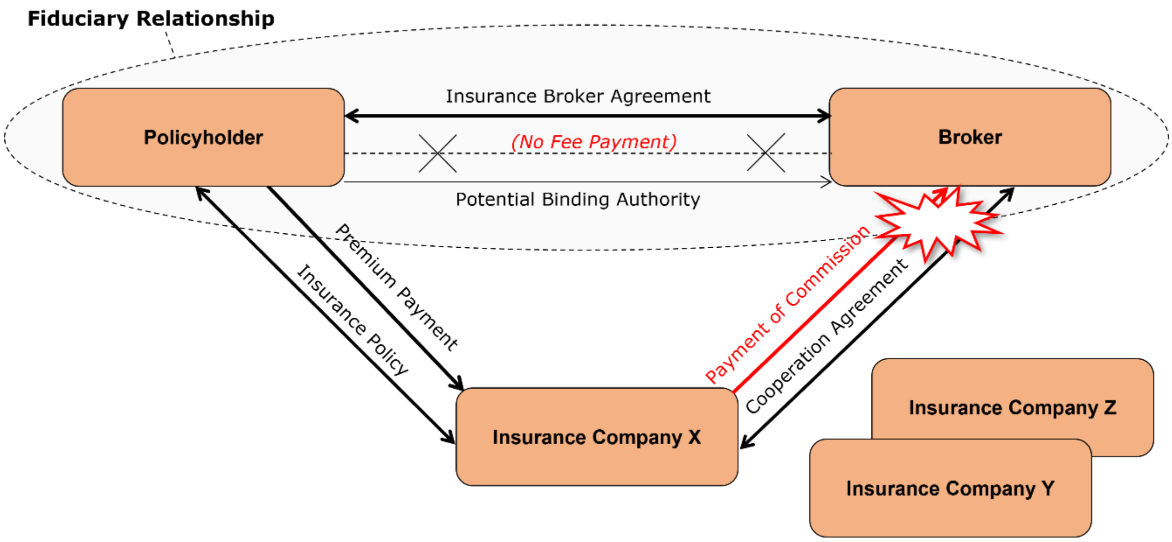
This compensation model induces as conflict of interest for non-tied intermediaries[1] and, in

[1] Cf. Botschaft, BBl 2020, 9012.

particular, brokers. As a matter of contract law, the brokers act on behalf of the customers (i.e. the policyholders) and represent their interests *vis-à-vis* the insurance company. Yet, they are paid by the insurance company. This constellation may lead to a conflict between the interest of the policyholder in an optimal insurance coverage at the best price, on the one hand, and the interest of the non-tied intermediary to maximize its compensation, on the other. Such conflict of interest is exacerbated by compensation models based on the number of clients introduced or the fee volume generated by the broker with one insurance company.

The following chart summarizes the pattern of contractual relationships between insurance broker, insurance company and policyholder:

where it is often unclear to clients whether financial service providers receive additional fees (through retrocessions, kick-backs and the like) from third parties. This structural difference led to a legal debate whether insurance broker provisions are subject to the established case law of the Federal Supreme Court on retrocessions which has been developed for the asset management industry and was extended to the entire financial services industry by the Federal Act on Financial Services of 15 June 2018[2] ("FinSA"). Some authors argue that the case law on retrocessions should apply to insurance broker provisions only if a broker receives excessive compensation. In any case, it seems that the majority doctrine acknowledges that growth-, volumes- or damage-dependent (*schadenabhängige*) on-top remunerations paid by an insurance company to a broker should be treated similarly to retrocessions.



2 OVERVIEW OF COMPENSATION UNDER SWISS CONTRACT LAW

The economic reality that the policyholder indirectly pays the broker remuneration through higher gross insurance premiums seems to be widely accepted in the insurance industry. This contrasts with the typical retrocessions paid in the financial industry

Although the topic has been extensively discussed in legal doctrine, case law remained rare on the issue and, to our knowledge, the Federal Supreme Court never conclusively decided on it. However, one noteworthy case of 2014 and 2015 (which revolved around the – allegedly untimely – termination of a brokerage contract by the client, indirectly raising the question of the principles

[2] SR 950.1.

applicable to third-party compensation) illustrates the jurisprudential uncertainty: The lower court of the Canton of City of Basel determined in 2014 that an insurance broker agreement qualifies as an innominate contract (*Innominatvertrag*) with elements of a contract of mandate. Hence, it applied art. 400 of the Swiss Code of Obligations[3] ("CO") which provides that an agent is, in principle, required to pass on any benefit received as a consequence of the performance of the mandate, such as retrocessions and similar payments or benefits, to its principal. Consequently, the lower court ruled that brokerage fees had to be surrendered by the broker to the policyholder if the policyholder does not provide in advance an "informed consent" to the retention of the brokerage fees.[4]

Upon appeal, the Court of Appeals of the Canton of City of Basel concluded that the case law on retrocessions was not applicable to insurance brokerage fees and that the policyholder was not entitled to them in the present case.[5] Indeed, according to the Court of Appeals, the legal basis of the brokerage fees – unlike retrocessions – does not lie in the cooperation agreement between the broker and the insurance company. Rather, the legal basis lies in an assumption of debt by the insurance company (i.e. release of the customer from its obligation to pay the broker on the basis of the insurance brokerage contract). Due to this difference in the legal structure, the court argued that there is no room for extending the case law on retrocessions to brokerage fees and stipulating a duty to surrender them to the client. Hence, art. 400 (1) CO would not apply in such contexts.[6] Although the Appeal Court's decision was in turn appealed, the Swiss Federal Supreme Court did not decide on the question of the duty to surrender brokerage fees (but at least ruled that the theory of "assumption of debt" can, in principle, not be followed).[7]

Overall, absent a conclusive decision of the Swiss Federal Supreme Court, considerable uncertainty remains on whether commissions paid to brokers should be treated in the same manner as other retrocession payments.

3 COMPENSATION UNDER THE REVISED INSURANCE SUPERVISORY ACT

3.1 Overview

In October 2020, the Swiss Federal Council published a draft bill for the partial revision of the Federal Insurance Supervisory Act[8] ("rev-ISA"). The rev-ISA is currently pending in the Swiss Parliament and likely to enter into force around 2023.

In the spirit of the FinSA which entered into force on 1 January 2020, the rev-ISA aims at revising the regulatory framework applicable to non-tied intermediaries, such as brokers, with respect to conflicts of interest and, in particular, third party compensation (art. 45*a* and 45*b* rev-ISA). The new rules on third party compensation distinguish between two set-ups: (a) the non-tied intermediary is exclusively remunerated by an insurance company or a third party or (b) the non-tied intermediary is remunerated by the policyholder as well as by an insurance company or another third party. Despite some criticism in the public consultation procedure, these draft supervisory duties on how to deal with third party compensation apply, however, only to non-tied intermediaries (in contrast to tied intermediaries, such as agents).[9]

[3] SR 220.
[4] K5.2013.18 of 30 October 2014, E. 7.2.
[5] ZB.2015.7 of 18 October 2015, E. 6.1.
[6] ZB.2015.7 of 18 October 2015, E. 6.2 and 4.2.1.
[7] 4A_152/2016 of 26 August 2016, cons. 4.6.
[8] SR 961.01.
[9] Cf. Botschaft, BBl 2020, 9012.

3.2 Broker only Receiving Compensation from an Insurance Company

If a non-tied intermediary receives compensation only from an insurance company or a third party (e.g., a fee, commission, or similar financial benefits) but is not compensated by the policyholder, the broker may accept such compensation if it has expressly informed the policyholder (art. 45*b* (1) rev-ISA).

Although the law refers to an "express information" of the policyholder, this disclosure can be included in global contract terms such as general terms and conditions (*GTCs*).

The disclosure must

(i) indicate the type and the amount of the compensation, and
(ii) be made prior to the provision of the service or entering into an agreement.

If the amount cannot be determined in advance, the policyholder must be informed of the calculation parameters and the range amounts of the compensation.

3.3 Mixed Compensation

If the broker accepts remuneration from the policyholder for its insurance brokerage services and, additionally, seeks to receive a further compensation from an insurance company or another third party, stricter rules apply. In principle, the intermediary has to pass on the compensation to the policyholder. The broker may retain such additional compensation only if the policyholder has been **expressly informed** about the compensation and **expressly waived** the right to receive such compensation (art. 45*b* (2) rev-ISA). An implied or tacit waiver (*stillschweigender Verzicht*) is not sufficient.[10] Even if the passing-on of such compensation is waived, the policyholder must be provided with information on the compensation received upon request. These rules on how to deal with third party compensation mirror the rules that apply to retrocessions for financial service providers under the FinSA (art. 26 (1) FinSA).

Under the rev-ISA, compensation is defined as any benefit that accrues to the non-tied intermediary, in connection with the provision of the brokerage service, from third parties (in particular from insurance companies), including brokerage fees, commissions or other pecuniary advantages. The rev-ISA does not deal with types of "compensation" which by its very nature cannot be passed on to clients (such as hospitality events, trainings or intangible gifts). However, in accordance with FinSA and its implementing ordinance FinSO[11], the authors take the view that such compensation must be disclosed as a conflict of interest in accordance with art. 45*a* rev-ISA.[12]

3.4 Legal Nature of Art. 45*b* rev. ISA

According to the legislative materials, art. 45*b* rev-ISA is a public law (supervisory law) duty (*öffentlich-rechtliche bzw. aufsichtsrechtliche Pflicht*) to provide information on compensation received from third parties and to pass this compensation on to the policyholder. Hence, art. 45*b* rev-ISA is not intended by the legislator as a dual norm (*Doppelnorm*) and has no direct effect on the civil law relationship between broker and policyholder. In particular, it does not take precedence over claims under Swiss contract law, i.e. the law of mandate. However, in line with the doctrine developed under the FinSA, these public law duties may be used to construe the civil law relationship and duties. To this extent, they may have a spillover effect on the civil law relationship (*Ausstrahlungswirkung auf die zivilrechtliche Beziehung*).[13]

[10] Cf. Botschaft, BBl 2020, 9013.
[11] SR 950.11.
[12] Cf. art. 29 (1) FinSO.
[13] Cf. Botschaft, BBl 2020, 9012.

4 CONCLUSION AND OUTLOOK

The wide-spread brokerage fee remuneration model (*Courtagen-Vergütungsmodell*) may create conflicts of interest. This is mainly because the broker, with a view to maximize its own profit, may propose insurance products that are not in the customer's best interests. The new supervisory law provision of art. 45*b* rev-ISA addresses this issue and aims to reduce the potential conflict of interest by requiring disclosure of such compensation.

Looking at the rev-ISA, the new supervisory law duties in cases where a broker accepts remuneration from the policyholder and from an insurance company (art. 45*b* (2) rev-ISA) are similar to the rules for retrocessions under the FinSA **and** civil law duties of financial service providers. Hence, it seems that at least the Federal Council, and if the bill is enacted, the Federal Assembly consider that commissions paid to insurance brokers should be treated similarly to retrocession payments paid by banks to external asset managers or distribution fees paid by fund managers to distributors, if the broker accepts remuneration from both the policyholder and an insurance company (or another third party).

According to the legislative materials, art. 45*b* rev-ISA is, however, not designed as a provision of a dual nature (*Doppelnorm*), but solely as a public law (supervisory law) duty. Consequently, the civil law relationship will still (solely) be governed by the Swiss law of mandates and corresponding case law. With respect to broker commissions, it remains therefore unclear whether the case law of the Federal Supreme Court on retrocessions also applies to insurance brokerage remuneration.

Considering the "spillover effect" of art. 45*b* rev-ISA on the civil law relationship which allows a civil judge to refer to the supervisory conduct obligations of the rev-ISA to concretize the contractual relationship, and the fact that art. 45*b* rev-ISA mirrors the case law of the Federal Supreme Court on retrocessions, it is likely that these rules will also affect the issue as a matter of contract law.

In this context, with respect to the waiver requirement, art. 45*b* rev-ISA is stricter than the case law of the Federal Supreme Court on retrocessions as art. 45*b* rev-ISA requires an express waiver (in contrast to e.g. a silent or tacit waiver). On the other hand, the Federal Supreme Court applies stricter criteria in its civil law jurisprudence regarding the level of disclosure for retrocessions compared to the requirements under art. 45*b* rev-ISA. It remains to be seen whether the Federal Supreme Court continues to apply such stricter criteria to contractual relationships given the new supervisory law provision of art. 45*b* rev-ISA and its potential spill-over effect.

Today, most insurance broker agreements do not include specific information on the type and amount of compensation received by the broker from the insurance companies. Broker agreements must be reviewed in view of the upcoming legislative changes. Amending the broker agreements to comply with the new rules of art. 45*b* rev-ISA will, for one, ensure compliance with the new supervisory law requirements for non-tied intermediaries. At the same time, it will also significantly reduce the current risks that a court would oblige brokers to pass on brokerage fees to their clients as a matter of private law in the event of a respective claim being brought.

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