

## For general insurance companies

### Outsourcing claim activities to private investigators

**This factsheet will help you understand whether you have appropriate controls, oversight and due diligence procedures when using external private investigators. It explains our expectations of insurers when using private investigators and the actions we are taking to address potential risks to consumers.**

#### **Key message**

Insurers are responsible for the actions of the private investigators investigating claims of the insurer.

#### **Why have we looked into how insurers use private investigators?**

Many insurers use private investigators, particularly to help them deal with potential claims fraud and exaggeration. We expect insurers to behave appropriately and do the right thing in their use of private investigators.

When using the services of a private investigator, either directly or via a third party such as a claims administrator or solicitor, insurers are outsourcing part of the regulated activities they perform. The work

falls within the FCA Handbook glossary definition of outsourcing which is '.....the use of a person to provide customised services to a firm.....'.

Private investigators are potentially valuable to insurers (and their customers) in identifying fraudulent claims. But we have been concerned about how insurers are meeting their obligations under our rules (see 'Our regulatory requirements' at the end of this factsheet) when outsourcing work to private investigators. As SYSC3.2.4(G) states 'a firm cannot contract out its regulatory obligations'. So we carried out thematic work to look at insurers' attitudes, processes and controls when using private investigators in the UK personal lines and commercial markets.

**'We expect insurers to behave appropriately and do the right thing in their use of private investigators'**

### Our work and research

We sent a questionnaire to 10 insurers and did follow-up visits to firms. Participating firms co-operated fully and were generally highly engaged with our work. We also looked at information from other sources including online forums and other public domain disclosure channels. We wanted to:

- establish the extent to which insurers use private investigators
- their motivations and strategic approach when doing so, and
- the control frameworks they put in place when outsourcing these activities

### Our overall findings

Insurers use private investigators to fulfil various functions in the claim management process, but the extent to which they were used, the activities they performed and the controls in place over these activities varied considerably between insurers.

All but one of the respondents highlighted the potential reputational risk to the industry which could arise from the use of private investigators and their actions when working for insurers. However, the extent and robustness of the due diligence and control framework operated by insurers outsourcing work to private investigators was not always consistent with the potential risks involved in performing an activity directly affecting a firm's claims handling.

### Our findings in more detail

Our thematic review revealed:

- The relationship between insurers and private investigators was often informal, with private investigators appointed on a case-by-case basis. Six of the insurers questioned did not have full contractual agreements in place with the private investigators acting on behalf of the firm. Where no such contractual agreements were in place it was not clear how the basis and scope of the private investigators' work was determined.
- There was significant variance in the formality and level of detail of insurers' procurement processes and due diligence when selecting private investigators. Of those questioned five did not follow a formal procurement process.
- There was also variance between firms in the processes to appoint a private investigator to work on a specific claim case, both in its formality and the seniority of those initiating and approving this decision.

- Some insurers did not have effective internal quality assurance processes to provide appropriate oversight of private investigators by claims handlers when using their services for specific claims.
- Eight insurers undertook limited or no external due diligence or technical (file review) activities regarding the quality and appropriateness of work undertaken by private investigators.
- Some insurers had high-level management information on their use of private investigators, while others did not. Of the insurers questioned:
  - Two had no management information on the number of claims where a private investigator had been appointed
  - Nine had limited or no management information to demonstrate how frequently private investigators appointed to undertake surveillance activities had actually identified any evidence of claim exaggeration or fraud. Such information could help monitor whether the insurer's fraud indicators are appropriate and ensure that claimants had been treated fairly.
- We did not identify any issues relating to the remuneration of private investigators, who were predominantly paid a daily or hourly rate.
- Most insurers in the review advised that external solicitors or third-party administrators would instruct private investigators on their behalf.

### What happens next?

Based on our findings and conclusions, we are taking a range of actions to address the potential risks to customers. These include:

- publishing this factsheet to inform the industry of our work and outline our findings and expectations
- requesting further information and/or taking appropriate action with individual insurers where the information we've received indicates specific failings or poor practice
- considering this element of firms' practices in our day-to-day supervision and firm visits, including asking to see evidence of the work performed to ensure firms are complying with these regulatory obligations, and
- continuing to monitor the use of private investigators. This may mean we perform further thematic work in the future.

## Summary

Insurers need to ensure they are:

- aware of how the FCA Handbook applies to work outsourced to private investigators when handling claims as part of their regulated activities, and
- able to demonstrate how they monitor and mitigate any potential risks to customers arising from outsourcing claim functions/activities to private investigators

We will take seriously any evidence of non-compliance with regulatory standards by insurers when using private investigators and will take action against individual insurers not acting in line with the requirements of the FCA Handbook.

## Our regulatory requirements

When using a private investigator, insurers are outsourcing part of the regulated activities they perform and the work falls within the FCA Handbook Glossary definition of outsourcing which is ‘.....the use of a person to provide customised services to a firm.....’

This means that we expect insurers to ensure that the work performed by the private investigators, which impacts upon their claims handling practices, is consistent with their regulatory obligations under SYSC, PRIN and ICOBS, and they are able to evidence this. So it is particularly important that insurers are aware of the following sections of the FCA Handbook and understand the impact they have on their practices in this area:

- **ICOBS 8.1.1R**
  1. An insurer must handle claims promptly and fairly.
- **PRIN 2.1.1R**  
Principle 2 – Skill, care and diligence – A firm must conduct its business with due skill, care and diligence.

Principle 3 – Management and control – A firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems.

Principle 6 - A firm must pay due regard to the interests of its customers and treat them fairly.

- **SYSC 3.2.3G**
  1. A firm’s governing body is likely to delegate many functions and tasks for the purpose of carrying out its business. When functions or tasks are delegated, either to employees or to appointed representatives or, where applicable, its tied agents, appropriate safeguards should be put in place;
  2. When there is delegation, a firm should assess whether the recipient is suitable to carry out the delegated function or task, taking into account the degree of responsibility involved;
  3. The extent and limits of any delegation should be made clear to those concerned.
  4. There should be arrangements to supervise delegation, and to monitor the discharge of delegates functions or tasks; and
  5. If cause for concern arises through supervision and monitoring or otherwise, there should be appropriate follow-up action at an appropriate level of seniority within the firm.
- **SYSC 3.2.4G**
  1. The guidance relevant to delegation within the firm is also relevant to external delegation (‘outsourcing’). A firm cannot contract out its regulatory obligations. So, for example, under Principle 3 a firm should take reasonable care to supervise the discharge of outsourced functions by its contractor.
  2. A firm should take steps to obtain sufficient information from its contractor to enable it to assess the impact of outsourcing on its systems and controls.
- **SYSC 13.9.1G**  
As SYSC 3.2.4G explains, a firm cannot contract out its regulatory obligations and should take reasonable care to supervise the discharge of outsourced functions. This section provides additional guidance on managing outsourcing arrangements (and will be relevant, to some extent, to other forms of third party dependency) in relation to operational risk. Outsourcing may affect a firm’s exposure to operational risk through significant changes to, and reduced control over, people, processes and systems used in outsourced activities.

- **SYSC 13.9.4G**

Before entering into, or significantly changing, an outsourcing arrangement, a firm should:

1. Analyse how the arrangement will fit with its organisation and reporting structure; business strategy; overall risk profile; and ability to meet its regulatory obligations;
2. Consider whether the agreements establishing the arrangement will allow it to monitor and control its operational risk exposure relating to the outsourcing;
3. Conduct appropriate due diligence of the service provider's financial stability and Expertise;
4. Consider how it will ensure a smooth transition of its operations from its current arrangements to a new or changed outsourcing arrangement (including what will happen on the termination of the contract); and
5. Consider any concentration risk implications such as the business continuity implications that may arise if a single service provider is used by several firms.

- **SYSC 13.9.5G**

In negotiating its contract with a service provider, a firm should have regard to:

1. Reporting or notification requirements it may wish to impose on the service provider;
2. Whether sufficient access will be available to its internal auditors, external auditors or actuaries (see section 341 of the Financial Services and Markets Act 2000) and to the appropriate regulator (see SUP 2.3.5 R (Access to premises) and SUP 2.3.7 R (Suppliers under material outsourcing arrangements));

3. Information ownership rights, confidentiality agreements and Chinese walls to protect client and other information (including arrangements at the termination of the contract);
4. The adequacy of any guarantees and indemnities;
5. The extent to which the service provider must comply with the firm's policies and procedures (covering, for example, information security);
6. The extent to which a service provider will provide business continuity for outsourced operations, and whether exclusive access to its resources is agreed;
7. The need for continued availability of software following difficulty at a third party supplier; and
8. The processes for making changes to the outsourcing arrangement (for example, changes in processing volumes, activities and other contractual terms) and the conditions under which the firm or service provider can choose to change or terminate the outsourcing arrangement, such as where there is:
  - (a) a change of ownership or control (including insolvency or receivership) of the service provider or firm; or
  - (b) significant change in the business operations (including sub-contracting) of the service provider or firm; or
  - (c) inadequate provision of services that may lead to the firm being unable to meet its regulatory obligations.

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