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FCA FINDINGS ON DELEGATED AUTHORITIES

Financial Services - Insurance

FCA review of delegated authorities in the general insurance market

The Financial Conduct Authority recently published the findings of its thematic review (TR15/7) on delegated authority arrangements in the general insurance (GI) market (the "Report"). Delegated authorities are widely used in the UK to provide for the outsourcing of a number of functions to third parties including underwriting, claims, complaint handling, product design, etc.

This allows for a flexible market that adapts to the needs of customers. However, The FCA's findings also show that delegation requires careful management and some insurers and intermediaries seem to have overlooked this. This is because outsourcing arrangements bring more complexity and this that can lead to a lack of clarity amongst those involved as regards their respective regulatory duties and responsibilities.

Delegation and regulatory duties

In the report the FCA notes that the industry has developed a range of business models to meet the varied insurance needs of customers and these often include some form of delegation. However, a firm cannot contract out of its regulatory obligations. They key for those involved is therefore to identify how the delegation impacts on the firm's regulatory duties and to take the necessary steps to ensure compliance. How this can be done depends on the type of delegation involved.

Outsourcing

In the FCA Handbook Glossary, one definition of outsourcing is as follows: "an arrangement of any form between a firm and a service provider by which that service provider performs a process, a service or an activity which would otherwise be undertaken by the firm itself."

Delegation of significant functions (such as, for instance, claims handling) is "outsourcing", which is subject to the relevant requirements of the FCA Handbook. The Report helpfully lists the most relevant rules and guidance. These include for instance the Threshold Conditions (COND) concerning suitability and appropriate resources; the Principles of Business (PRIN) concerning risk management systems and treating customers fairly; the Senior Management Arrangements, Systems and Controls (SYSC) that relate to PRIN 3 concerning operational risk and of course, the Insurance: Conduct of Business sourcebook (ICOBS), notably those concerning claims handling. These are only a few examples and readers are referred to the Report for the full list.

Other types of delegation

The term delegation however is sometimes used to describe commercial arrangements that do not necessarily involve "outsourcing" in the strict sense of the FCA Handbook. In these cases, responsibilities flow from the actual role or function undertaken by each participant.

Differentiating between outsourcing and other types of delegation can be tricky and the FCA recognises that the delegating arrangements themselves can be complex. All this adds to the difficulties participants face in identifying what their respective responsibilities are. Yet this is critical to ensure compliance with the FCA Handbook. In the Report, the FCA makes it clear that regulated firms must understand the scope of their regulatory responsibilities and make sure that everyone else involved in the chain of delegation does too.

Findings

The FCA carried out the review to understand how firms approach outsourcing across the GI sector. It also wanted to ensure that, even when outsourcing arrangements are in place, customers remain placed at the heart of firms' business models. The report comments that a customer's experience should not be affected by whether a product or service is provided and distributed by a single institution or by two or more institutions.

The FCA reviewed 12 insurers' outsourced underwriting and claims handling arrangements and the associated activities of 19 intermediaries and third party administrators. It found that many of the firms reviewed had not adequately considered their regulatory obligations in relation to both outsourcing and fair treatment of customers.

We set out below some of the more specific findings made by FCA:

- ▶ some insurers did not have clear arrangements to assess conduct risks associated with delegated authorities;
- ▶ some insurers did not regard the delegation as "outsourcing" when it clearly was or they did not focus their due-diligence on conduct issues when selecting third parties;
- ▶ some insurers had not considered whether the products they underwrite treat customers fairly, both in terms of the value and service delivered, because they focussed purely on financial performance;
- ▶ some insurers exercised insufficient control over outsourced claims function and over the management of potential conflicts of interest;
- ▶ some insurers relied disproportionately on the audits carried out by third parties to monitor delegation rather than having appropriate internal controls around outsourcing;
- ▶ some intermediaries who designed products did not recognise the extent of their responsibilities and this was reflected in a lack of appropriate consideration of customer needs;
- ▶ some insurers and intermediaries had insufficient oversight of the performance of products and delivery of services and this was compounded by poor or incomplete MI;
- ▶ the above contributed in some cases to shortcomings in complaints handling, with incomplete complaints data being collected;
- ▶ products providers did not always appreciate the complexity and the risks of the distribution model they were using.

What Next?

The Report sets out the FCA's expectation of all concerned (insurers, intermediaries and others involved in delegated authorities). Fundamentally, the FCA expects all firms involved in outsourcing to review their arrangements and address shortcomings such as those identified in the Report.

As a first step, all parties ought to recognise when they are outsourcing and put in place effective monitoring to manage the conduct risks that arise. The Report notes the impact of Solvency II and of the recast Insurance Mediation Directive (now the Insurance Distribution Directive).

The FCA said it will provide feedback to individual firms involved in the review and follow-up on specific issues identified. It also intends to engage with relevant trade bodies and groups of firms to discuss its findings more generally.

The Report, which comes shortly after the FCA thematic Review on the Handling of insurance claims for Small and Medium-sized Enterprises (SMEs) and its work on add-on and GAP insurance, sends a clear signal that the FCA believes there is room for the GI industry to improve customer outcomes across the board.



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