StrategicRISK

FERMA DIRECTORS' ROUNDTABLE

RISK AND REGULATION IN EUROPE

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FERMA Directors' Roundtable participants

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Director, FERMA

Gilbert Flepp
Technical lines manager – continental Europe, ACE European Group

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INTRODUCTION

As might be expected, the economic crisis dominated the first part of the discussion. It was agreed that while most risk managers do not have an active role in board decision making, they can bring clarity and ensure that boards understand the risks and the implications for the business.

Participants spent time discussing the possible effects of proposed corporate governance reforms and the new risk management standard, ISO 31000. Although certification of compliance with the latter is not being introduced with publication of the standard, some felt it was on the horizon.

Of particular concern was the impact that Solvency II would have on the insurance market. Some suggested that the long-term effect would be reduced capacity and higher premiums for larger firms. There was also a fear that a more formalised method of capital allocation might remove some control from experienced underwriters who actually understand individual organisations and their risks.

Broker remuneration and the possible influence of contingent commissions on brokers' market recommendations also came under the spotlight during the discussion. Some participants did not see this as a key issue for risk managers of large organisations who are in a position to demand transparency of remuneration from brokers and make their own choices of suitable insurers.

The directors concluded by discussing where they considered FERMA provided value to its member national associations and their members. In view of the multinational nature of most large organisations, the ability to work together on European issues, liaise with the European bodies representing other risk-associated disciplines, and communicate what was happening at the European level was considered key. The networking opportunities provided by the FERMA Forum were also invaluable.

Sue Copeman, editor, *StrategicRISK*

Gilbert Flepp, technical lines manager – continental Europe, ACE European Group

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Of particular concern to FERMA directors was the impact that Solvency II would have on the insurance market

PETER DEN DEKKER: What can business managers do to help their companies survive the crisis? That is an interesting question. Paul, as a risk manager what can you do?

PAUL TAYLOR: A lot of the current issues are around financing companies and the impact that is having on their suppliers and customers, as well as themselves. I think where the risk manager can help is getting clarity on some of the risks and the issues that are occurring, particularly up and down the supply chains. In terms of finance, most risk managers are not involved in the detail of financing a company, so they can only probably throw in ideas from the outside.

In this crisis, cash is king; it is getting money through the businesses. Working capital is a key part of that. The problem is that if you reduce your working capital, it implies you are reducing and destocking, which in the current environment creates other issues, with suppliers potentially going out of business. There is some added value in trying to balance those aspects of the supply chain in terms of strategic stocks, identifying pinch points and critical areas in the customer's and supplier's supply chain.

ANDREAS WANIA: In your opinion, with regard to capital management, how much involvement these days do risk managers have in the real decision-making process of a company?

PAUL TAYLOR: Unless you are in the hierarchy of the few chief risk officers who are around, they are fairly limited in what they can do. Certainly within an enterprise risk management approach, there must be processes built into the whole decision making, whether it is capital expenditure, strategic planning or helping an organisation, as well as looking at the opportunities to quantify the downside and clarify the downside issues to obtain a good balance. You can then look at how much risk you want to take.

PETER DEN DEKKER: As part of the decision-making process, risk managers should not be saying yes or no. They are the facilitators and can make a conscious decision only to advise or warn the board. It is the board that decides whether or not to destock a company and take the additional risks that may result if, for example, their suppliers go out of business.

ANDREAS WANIA: Risk management is part of the decision-making process. It raises concern and sends out a warning signal saying: 'Here's a risk'.

PAUL TAYLOR: It is also providing the methodology to bring those issues up. Often boards will talk about issues in the organisation and strategic issues, particularly some of the risks, without them being well quantified. What risk management can do is bring a discipline to that, to help quantify those risks so that they can be considered as part of the overall business plan and decisions can be made on whether or not those risks are acceptable. If they are not, appropriate action follows.

ANDREAS WANIA: Do you feel that boards are listening more or less now than in previous years?

PAUL TAYLOR: I think they are listening more.

MARIE-GEMMA DEQUAE: Can I raise two points? First, what types of risks are occurring today? I think the priority is credit risk. That is something I have been talking about for a long time, and it is important that a risk manager is involved in credit risk, because that is where everything starts.

At the end of last year credit risk increased dramatically from the third to the fourth quarter. It was the first time the risk evaluation of credit insurers changed. They completely changed their acceptance of credit limits, focusing on cash availability and negativity regarding company indebtedness. That hurts companies on both sides of the supply chain. If your supplier does not obtain the limits he needs to supply you, you have a problem on the supply side. If your clients have trouble obtaining their limits, you are then potentially in trouble as regards supplying your clients. That is one of the big risks that have to be managed differently to before.

On a more strategic approach, I am currently more involved in corporate governance and what the board needs in terms of risk oversight. With board members' liability increasing, it is important that they have the right risk oversight. You have the enterprise risk management approach that companies are often building on the global side; on the other side you have classical operational risk management, growing from bottom up and trying to build active risk management partnerships in companies.

However, what I see – and I hear it from other colleagues – is that there is a zone of non-communication in a lot of companies between the real operational risk management and the more enterprise risk management focus that is built to provide risk oversight to the board.

You need a better tool to communicate from the operational side to enterprise risk management, reporting on all risks to the board. Paul, you adopt a more enterprise risk management approach and are working to transfer information from the bottom to the global side and the board.

PAUL TAYLOR: It is also from the top down.

MARIE-GEMMA DEQUAE: We will experience that change in a lot of companies. They are becoming aware that on the operational risk side there are risks such as credit, which are major risks these days and should be prioritised and communicated to the board. Tomorrow's winners are the companies that do not have high debt and have a lot of cash to catch the opportunities in the market today.

PETER DEN DEKKER: There is also a downside here. There may be a short-term focus on a risk, which is involved with trying to survive the crisis, and that can sometimes contradict a longer term focus on enterprise risk management.

PAUL TAYLOR: That is something that offers an opportunity for risk managers because there is very short-term thinking at the moment about cutting costs.

MARIE-GEMMA DEQUAE: You have academics who warn about the short-term 'yo yo' effect on decision making. Risk management has to be focused on the longer term, translating the longer term into the shorter term.

'Risk management is part of the decision-making process. It sends out a warning signal'
ANDREAS WANIA

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'How many companies really want to describe the key risks to their business and put them in an annual report?'
PAUL TAYLOR

Some professors are changing their focus from performance management to risk management because they feel that in the longer term you need to reason in business cycles, and that has not been done in the past. Risk managers are in fact working on the longer term more and translating it to the shorter term. There are a lot of opportunities for risk managers today.

PETER DEN DEKKER: If you look at, for example, annual reports of publicly listed companies, how much of that is a legal-driven document of compliance and window dressing rather than an outline of their enterprise risk management approach?

PAUL TAYLOR: You have probably answered that yourself, Peter. I am most familiar with the UK reporting requirements, although I have seen those of other countries as well. There are requirements in terms of the information you have to report and it becomes very stylised. Frankly, it gives little value, because it is generic and the amount of information given is generic.

There is a big issue here. How many companies really want to describe the key risks to their business and put them in an annual report to tell the world, including all of their competitors? I do not think many do.

You can talk about the generalities, the generic risks. Everybody is dealing with treasury, financial, operational, supply chain, business continuity, regulation and so on. Do you really want to disclose some major risks that you are running and how much risk you are taking?

JORGE LUZZI: There are companies that are not quoting the worst because this kind of information could generate a problem with competitors and affect the share price.

PAUL TAYLOR: In France, I think the requirements are the same, if not more detailed than the UK. In the UK, there are requirements to report on the risks in annual reports.

MARIE-GEMMA DEQUAE: In France, you have to report on insurance of the risks as well, as prescribed by the Loi sur La Sécurité Financière (LSF). The problem is, what does 'report on insurance' mean?

PETER DEN DEKKER: You can say 'we are adequately insured in relation to the risks we take', but you are not going to say 'we have €1bn in limits', because that is not information you want to disclose.

JORGE LUZZI: That was the problem in the past with the auditing of the risk management department. A guy from auditing arrived and said: 'Do you have the policies? All the policies are here, well done'. The insurance was very good but no one looked any deeper. They didn't ask: 'What are you doing? Is the decision correct? Are you doing risk mapping?' These are key points.

PETER DEN DEKKER: With reference to a standard, what are companies going to have in two years' time? Will it be COSO [Internal Control Framework] or ISO 31000 [Risk Management – Principles and Guidelines]?

PAUL TAYLOR: I think it depends on who is in the driving seat in which company. I think the ISO standard is coming in soon.

PETER DEN DEKKER: December will be the official communication.

PAUL TAYLOR: The fact that it is an international standard means it will start to be used. I know FERMA's position – and a lot of risk managers' positions up to now – is that as a guideline it is fine, but as a certifiable standard: 'No thank you'. I have to say that in five years' time, I am pretty sure we will have a certifiable standard. It is just the way the world is moving.

JORGE LUZZI: It's a matter of time, it always happens like that. And once one organisation gets certified, a lot of people will do big business with them.

PETER DEN DEKKER: Then again, if you are a shareholder and you want to invest in a company, you'll read this one page in the annual report saying 'we use COSO standard' or 'this is our framework', but it does not mean anything.

PAUL TAYLOR: It is like the ISO 9000 quality standard. You can be completely compliant and document this, but you may have consistently poor quality.

JORGE LUZZI: This goes against what we have been saying in a way, but if a company makes it clear that there is something wrong or there are mistakes, eventually the management will get sued. Everything you say could be used against you. It is problematic. We would love to have a clear analysis – it's our job, in a way – but there will be a lot of resistance.

PAUL TAYLOR: There are two interesting developments in Europe at the moment. There is the 8th Directive, which is moving audit committees and things forward in a lot of countries. In the UK, that has already been in place for 10 years, with the combined code and Turnbull [Guidance for Directors on the Combined Code]. So apart from a couple of things, the 8th Directive probably does not mean much for the UK, because we are already there.

This year, the UK corporate governance code, which is the combined code and Turnbull, has been reviewed again and the initial conclusions – initially related more to banking and finance but rolling out into industry – are

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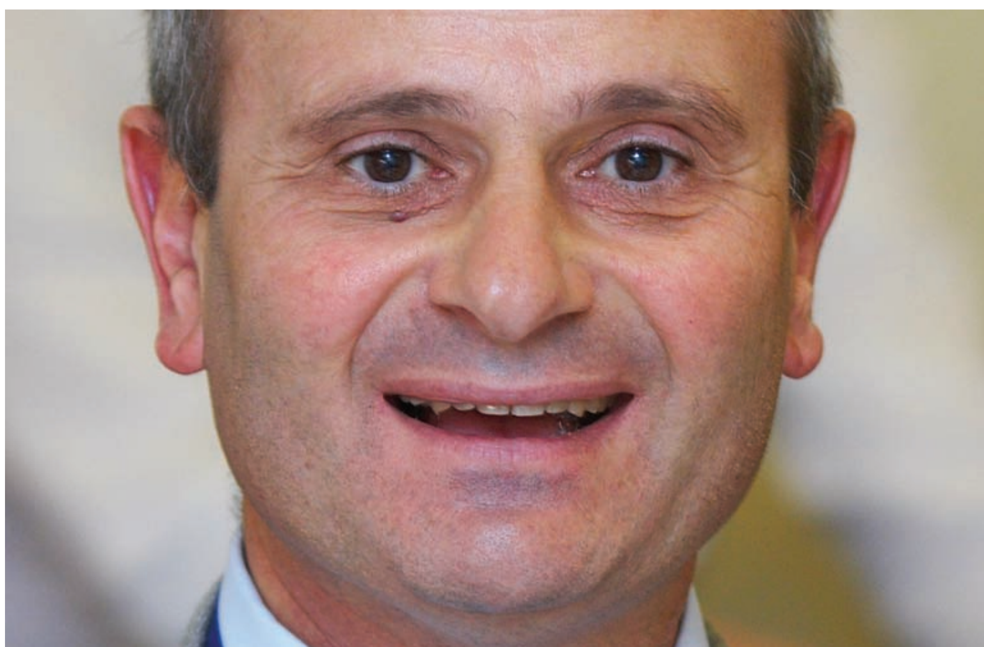

that the combined code does not have enough in it about risk management and the Turnbull compliance is basically an internal control guidance. Risk management is mentioned in a couple of places.

There is a realisation that although those codes have done some very good things in terms of reporting, it has become more of a box ticking exercise. What needs to come out is risk management up front that helps support and drive decision making. The control aspect, which is the Turnbull guidance, probably needs some modification but works quite well as an internal control guidance document. That is the thinking that is emerging.

There is also a school of thought that audit committees need to be rethought. This is interesting because it's just starting with the 8th Directive coming in. What is being said in the UK is that the audit committee should not be dealing with risk. It is a backward-looking committee that looks at compliance; it looks at having all the boxes ticked.

PETER DEN DEKKER: That is what audit means.

PAUL TAYLOR: You are absolutely right, and people are starting to realise that. The thinking is that the forward looking part of the governance structure is where the board is looking at strategy, so that is where risk should be put. There was an initial second report that came out in July that started to talk about a lot of these issues. Airmic [the UK risk management association] has been feeding into that as much as possible.

It is interesting that we have these two speeds running in Europe at the moment. Somehow, we need to try and make a link and perhaps feed some of the next steps that have already gone on, particularly in the UK and maybe elsewhere, into that 8th Directive and make sure it is as solid as possible.

PETER DEN DEKKER: There are a lot of corporate governance laws in place in various countries. Now we have the 8th Directive, which has not been compiled out of local governance codes; it is a European directive.

MICHEL DENNERY: The directive depends on the corporate governance that has been adopted by different companies, and it depends on different countries with their formal laws, but generally speaking I do not think it will change the responsibility of the board of directors. Their responsibilities were already complete and entire, so they cannot be more responsible than they were before. However, there could be more claims.

The directive does not just apply to the board of directors. There is a pressure on the general and operational management, as well as the strategic management through the board of directors, to be more conscious of the risks, the risk exposure that companies accept, and what level of risk is considered acceptable for the different stakeholders, customers and shareholders especially. I think it will be a good thing if companies take it as a way of improving their management.

The directive has been transposed in the majority of European countries since last year, and it comes into operation at the end of the year for a lot of countries. Of course, at the beginning we have to be conscious of what is going to change, but there will be links between risk management, internal control and internal audit and, generally speaking, different controls on audits.

Now risk management can deal with different kinds of controls, internal or external audits, to keep the knowledge of exposure that people have, inherent risk, residual risk and target risks, and to improve the management of target risk that is accepted by the company, customers, shareholders and suppliers – but mainly customers and shareholders.

CARL LEEMAN: An interesting conclusion on the ISO 31000 is that, although the bulk of the corporate risk management associations were against it, it was still implemented as ISO designed it. That has something to say about how weak or strong our lobbying is on that subject.

PETER DEN DEKKER: I think the criticisms have perhaps been more related to the certifiable aspects than the actual contents of the standard.

CARL LEEMAN: My recollection is that we were all against it, and then at a certain point we just realised it was no use standing on the sidelines shouting: 'We are against it'. We saw that it was going to proceed anyway. Then we started to say: 'Okay, we will try to modify it a little bit'. I do not think this was a big success. The only thing we achieved was that they agreed not to certify. That certification has been delayed for a number of years.

PAUL TAYLOR: I don't think the standard is in a format that can be certifiable at this stage. It needs an extra few steps.

MARIE-GEMMA DEQUAE: The content is OK, but it is the whole process and the future. As risk managers, it is a fact that we look at the future. That is the reason why we have problems with it.

PETER DEN DEKKER: What is FERMA going to do for its members in respect of the ISO 31000 and the 8th Directive?

PAUL TAYLOR: We have formed an enterprise management working group team within FERMA, consisting of me, Michel Dennery and Marie-Gemma Dequae. The objective

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is to lay out a direction for the future, where FERMA can really add value in influencing enterprise risk management and risk management development in Europe. Is that a reasonable description, Marie?

MARIE-GEMMA DEQUAE: Yes.

PETER DEN DEKKER: In doing this, we also hope to demonstrate to our members that this is one of the ways in which FERMA adds value.

Perhaps we could move on to Solvency II [a principles-based supervisory framework for European insurers]. Is Solvency II really there to protect the customers?

First of all, Solvency II is not there yet; it is coming. The good thing is that FERMA is not the only organisation that is seriously concerned about the impact Solvency II will have on the insurance market in general. The CEA [Comité Européen des Assurances] has major concerns. There was an interesting letter from the CEA recently to CEIOPS [Committee of European Insurance and Occupational Pensions Supervisors], in which it stated a number of issues and concerns that were actually raised by FERMA in our press release in April, during the adoption of the Solvency II in the European parliament. These included the increase of pricing, consolidation, the position of small and medium-sized insurers, the availability of capacity, emerging risks and retail risks.

Solvency II in its present form is not going to achieve the original goals of the European Commission to have policyholder protection and better security of insurance companies. As it looks now, it will affect a lot of small and medium-sized companies.

As the CEA has stated, there will be a consolidation wave coming up, which means less competition, maybe even fewer employees in the insurance industry in general, which might also be an interesting world within Europe. We also have the impact on the price, if insurers are going to allocate their capital only to, let us say, the lower risks – and the lower risks are not FERMA members. We have a different agenda: if there will be a decrease in capacity, especially for special risks that FERMA members need, then it can only have a price impact. So price may be a concern for us, but availability is even more of a concern.

JORGE LUZZI: The crisis is bringing a lot of pressure for risk management departments about how and what they should buy from the market. At the moment, all industrial companies are having a kind of cost-reduction pressure, much more than before. When Solvency II happens we will face a reduction in capacity, which will directly affect what we pay and perhaps the same will cost more. It does not look very appealing for us.

ANDREAS WANIA: Do you not feel that at the moment you should not be too concerned about available capacity? At least in the short term, Solvency II would not necessarily reduce capacity. There is an over-supply at the moment. I am also not sure I share your concerns that this will immediately have an impact on the price and you will need to pay more. I am only talking about the short term.

PAUL TAYLOR: But what do you see as the medium- or long-term implications of Solvency II?

GILBERT FLEPP: There will be a drive for insurers to allocate capital in a much more efficient and analytical way, using models.

PAUL TAYLOR: What is the implication of that? More internal costs for the organisation? Slower decision making? How do you see that turning out in terms of selling and marketing your products?

GILBERT FLEPP: This is just my personal opinion because I do not have much involvement in this area. I know that in our company and in most others there are already people who are starting to spend a lot of time on these issues. Even if Solvency II is delayed further until 2012, which is possible, it will involve significant cost in terms of development of this flow in the organisation chart, and it will most probably increase the cost of our product and capital.

PAUL TAYLOR: Will that then be passed through in terms of pricing for customers?

PETER DEN DEKKER: There is a serious risk that capacity will be allocated by the board of management and/or the chief risk officer/chief financial officer, instead of the underwriters defending a good risk where they say: 'I need this capital'. You will probably see a clash between management and underwriters.

GILBERT FLEPP: It is probably going to be very progressive. Even pricing models are still at different stages of development in insurance companies. These are things that are supposed to have been in place for tens of years, so it is going to be progressive. At least it will raise the consciousness of companies about capital allocation, which cannot be seen as being equal for different lines of business.

We are working a lot more closely with our actuaries. We have to improve the level of the thought process we put into this. We did it a few years ago for natural catastrophe modelling and now we are starting to do it for capital allocation. This will develop in all companies.

JORGE LUZZI: My feeling is very close to Peter's. I think that today we have the underwriter who understands about risk, he gets a lot of information, and finally takes a

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decision – 'We need this capital to invest in this company', and so on. My worry is exactly the same: this will remove decisions from the technical guy to top management.

GILBERT FLEPP: We are working more and more in close co-operation with actuaries and we have to spend more time on this. In a company such as ACE, we will still keep the focus on our business, which is to underwrite risk. But it will involve more complex and multi-decisional teams, that is for sure.

CARL LEEMAN: The initial aim was to protect customers from bankruptcies of insurance companies.

GILBERT FLEPP: Well, it does in a way.

CARL LEEMAN: But was there a need because you can invent as much regulation as you want?

MARIE-GEMMA DEQUAE: The European Commission tries to promote competition but if you look at Solvency II you will see competitive advantage in the markets growing for the large multi-line insurers, and a competitive disadvantage for smaller, niche, one-line insurers and mutuals.

At some time as risk managers, we need these additional markets. In the Belgian market, for example, we have private insurance for workers compensation, and that is a line that is very specialised. You do not have a lot of players in it and there is even a mutual insurer that is only involved in that line of business. This new legislation means the European Commission is creating a competitive disadvantage for such companies.

GILBERT FLEPP: It might be a problem for mono-line insurers, of course, but is it really going to be quantified in that way?

MARIE-GEMMA DEQUAE: They are already prepared and they are very carefully calculating their solvency and capital requirement ratios. It is a fact of life that if you have different lines, you have a diversification of your risk. It is risk management, in fact. The mutuals usually have a different approach, but the effect of Solvency II will be different.

GILBERT FLEPP: It is also a reflection of the reality. Look what happened, for example, to organisations in the US, such as Freddie Mac [Federal Home Loan Mortgage Corporation]. They were really mono-line and have been severely hit, so it is not totally absurd to try to identify that there is a special risk, which we have all seen materialise.

PETER DEN DEKKER: I can read you one line from the CEA position paper directed at CEIOPS. In one of the many major concerns, just as an indication, it says: 'We are convinced that if the levels of capital implicit in the draft advice are maintained, then the real losers, literally, will be Europe's citizens. They will pay much more than they need to for all classes of insurance and the market for insurance products, both in the general and in the life side of the market, will be smaller than it should be.'

CARL LEEMAN: It is just more regulation. Insurers have to invest a lot of money and energy, and dedicate people to Solvency II to ensure they are compliant. For the clients – the insureds – the added value will be zero, even negative: fewer competitors and higher premiums to pay.

Peter, do you think the European authorities will be willing to listen to reason on this or is it a fait accompli? On a European level, we're seeing a lot of insurance issues being dealt with in the same way as they deal with financial issues and the banks. This is despite the fact that insurers have quite different risks and businesses. We had Basel II for a number of years but a lot of banks still went bankrupt. There needs to be some huge lobbying on the subject of Solvency II.

PETER DEN DEKKER: The good thing is that for the first time in the process we have common concerns, both the insurance buyers – at least the industrial buyers – and the insurers' associations. That means we can step up our efforts at the European Commission. This legislation is like a big oil tanker: you can maybe deviate the direction a bit but it is sailing in the direction of 2012, maybe later for implementation. We just have to find a way to influence parts of the implementation phase. It will not be major.

GILBERT FLEPP: From what I have heard, at each level when a company is implementing a deployment of this work, they realise how much more complex it is than they had initially foreseen. It is probably going to be delayed, but it is probably also going to result in some findings that will be useful for everyone. However, the final result will probably be very different from the original objective.

JORGE LUZZI: Insurers' clients are very worried about this.

PETER DEN DEKKER: This is going to be an interesting part of the discussion during the FERMA Forum [which took place on 4-7 October after the roundtable discussion]. We will also be talking about this with the CEA and with the European brokers' association.

CARL LEEMAN: Is there any standpoint from the brokers on this subject? Are they doing anything?

PETER DEN DEKKER: That is a problem. We have failed to see any position from the brokers' association on a European level on this issue.

> **'On a European level, we're seeing a lot of insurance issues being dealt with in the same way as banks'**
>
> CARL LEEMAN

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‘We do not have control of what is going on, so we do not know how much we pay for the service we get’

JORGE LUZZI

CARL LEEMAN: They will not want to be involved in it because if the premiums go up, they have more commission. It is as simple as that.

PAUL TAYLOR: They don’t have a strong interest in it.

PETER DEN DEKKER: That is strange because they should represent the interests of their clients.

CARL LEEMAN: In recent months we have seen that brokers are more concerned about their own things. Contingent commissions tell the same story. If brokers were really concerned for their clients, they would not be willing to talk about the reimplementation of contingent commissions.

PETER DEN DEKKER: That is a nice bridge to one of the next issues on the table, which is broker remuneration. I would love to put this aside and have BIPAR [the European Federation of Insurance Intermediaries] be more active on Solvency II, on issues that are really important for their clients, rather than looking at their own organisation.

Basically, we all have to eat. Brokers need to have a decent income; we also need to be aware that their income has to be in relation to their services. If we can try to come up with an interesting discussion with BIPAR on how you can secure that link, instead of only going for volume or profit-based contingent commission, that might be an interesting discussion.

CARL LEEMAN: Just the fact that they dare to defend the whole thing is strange to me because what they are saying, if you read between the lines, is that the more business I place with one insurer, the more money I will get. How can they combine this with the interests of their clients? It’s impossible.

PETER DEN DEKKER: We are talking about something we are not sure about. We do not know the basis on which they receive contingent commissions. We need to have some clarity about that.

JORGE LUZZI: We all know that after big problems the large brokers stopped this, and announced that they had. Now things seem to be changing. In addition, we do not have control of what is going on, so we do not know how much we pay for the service we get. In general, if you hire someone to do a service for you, the basic thing is to know how much you pay directly or indirectly to them.

PAUL TAYLOR: Jorge, I think one of the things for organisations such as we are all involved in, which are mostly pretty large organisations, is that we have got the power to demand that the brokers do declare all of those commissions related to us.

Personally, on that basis I think it is less of an issue for the kind of organisations we represent. It is much more of an issue for the organisations that are probably not represented by us, the SMEs that do not see those hidden commissions and have no influence, and perhaps also will be more influenced by a broker’s persuasive proposal that a certain insurer is better – which might be linked to their commissions. I would hope that most of us, as risk managers, actually choose our insurers ourselves. It is not the broker who chooses them for us.

JORGE LUZZI: That’s true.

MARIE-GEMMA DEQUAE: I remember assisting a European Commission public hearing where there was a representative from SMEs, a buyer of insurance and services from brokers. He said publicly: ‘I am not interested in what I pay as brokerage. I need the service and I pay the invoices as I get them.’ We are worried for the SMEs, but they are not. Also, the services they require are much less. We ask for block global approaches representing a lot of money. SMEs require a very different approach from the broker. I should add that this hearing took place two or three years ago.

JORGE LUZZI: It could also happen today.

PETER DEN DEKKER: There should not be a problem if we come up with a type of disclosure agreement with the brokers’ associations, so at least they disclose if they have received contingent commissions, from which insurers and on what basis. We are professional enough to deal with it on an individual basis with a broker and say ‘I agree or I do not agree with it’ or ‘I want more details of your deal’.

CARL LEEMAN: In the long run you have no choice, Peter, because everybody will do it then. If you say ‘I do not agree’, then what is your option? All the brokers will be playing the same game.

PETER DEN DEKKER: Yes, but that’s a different matter. At the moment we do not have this disclosure.

MARIE-GEMMA DEQUAE: We have a position paper with the Belgian association of brokers. It is on their website, and it is a position between BELRIM [Belgian risk management association] and UPCA [Professional Union of Insurance Brokers] in Belgium. It is six or seven points explaining what information has to be disclosed on the commissions they receive, not only on the direct but also on the reinsurance side.

CARL LEEMAN: I remember those negotiations. The bigger brokers were quicker to agree; it was really the smaller ones who fought against it.

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MARIE-GEMMA DEQUAE: Good point, Carl. We have two associations in Belgium: the larger brokers' association, UPCA, and a smaller one. We couldn't reach an agreement with the smaller one. The problem for the European brokers' association, BIPAR, is that it represents both the larger and the smaller national brokers' associations. It would not be easy to come up with one position paper.

MICHEL DENNERY: There are two targets: the quality of the service and the price we pay for it. We must not forget both targets and the balance between them. First, we want to be sure we pay for the best service and when there are some contingent fees paid by the insurer, we are not sure that we will have the best proposal. We have to know exactly what we pay for this service. Disclosing the fees is the second point we have to pay attention to.

I also think there is a difference between big companies that can afford to have insurance departments with competencies to buy insurance through brokers, and small companies that cannot afford usually to have a big competence and a big department for insurance. We have to take that into account in our position paper, because they have to be more assured that they will pay for a good service. Big companies will have the means to ensure the quality.

PETER DEN DEKKER: If they do not disclose, you do not know what they get, and from whom. We are all talking in the air.

MICHEL DENNERY: I think we have to understand that disclosing the fees might change the relationships between brokers and insurers and between brokers and us. Brokers are for now the customers of the insurers, and we are the customers of the insurers. If we change that, brokers will become our suppliers.

PAUL TAYLOR: That is the way it should be.

JORGE LUZZI: I agree with that.

MICHEL DENNERY: We need to have a good supplier we can rely on and is not dependent on insurers, but we need to be sure they will find the best insurance contracts from better insurers specialising in the items we need.

JORGE LUZZI: In general I agree with that, although I have some reservations. Normally brokers dealing with very small clients will choose the insurer. They do not choose the insurer with larger companies such as us; normally we are the ones that choose the insurer. We ask for what we would like to buy and they give us some recommendations. Then there are agents – an arm of the insurer that operates almost as the insurer's commercial department.

PETER DEN DEKKER: They are not independent, but it is clear – at least you know it.

JORGE LUZZI: Yes, it is clear they are paid by the insurer. We hire a broker and we pay a fee or a commission included in our rate. We hire them to provide a service. Unlike small clients, we do not say: 'Give me an insurance policy.' Smaller companies go to the broker and the broker says: 'You are my client; I am the client of the insurance company. I go to the insurance company and I see how much commission it will pay me. After that I will consider the advantages for my client – the final one in the line – and the advantages for the broker.' In our case, being big companies, the broker has a lot to do for us, but it is more technical and we hire them to do something specific, not to choose markets, for example.

GILBERT FLEPP: It may interest you to know the attitude of my company regarding contingent commissions. It is very simple and it has not changed for years: pure transparency. If the broker comes to us and says: 'For such and such a service, we want to have an additional income,' we say that, provided the client is fully aware of it and we have proof of that, and provided this relates to an actual delivery of an additional service, it is fine. We discuss it, but it has to be transparent.

CARL LEEMAN: I think there is a big difference with providing a service – for example, if they issue a policy or handle a claim that is a service they give. Normally they should send you an invoice for that, but it is different from a contingent commission that is only based on volume.

PETER DEN DEKKER: It is interesting that the three major brokers at that moment are saying no to contingent commissions, but we have not seen any response from an insurer saying: 'Yes, we agree. We are also not going to pay contingent commissions anymore.' That is what we were missing, actually, because now what happens is that the three big brokers do not receive any contingent commissions but the rest of the market does. I can imagine that there is not a real level playing field. Whether we want that or not is another discussion. From my side, I think it is important to have disclosure.

GILBERT FLEPP: Disclosure will work better if it is applied at your level and if the insurers are also playing the game. Just after the Spitzer case, our initial plan was to put the commission level on each individual policy. That raised such turmoil within the broker community that we had to back down.

MICHEL DENNERY: I think it is one of the very last examples of where we do not know what we pay for a service. There are a lot of services that are clear and disclosure has been done. I do not understand why the general position of brokers is to say no.

GILBERT FLEPP: Without wishing to defend the brokers – when they are asked to tender, if clients are giving too much weight to the pure price and not enough, as you said, to the quality of the service, you are driving the brokers to look for some kind of contingent commission.

CARL LEEMAN: I do not agree. As industrial companies, we have to cut costs these days everywhere.

GILBERT FLEPP: If you buy a watch and you have the choice of an Omega or a Swatch, if you want to cut prices you choose the Swatch.

JORGE LUZZI: The service is not the problem; we are ready to pay for the service. What we want to know is this: if an

'The attitude of my company to contingent commissions is very simple and it has not changed for years: pure transparency'

GILBERT FLEPP

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