



Principals and their appointed representatives in the general insurance sector





Introduction

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Agenda

1. Background
2. High-level findings
3. Review scope and methodology
4. Regulatory framework
5. Findings
6. Actions
7. Expectations and next steps
8. Q&A session

Background

- Over 20,000 appointed representatives involved in the distribution of general insurance products

- Supervisory work identified concerns around principals' oversight of appointed representatives

- Business plan commitment for 2015/16

High-level findings

Business model and risk management

- Majority of firms in the sample lacked effective risk frameworks
- AR alignment to and impact on wider business model

Governance and oversight – before appointment

- Solvency and suitability of the AR
- Majority of firms in sample did not have adequate understanding and resources to oversee and control ARs

Governance and oversight - contracting

- Shortcomings in contracts – scope of activities
- Issues such as multiple principal arrangements, categorising ARs, implementing approved persons regime, client money

Governance and oversight – control and monitoring

- Shortcomings in understanding and oversight of regulated activities of ARs – many risks not identified and addressed
- Most firms lacked effective monitoring activity and control

Consumer outcomes

- Potential mis-selling – customers buying products didn't need, not eligible for or without adequate information
- Understanding and application of client money rules

Summary and actions

- Widespread shortcomings in area where rules and obligations are clear and longstanding

- Significant risk of customer detriment

- We have taken early intervention actions where necessary to mitigate issues

Scope and methodology

- Online survey of 190 GI principals with a network of ARs
 - Over 6,000 ARs, 15,000 sites, 75,000 representatives, 10 million annual sales and £500m annual revenue
- Sample of 15 principals for more detailed work
 - 783 ARs across a wide range of GI activities
- FCA visited 14 of the principal firms and 25 ARs
 - Interviewed management and staff, reviewed processes, controls and oversight
- Reviewed customer facing documents and sales files, listened to sales calls and considered post sales activities
 - Assessed effectiveness of monitoring activity and resultant actions

Regulatory framework

- ARs undertake regulated activities under the supervision of an authorised firm acting as principal, so are exempt
- A principal accepts regulatory responsibility for its ARs
- ‘.....anything that an AR has done or omitted to do.....will be treated as having been done or omitted to be done by the firm’ – SUP12.3.1(G)
- The key FCA rules and guidance against which we carried out this review included:
 - Chapter 12 of the Supervision Manual (SUP)
 - FCA Principles for Businesses (PRIN)
 - Senior Management Arrangements, Systems and Controls (SYSC)
 - Threshold Conditions (COND)
 - Insurance: Conduct of Business Sourcebook (ICOBS)
 - Client money: insurance mediation activity (CASS 5)



Thematic review findings



Business model and risk management

Clearly defined business model?

- Majority of principals could not demonstrate that they had considered how appointment of ARs would impact on their core business
- Were AR activities consistent with their risk appetite?

Diversification through ARs

- Wholesale intermediaries taking on retail ARs
- Lacked ability to ensure practices and sales were compliant

Sustainable business

- Majority of principals had not considered the costs of operating a compliant AR network
- ARs were sometimes viewed as a “cash free investment”

Business model and risk management (cont.)

Growth of networks

- Some firms had grown their networks rapidly and lacked sufficient skills and resources to manage the risks presented
- Examples where principals had altered and broadened their business models to grow - creating new risks

Umbrella networks

- Some principals in our sample were “umbrella” networks, whose sole or primary purpose was to operate ARs
- These firms did not always appear to have understood the full extent of their responsibility for their ARs
- Could not always show they met their regulatory obligations and understood and mitigated the risks of their ARs’ activities

Governance and oversight – prior to appointment

Due diligence – fit with principal's own business

- Lack of evidence that risks had been considered and understood
- Conflicts of interest, including relevant relationships with AR

Due diligence – AR and activities

- Many had not fully considered the solvency and suitability of the AR
- Experience and capabilities of the AR and its management
- Type of products sold, sales processes and the needs of consumers
- Remuneration of sales agents and related risks

Governance and oversight – set up

Contracts

- Required to be in place - SUP 12.5 sets out key required terms
- Provide a basis for effective control and oversight
 - Many contracts failed to clearly define and limit AR activities
 - What was set out in contract not imposed
 - Multiple principal arrangements not in place

Other issues

- Implementation of approved persons regime for directors of ARs
- Client money and risk transfer arrangements

Governance and oversight – on-going monitoring

Overall finding

- The majority of the principal firms in our sample could not demonstrate that they consistently exercised adequate control over their ARs' activities.

Adequate resources

- Majority of principals lacked resources to effectively oversee their ARs
- Insufficient staff with appropriate skills or regulatory knowledge
- Lack of independence and conflict with commercial relationship

Monitoring framework

- Absence of appropriate framework or support for oversight
- In over half of the firms there was no risk based approach to AR oversight

Governance and oversight – on-going monitoring

Monitoring activities– visits, MI and financial assessments

- Minority of ARs had received a monitoring visit from their principal in the last year
- Most firms performed some monitoring but effectiveness varied widely
- Monitoring by most firms insufficient to identify potential customer detriment
- Undue reliance on system controls without other monitoring
- ARs operating outside core processes and systems
- Most principals did not have sufficient MI to enable them to identify key risks and trends within their AR network
- Many ARs had not had a financial assessment carried out in the last year

Follow up of issues and imbalance in principal AR relationship

- Lack of evidence of follow up and decisive action when issues identified at ARs
- Imbalance in the relationship between the AR and the principal – Size, Customers
- ARs dictate the terms of engagement although using principal authorisation

Governance and oversight - on-going monitoring (cont.)

Training and competence

- Quality of training and competence regimes varied widely
- In many cases there was no effective quality assurance to assess understanding

Termination of AR relationship

- Ongoing obligations to customers when AR appointment terminated not understood
- Appropriate arrangements not always in place to protect principal and customers

Customer outcomes

Customers who buy from an AR should be afforded the same protection as if they were buying from the authorised firm itself.

We found that:

- Most principals did not have adequate systems and controls to enforce compliance with PRIN and ICOBS
- Many principals did not know whether customers of their ARs were treated fairly
- In five of the firms we saw examples of potential mis-selling, unauthorised business or other customer detriment
- Some firms had not ensured effective risk transfer was in place or appropriately protected client money

Customer outcomes - Sales

AR sales activities – understanding and control

- Most principles did not consistently exercise effective oversight of their ARs' sales practices
- Some ARs were selling products which the principal had no experience of selling
- Cases of unauthorised business – activities outside principal permissions or parties not authorised or exempt
- Activities covered by permission and AR contract but that principal not aware of
- Lack of understanding of sales scripts and processes
- No effective quality assurance processes
- No ability to demonstrate ICOBS and PRIN compliance
- Examples of mis-selling and detriment

Customer outcomes – CASS, post-sales activities

Client money and risk transfer

- Shortcomings in creation of effective risk transfer arrangements
- Principals not party to risk transfer arrangement and unsighted on existence or contents of insurer TOBA
- Risk transfer conditions not being met
- Failings in operation of client money environment
- Client money used to fund premium finance operation

Post-sales activities

- Less than a quarter of firms had put in place processes for assessing and improving customer outcomes
- All the principals had a formal complaints procedure but most did not have effective processes to identify, monitor and record complaints

Customer outcomes - products

Warranty insurance products

- Warranty products – outbound and inbound calls
- Sales scripts, processes and controls – treating customers fairly
- Targeting of product– vulnerable customers

Travel insurance

- Two stage processes for customers with pre-existing medical conditions
- Controls to ensure customer does not have policy under which they are ineligible to claim

GAP

- New rules relating to GAP insurance introduced in September 2015
- Shortcomings in new processes or compliance with these
- Examples of falsified customer signatures

Our actions

In response to the issues identified and the related risks to consumers we have taken the following early intervention actions in relation to five of the principal firms:

- Agreed the imposition of voluntary requirements on the regulatory permissions of five of the principals, in each case preventing the principal from taking on any new ARs.
- In two cases, the requirements also limited or ceased elements of the firm's existing AR activities, by stopping sales by particular ARs or of particular products.
- Requested and received action plans from these firms to address the issues identified.
- We have commissioned two section 166 skilled persons reports to consider and address the issues identified at two principal firms.

One principal has ceased its activities and left the general insurance sector since our review commenced.

Our expectations

We expect principal firms to be able to demonstrate that they:

- Have considered the impact of ARs on their own business and ability to meet threshold conditions
- Assess the solvency and suitability of their ARs
- Put in place compliant contractual arrangements with their ARs
- Have adequate controls over their ARs' regulated activities for which the firm has responsibility
- Have adequate resource to oversee the ARs and enforce compliance with relevant Handbook obligations
- Ensure that the ARs are fit and proper to deal with clients in their name so that clients dealing with the ARs are afforded the same level of protection as if they had dealt with the firm itself.
- Can demonstrate that the ARs treat customers fairly and do not mis-sell general insurance products
- Appropriately identify and protect client money, or ensure that effective risk transfer arrangements are in place
- Ensure that their ARs deliver post-sales services in a compliant manner

Next steps

- We are sending a 'Dear CEO' letter to the chief executive officers of relevant principal firms setting out our expectations
- We are planning to perform additional work with some of the firms in the wider survey sample
- We are continuing to work with the firms included in our detailed review, providing individual feedback to these firms and setting out any actions required
- We will consider the need for further thematic or supervisory work, and expect that this will remain an area of supervisory focus.
- We will consider the need for other regulatory actions as a result of the findings, including changes in Authorisation processes or the need for Policy work
- We will engage actively with the sector, including via engagement with relevant trade bodies, to take forward these findings



Panel

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