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Update

The relationship between insurers, insureds and insurance brokers

Important High Court judgment provides clarification

In this article we look at the issues that arose and some issues for the market.

As reported in our e-alert on 6 January 2012, the Court of First Instance in Hong Kong has handed down an important judgment that upholds the long established commercial practice of an insurance broker acting as agent for the insured and not as agent for the insurer. The court's judgment in *Hobbins v Royal Skandia Life Assurance Ltd & Anor,* HCCL No.15 of 2010, also refers to the trade practice surrounding the payment of commissions by insurers to insurance brokers with respect to the business brokered on behalf of a client (the insured). The judgment finds that commissions paid by an insurer to an insurance broker are not illegal secret profits, unless in excess of what is normally paid in the insurance market.

Key points

- The judgment recognises the long established practice of insurance brokers being agent for the insured (the client) and not the insurer.
- Insurers and insurance brokers would do well to review their terms of business and business practices to ensure that these reflect that there is no agency as between the insurer and insured. Keeping proper records in this regard is also important.
- Insurance brokers should refrain from activity that purports to clothe them with apparent authority to act as an insurer's agent[1].
- The mere payment of brokerage fees by an insurer to an insurance broker does not make the broker the agent of the insurer.
- The judgment recognises a long line of authority in various common law jurisdictions that confirms commissions paid by an insurer to an insurance broker do not constitute illegal secret profits, unless they are in excess of what is normally paid in the insurance market. Therefore, an insurer who pays such commissions to an insurance broker does not commit an illegal act in Hong Kong under section 9(2) of the Prevention of Bribery Ordinance (Cap.201).
- In terms of a claim to civil remedies the judgment recognises the practice of insurance brokers receiving commissions from insurers, provided those commissions do not exceed the usual market rate. In this context, a minimum good practice for

1 See our December 2010 e-bulletin on "Apparent authority".

insurance brokers would be to disclose to their clients the fact they are to be remunerated (and only remunerated) by way of commissions and other fees paid by the insurer.

- The judgment may invite a review of the guidance given to members of organisations such as the HKFI, CIB and PIBA[2] regarding the disclosure of broker commissions.
- In some jurisdictions legislation is being considered to put the issue of insurance broker commissions on a statutory footing. If there is to be any further disclosure obligation on insurance brokers in Hong Kong the judgment suggests that this should be a matter for legislation (not the courts).

Facts

The plaintiff investor is an extremely successful businessman and an experienced investor. Pursuant to a number of client agreements executed between 2005 and 2008 (the client agreements) the plaintiff appointed an insurance broker to act as his broker to purchase Investment Linked Assurance Scheme (ILAS) products from a number of insurers, including the defendant insurance company (the insurer).

The broker on numerous occasions disclosed to the plaintiff that he would not be paying for the broker's services or financial advice; rather, the broker was to be paid commissions and fees paid by the insurers whose ILAS products were purchased by the plaintiff.

The client agreements also acknowledged that the ILAS products had been explained to the plaintiff, as had the fact that commissions would be paid by the insurer to the broker.

The plaintiff later terminated the broker's services. He commenced court proceedings against the insurer and the broker, seeking to set aside the investments and to recover the commissions and fees paid to the broker by the insurer with respect to those investments. In essence, the plaintiff alleged that in recommending ILAS products the broker was not acting in the plaintiff's best interests and was in breach of fiduciary duties owed to him.

In particular, the plaintiff alleged that the contracts by which he bought ILAS products were either contrary to section 9(2) of the Prevention of Bribery Ordinance (the PBO) or tainted by fraud; therefore, he argued, those contracts were invalid. In short, section 9(2) of the PBO makes it, among other things, unlawful for a person (without lawful authority or reasonable excuse) to offer any advantage to an agent as an inducement or reward with respect to the agent's performance of his principal's affairs or business. Section 9(5) of the PBO provides for a defence if the agent receives "the advantage" with the permission of his principal and in the circumstances set out therein.

Issues

The principal issues were as follows:

- was the broker the insurer's agent either as a matter of common law or pursuant to section 2 of the Insurance Companies Ordinance (Cap.41 – the ICO)[3];
- were the contracts whereby the plaintiff purchased ILAS products from the insurer illegal by reason of the PBO;
- as a matter of civil redress, did the broker breach any fiduciary duties owed to the plaintiff and, if so, was the insurer liable for this as a principal; and
- in the event that the plaintiff succeeded in his claims, what were the appropriate remedies?

Decision

Agency

The court noted that there was no dispute that the broker was the plaintiff's agent. However, on the basis of the contractual agreement between the insurer and the broker, the court had little difficulty finding that the broker was not the insurer's agent; indeed, there was an express term to this effect in that agreement. Therefore, the broker had no actual authority to act as the insurer's agent; neither was there any evidence of the broker having any apparent authority to do so. The court also found that there was no evidence that the broker ever held itself out as an agent for the purposes of section 2 of the ICO.

The judgment is also noteworthy as it is the first case in Hong Kong to examine market practice in this regard. One can do little better than quote from the judgment:

"… it has long been established at common law that insurance brokers (such as the broker) are acting solely as agents for an insured. The mere fact that an insurer pays brokerage fees to a broker does not mean that the broker is undertaking to perform any obligation on behalf of the underwriter."

Alleged illegality

The court found that (in a civil context) the contracts whereby the plaintiff purchased ILAS products from the insurer were not illegal by reason of the PBO. The court noted that:

"In my view, there is 'lawful authority' (consisting of a long line of judicial pronouncements stretching from the 19th century to the present) for the commercial practice that an insurance broker acts as an agent of the insured and not of the insurance company. As a result of that line of judicial pronouncements, it has long been settled at common law that commission paid to an insurance broker by an insurer does not constitute an illegal secret profit unless it is in excess of what is normally paid within the insurance market."

2 Hong Kong Federation of Insurers, Hong Kong Confederation of Insurance Brokers, Professional Insurance Brokers Association, respectively.

3 Section 2 defines an "insurance agent" for the purposes of the ICO as: "a person who holds himself out to advise on or arrange contracts of insurance in or from Hong Kong as an agent or subagent of one or more insurers".

There was no evidence that the commission or fees paid to the broker by the insurer were otherwise than normal in the insurance market.

Civil claims

Essentially, the issue was whether the broker (as the plaintiff's agent) had adequately disclosed the commissions or fees that it earned from the insurer in connection with the business placed with the insurer on the plaintiff's behalf.

The court noted that on numerous occasions the broker had informed the plaintiff that it was not charging him for its services; rather, the broker had informed the plaintiff that its remuneration was by way of commissions paid by the insurer on products that the plaintiff purchased from the insurer.

In terms of disclosure the broker had complied with what could be said to be good practice for insurance brokers. Importantly, the court also found that the broker had not misrepresented the position to the plaintiff; neither had the broker breached any duty owed to the plaintiff as his agent.

The court noted that, once the plaintiff had been informed that the broker's remuneration would come from the insurance companies with which his business was placed, the plaintiff could have asked for details of the commissions before deciding whether to proceed with an investment.

Remedies

There were none. Having found that the broker was not the insurer's agent and had not breached its duties to the plaintiff, there was no basis for finding either the broker or the insurer liable for any redress to the plaintiff.

Comment

We are aware of a huge interest in the insurance market with regard to the outcome of the case. In our opinion, on the law and the facts, the outcome is a victory for common sense.

Since the financial credit crisis a few years ago many financial advisers and institutions have found themselves on the receiving end of lawsuits alleging all manner of claims in negligence or more. This trend is likely to continue as issues of counterparty risk and sovereign risk work themselves out. No doubt, some of these claims may have merit. The outcome of the court's judgment confirms that this is not such a case.

Indeed, the outcome of the case is, arguably perhaps, more an illustration of a disgruntled experienced investor; referred to in the judgment as "far from being a babe in the woods in matters of financial investment".

The outcome of the case might be contrasted with that in, say, *Field v Barber Asia Ltd*[4]; a well known case involving a retail investor dispute in Hong Kong in which (among other things) a completed risk disclosure statement by an inexperienced investor was no bar to a successful claim in negligence against a financial adviser.

What is required by way of reasonable disclosure to an investor will vary according to market practice and the circumstances of the case. In cases involving commercial investors and in the absence of egregious conduct on the part of a financial adviser, the courts are usually reluctant to go behind the contractual documents[5]. In the case at hand, the plaintiff was not only an experienced investor and a very successful businessman but he also had a preference at times for leveraging intricate investments. The plaintiff was known to override advice received when he saw fit.

The outcome of the case also demonstrates the importance of having the proper terms in client agreements, keeping proper records and giving adequate disclosure in accordance with good practice. Whether the legislature in Hong Kong decides to legislate with respect to the issue of disclosure of commissions as between an insured and an insurance broker is a matter for another day.

Finally, the judgment also contains a salutary warning for any litigant that makes unjustified complaints of fraud in a civil case. The Hong Kong courts have shown themselves willing (as in this case) to make adverse costs orders against such parties.

In this case, Clyde & Co's Richard Keady and Melissa Chim acted for the successful insurance broker. The merged firm of Clyde & Co and Barlow Lyde & Gilbert have some 55 years of combined experience representing clients in the insurance industry in Asia.

4 [2004] 3 HKLRD 871
5 re Springwell Navigation Corp. [2010] All ER (D) 08 (Nov), re Camarata Property Inc. [2011] BCLC 54

Further information
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Further advice should be taken before relying on the contents of this summary.

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