



1 July 2008

CIRCULAR

RE: New Guidelines in relation to “Net Rating”

Following the release of our amended circular in July 2007 which provided additional information on guideline number (2) “fee for service” arrangements, a meeting was held with the Insurance Council of Australia (ICA) and National Insurance Brokers Association (NIBA), to discuss this issue.

Following this discussion and having conducted a number of inspections, the MFB and CFA now provide further information on “net rating”, specifically on the “fee for service” (FFS) arrangements.

As a general rule, the following circumstances or arrangements will not fall within the definition of “net rating”

- 1. Direct Insurance – where the property owner places insurance directly with the insurer.**
- 2. The insurance intermediary’s remuneration is based on a fee for service (FFS) arrangement with the insured. The FFS arrangement is purely a matter between the insurance intermediary and client. A fee for service arrangement must be clearly identifiable as being in place at the commencement of negotiations and contract, and that the insurance intermediary has initially advised no or reduced commissions are to be paid by the insurer.**

Please note, in this arrangement insurance companies should consider the following:

- FFS is to apply to all classes of insurance (property including motor & casualty but not including life, health, accident, aviation and marine hull) placed with your company/organisation by the insurance intermediary. Previously, FFS arrangements were required to be disclosed for all policies placed with all insurers.
- FFS is to apply to all sections (including subsections) of composite / packaged policies placed with that insurance company.
- FFS arrangements need to be clearly identifiable as being in place at the commencement of negotiations between the insurer and insurance intermediary. This should be in the form of an email, letter, written quotation included from the intermediary or any standard form documentation indicating nil commission from insurer or intermediary.

Where an insurer holds existing business and does not have evidence that a FFS applies then the insurer should seek confirmation in writing/email from the intermediary. Please note, where appropriate, the Victorian fire services may request a copy of FFS arrangements from the insurance intermediary.

- 3. A written agreement between the insurer and insurance intermediary is in place and accounts established for business written at various commission rates and/or ranges. Any variation outside the agreement which changes the insurance intermediary remuneration will result in the premium needing to be “grossed up” (premium plus commission as per agreement).**

For example, if the agreement incorporates a rolling commission rate (20% to 10%), and the insurer and insurance intermediary agree on 5% commission, then the premium plus the amount equal to 10% commission will need to be returned.

- 4. Rating discounts, including direct or intermediated business that is discounted for reasons that have nothing to do with remuneration of an intermediary - i.e. no claim bonus discounts, staff discounts, promotional discounts based on rating factors. These discounts must be identifiable and apply to a class of insurance or group of clients.**

For example, a special or once off discount (not a rating discount) for a particular client(s), will fall within the definition of a “discount” under the respective fire services Acts, and is required to be included as part of the premium to be returned.

The following key factors will be examined during inspections of Returns lodged by insurance companies and intermediaries, when determining whether “net rating” has taken place and the amount of premiums which must be returned under the Acts:

- **Remuneration structure the insurance company has with its intermediaries.**
- **Whether commissions / brokerage are normally paid to insurance intermediaries by the insurer on classes of insurance subject to contribution.**
- **Whether the remuneration agreement between the insurer and insurance intermediary entitle the insurance intermediary to receive commission / brokerage on those classes of insurance subject to contribution.**
- **Whether remuneration differs across products sold to the client.**
- **Whether the agency agreement entitle the insurance intermediary to reduce or waive commission / brokerage with the insurer.**
- **Due to the insurer waiving commission / brokerage, whether there is an identifiable fee for service arrangement between the insurance intermediary and the client, and has the intermediary initially advised the insurer that no commission is to be paid.**
- **Whether the insurance intermediary is entitled to receive a risk / premium rate discount due to reducing / waiving commission / brokerage.**
- **Variation of remuneration outside the agency agreement.**
- **Rating discount arrangements that are outside remuneration or pure risk (underwriting) discounts.**

The above factors apply irrespective of whether the insurer is based locally or offshore.

The MFB and CFA must emphasize that the above stated arrangements are guidelines only that promote consistency of practices throughout the market place.

We recommend that each insurance company/intermediary provide adequate training to relevant staff and implement system checks and controls to readily identify net rated premium that is subject to contribution under the Regs. The MFB/CFA will request from each contributor the procedures/processes they have implemented to address this issue. From inspections taken place thus far not all contributors are addressing 'net rating' adequately.

The MFB and CFA remind all contributors that the *Metropolitan Fire Brigades Act 1958 (MFB Act)* and *Country Fire Authority Act 1958 (CFA Act)* define "net rating" as follows;

"any practice or device adopted by an insurance company involving the waiving of commission or brokerage by an insurance intermediary which has the effect of reducing the premium payable to the insurance company".

Furthermore, the "insurance company" or "insurance intermediary" must include as a discount any reduction in gross premiums resulting from the use of net rating in relevant policies of insurance against fire issued by an insurance company.

In summary changes involve;

- Documentation required substantiating FFS arrangement.
- FFS arrangement should apply to accounts placed with a particular insurer rather than all insurers.
- Recommending all insurers/underwriters have a system in place to capture any "net rating" accounts.

We trust that the above information clarifies our position in relation to this matter. Should you have any further queries, please contact the MFB on (03) 9665-4275 or CFA on (03) 9262-8467. Alternatively, please visit the MFB website on www.mfb.vic.gov.au clicking the button titled STANDARDS & GUIDELINES and then clicking on "Returns and Premiums".

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