

## FCA Thematic Review on General Insurance Appointed Representatives

Following identified concerns highlighted in its Business Plan, the Financial Conduct Authority (FCA) has undertaken a detailed thematic review into firms using the Appointed Representatives regime of its general insurance regulations.

The UK general insurance sector comprises some 400 insurers and 5,100 intermediaries that are directly authorised. Many of these firms have appointed and accepted responsibility for over 20,000 Appointed Representatives (ARs). The sector accounts for over a quarter of all ARs registered across the financial services industry.

The Review uncovered widespread shortcomings in principal firms' awareness and understanding of the rules and guidance and compliance with the requirements. In the regulator's view, this creates significant concern of material risks to consumers.

In the FCA's own words, "the issues we identified were serious and widespread, and showed that over half of the principal firms did not fully understand the risks arising from their ARs' activities, or were unable to demonstrate that they were complying with their obligations to control and oversee these activities."

### Immediate actions:

- The FCA has taken early intervention actions in relation to five of the 15 principal firms and their ARs included within the review, and this has included enforcement action.
- This action included imposing 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. One of these firms has since left the market.
- It has recently published a Dear CEO letter for the rest of the sector highlighting its concerns and calling for the issues to be addressed, and will be undertaking additional work with a wider sample of firms.

## Background

In the UK general insurance sector, there are approximately 400 insurers and 5,100 intermediaries that are directly authorised by the Financial Conduct Authority (FCA). Some of these firms have appointed and accepted responsibility for over 20,000 Appointed Representatives (ARs) and these account for about 25% of all the ARs registered under the UK regulatory regime.

ARs are exempt from direct regulation because they undertake activities under the supervision of an authorised firm acting as their 'principal':

- the principal has regulatory responsibility for the AR and must put in place a written contract with the AR;

- anything that the AR has done, or omitted to do, is treated as having been done, or omitted to be done, by the principal itself;
- this means the principal is responsible for any regulatory breaches committed by their ARs in respect of the business for which the principal has accepted responsibility.

The FCA had identified concerns in relation to principal firms' understanding of their regulatory obligations for their ARs and the level of oversight of their ARs' activities.

In a number of instances, these shortcomings had resulted in detriment to the customer; for example, through mis-selling or failings in service provision. The regulator highlighted in its 2015-16 Business Plan that it would undertake this detailed investigation.

## About the investigation

The FCA has conducted a detailed thematic review into firms using the Appointed Representatives regime of its general insurance regulations. The final report is available: [www.fca.org.uk/your-fca/documents/thematic-reviews/tr16-06](http://www.fca.org.uk/your-fca/documents/thematic-reviews/tr16-06)

This investigation was divided into three phases:

- **Initial online survey:** of 190 principals operating a network of ARs, primarily in the UK general insurance sector. This was to gain insight into their business model and size, AR activities, governance structures, customer numbers, product types, sales methods and revenues;
- **Further desk analysis of 15 principals:** using a risk-based approach to represent a diverse range of business models, products distributed, sales methods and sizes of AR networks. These 15 principals had 783 ARs with 10,594 representatives operating at 1,684 locations. The FCA requested and reviewed further information from this sample of principal firms to gain greater insight into their businesses and the activities of their ARs; finally
- **Visited 14 principals and 25 ARs:** involved interviewing senior management and staff, reviewing policies and procedures, contractual documentation (including Terms of Business Agreements), customer-facing documentation (including sales scripts) and customer files, and listening to sales calls.

The material risk of customer detriment arising from the activities of ARs that are not subject to appropriate control and oversight from their principal. The ARs included sold a wide range of products (including home, motor, travel, Guaranteed Asset Protection (GAP), warranty and commercial combined) via a range of methods (face-to-face, internet, inbound and outbound calls, advised and non-advised), predominantly to retail and small business customers

## Key findings

In the FCA's own words, "the issues we identified were serious and widespread, and showed that over half of the principal firms did not fully understand the risks arising from their ARs' activities, or were unable to demonstrate that they were complying with their obligations to control and oversee these activities." (p.5).

- In five of the 14 firms, the regulator identified material risks to customers arising from their poor practices, which left the regulator "with no alternative but to take early supervisory intervention actions in the public interest".
- When considering the appointment of appointed representatives, many principal firms had not taken reasonable steps to assess their ability to oversee them effectively or put in place appropriate risk management frameworks to identify and manage the risks arising.
- This resulted in some appointed representatives conducting activities outside their principal's core areas of expertise where the principal lacked the ability or resources to oversee them effectively.
- Some principals had not assessed the solvency and suitability of their appointed representatives.

- Some principals had not put in place compliant contracts with their appointed representatives, which clearly set out what activities the appointed representatives were allowed to undertake.
- Many principals had not put in place appropriate control frameworks for the ongoing monitoring of their appointed representatives and to enforce compliance with relevant regulatory requirements. This was particularly relevant in relation to sales activities and treating customers fairly, where the regulator saw numerous examples of poor practices and mis-selling.

## **Detailed findings**

The findings fall into three categories: business models and risk management; governance and oversight; and customer outcomes. We have also highlighted in this briefing the training and competence findings.

### **Business models and risk management**

Almost half of the principals in the FCA sample could not demonstrate that they had considered and understood the nature, scale and complexity of the risks arising from their ARs' activities and, in particular, the risks these activities presented to customers. Some ARs were conducting activities outside their principal's core areas of expertise, where the principal lacked the ability or resources to oversee them effectively.

These principal firms could not consistently demonstrate that they had met the regulatory requirements to take reasonable steps to:

- consider how the appointment of ARs would impact their business model and core activities, including how the activities of potential ARs aligned with their existing activities and whether they had adequate resources to oversee the AR and enforce compliance with the AR contract and regulatory requirements;
- understand the nature, scale and complexity of the risks arising from the activities of their ARs; and
- put in place an appropriate risk management framework to identify and manage the risks their ARs presented to their business and to customers.

### **Governance and oversight**

Over half of the 15 principals included within the sample could not consistently demonstrate that they had effective risk management, oversight and control frameworks to identify, monitor and mitigate the risks arising from their ARs' activities.

- When considering the appointment of new ARs, many principals could not demonstrate how they had met their obligations to consider the solvency and suitability of the AR, the impact on their own compliance with threshold conditions, or the adequacy of their own controls and monitoring resources.
- At appointment stage and when contracting the relationship, the regulator found that some principals had not been effective in setting up an appropriate operational framework for their ARs, both in terms of contractual arrangements and the broader control environment.
- They saw examples of contracts that "were not fully compliant with the relevant requirements as well as shortcomings in categorising ARs, setting up multiple principal arrangements and implementing the approved persons regime".
- Regarding ongoing oversight, "over half of the principal firms in the sample were not able to demonstrate consistently that they had adequate controls over the ARs' regulated activities or adequate resources to monitor and enforce compliance by their ARs with the relevant requirements".

## Customer outcomes

The purpose of the regulatory framework is to “ensure that customers buying insurance products from an AR of an authorised firm are afforded the same level of protection (and therefore no less likely to receive fair outcomes) as if they were purchasing products from the authorised firm itself”.

For many of the principals, the apparent shortcomings in risk management, control and oversight gave rise to risks to customer outcomes, as the principal was not able to ensure its ARs complied with the relevant requirements:

- **Potential mis-selling and customer detriment as a result of ARs’ actions:** there were examples of this in a third of the principal firms, with most of these issues not previously identified by the principal. This included customers buying products that they may not need, under which they may be ineligible to make a claim, or without being provided with enough information (including key exclusions) to make an informed choice.
- **Sales activity – understanding and control of AR sales practices:** most of the principals in the regulator’s sample did not consistently exercise effective oversight and control of their ARs sales practices. The FCA’s review of sales processes, sales practices, sales calls and customer files identified serious shortcomings that created the potential for customer detriment, and (in a more limited number of cases) found clear evidence of actual customer detriment. In many of these cases, the shortcomings the regulator found had not previously been identified by the principal.
- **Products and distribution methods – areas of additional risk:** the FCA found significant shortcomings when the regulator reviewed some principal and ARs’ sales processes and practices for three products: warranty insurance, travel insurance and GAP (see box right). These shortcomings related to factors including consideration of the target market (including risks around vulnerable customers), sales scripts, sales processes and sales practices.

## Training and competence

- The majority of the principals seemed to regard training and competence of the sales agents as important and was an area of focus for the firm, but the quality of training and competence regimes across principals and their AR networks varied widely.
- In one particular case, there was a very effective training and competence regime. However, while other principals stated that training was a priority for them, the majority either did not assess competence or did not consider whether the training was implemented in practice and was delivering fair customer outcomes.

## Areas of additional risk: Warranty, Travel and GAP

### Warranty

- Two of the principals in the regulator’s sample sold warranty insurance products via the telephone.
- The ARs of one of these firms used outbound calls to sell in a way which potentially targeted vulnerable customers, due to the methods used to get customer leads and the timing of the calls.
- Neither of these principals exercised effective control over the sales activities of these ARs.

### Travel:

- Some ARs within the review sold travel insurance to customers with pre-existing medical conditions (PEC) in two stages.
- The customer was initially sold a standard policy that provided cover only if a claim was not due to a pre-existing medical condition.
- To obtain cover for a PEC, the customer was expected to contact another party separately. In some cases, the principal had no process in place for identifying customers with PECs or for ensuring that such customers contacted the other party to obtain full cover.
- In the absence of further controls and checks, this practice presents a significant risk that customers may buy a product that does not fully meet their needs, as they would be ineligible to make a claim regarding their PECs.

### Guaranteed Asset Protection (GAP):

- The file review found examples where sales agents at one of the ARs had falsified customer signatures in order to comply with the deferred element of the sales documentation, thereby circumventing the new rules.
- The firm’s sales monitoring and quality assurance process had not identified these or any other similar examples prior to the regulator’s visit, raising questions regarding the efficacy of these processes.
- This example “also raised serious concerns that customers were being mis-sold GAP policies, and may in some instances have bought a GAP product without being aware that they had done so”.
- Another of the three principals had identified similar issues through its own monitoring activity, but did not appear to have acted appropriately to address these issues.

Another weakness the regulator identified was where the training was heavily focused on product knowledge and the sales process, with no consideration of other important training needs such as understanding and recognising vulnerable customers and complaints.

## **Actions**

These shortcomings relate to rules and obligations that are clear and longstanding. Where the FCA has found material issues and potential breaches of the regulator's rules, it has taken timely actions to address the issues identified. In taking action, it has held principal firms to account for the issues identified, both those resulting from the principal's own actions or omissions and those arising from the shortcomings of their ARs.

To date, the FCA has taken the following early intervention actions in relation to five of the 15 principal firms and their ARs included within the review:

- agreed the imposition of 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.
- commissioned two section 166 skilled persons reports to consider and address the issues identified at two of the principal firms.

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

On 24 July, the regulator issued a 'Dear CEO' letter to the chief executive officers of relevant principal firms setting out the regulator's expectations and what actions the regulator expect them to take to address the issues raised in this report. This letter is included in Annex A of this briefing.

## **Next steps**

The FCA is sharing these findings with the sector so that other principal firms can consider to what extent these issues are relevant to their business and what changes they need to make as a result.

The regulator is also planning the following activities:

- planning to perform additional work with some of the firms in the wider survey sample who were not included in the regulator's more detailed work. This will focus on firms that are deemed to be higher risk and those where there were concerns regarding the quality of data submitted.
- continuing to work with the firms included from the detailed review. The FCA will provide individual feedback to these firms, setting out any actions required as a result the findings in order to address and resolve concerns. It will continue to use its range of regulatory tools and interventions, including the use of Enforcement powers, and are actively considering the need for customer redress in a number of cases.
- consider the need for further thematic or supervisory work, and expect that this will remain an area of supervisory focus.
- consider the need for other regulatory actions as a result of the findings of this report, including assessing whether there is a need for policy intervention or to adjust the regulator's approach to authorisations.
- engage actively with the sector to discuss how best to take these matters forward, including via engagement with relevant trade bodies.

## Expectations

The FCA expects principals to:

- be able to demonstrate that they consistently comply with their regulatory obligations to: consider the impact of ARs on their own business model and ability to meet threshold conditions;
- assess the solvency and suitability of their ARs;
- take reasonable steps to put in place an appropriate risk management framework to identify and manage the risks ARs present to their business;
- put in place compliant contractual arrangements with their ARs;
- have adequate controls over their ARs' regulated activities for which the principal has responsibility;
- have adequate resources in place to monitor and enforce compliance with the relevant requirements that apply to the regulated activities for which the principal is responsible; and
- to be able to demonstrate that they are consistently meeting the regulatory requirements so that their customers who receive products and services delivered by the ARs are consistently being treated fairly and receiving appropriate outcomes.

While this review was focused on the general insurance sector, the findings may also be applicable to principals and ARs operating in other sectors of the UK financial services industry. The FCA expects all principals to consider the findings in this report and to take appropriate action, where applicable, to address the issues that are relevant to them.

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**29 July 2016**

## Annex A: Dear CEO Letter (26 July 2016):

Dear CEO

FCA expectations of principal firms operating in the general insurance sector On the 22 July 2016 we published the results of our thematic review into the supervision by principal firms of their appointed representatives in the general insurance sector<sup>1</sup>. The report sets out our findings and the actions we expect firms to take to ensure that they meet their responsibilities as principals for their appointed representatives. Our review uncovered widespread shortcomings in principal firms' awareness and understanding of our rules and guidance and compliance with the requirements. This creates significant concern of material risks to consumers arising from the activities of appointed representatives operating in the general insurance sector.

### Our review found that:

- When considering the appointment of appointed representatives, many principal firms had not taken reasonable steps to assess their ability to oversee them effectively or put in place appropriate risk management frameworks to identify and manage the risks arising. This resulted in some appointed representatives conducting activities outside their principal's core areas of expertise where the principal lacked the ability or resources to oversee them effectively.
- Some principals had not assessed the solvency and suitability of their appointed representatives.
- Some principals had not put in place compliant contracts with their appointed representatives, which clearly set out what activities the appointed representatives were allowed to undertake.
- Many principals had not put in place appropriate control frameworks for the ongoing monitoring of their appointed representatives and to enforce compliance with relevant regulatory requirements. This was particularly relevant in relation to sales activities and treating customers fairly, where we saw numerous examples of poor practices and mis-selling.

To improve awareness, I am writing today to all principal firms operating in the general insurance sector. Given our significant concerns, we expect you to share this letter with your Board or equivalent, as we will consider these matters in any interactions with your firm.

### Responsibility of a firm for its appointed representatives

Our Handbook sets out the rules and guidance relating to appointed representatives and the continuing obligations of the principal firm. The main purpose of our rules and guidance is to place responsibility on the principal firm for seeking to ensure that its appointed representatives are fit and proper to deal with clients in its name, and to ensure that clients dealing with its appointed representatives are afforded the same level of protection as if they had dealt with the principal firm itself.

We place responsibility on the principal firm for the activities carried out by its appointed representative because an appointed representative is an exempt person carrying out regulated activities. The underlying legislation makes clear that: "The principal of an appointed representative is responsible, to the same extent as if the principal had expressly permitted it, for anything done or omitted by the representative in carrying on the business for which the principal has accepted responsibility."

We treat an act or omission of the appointed representative, in respect of the business for which the principal has accepted responsibility, as the act or omission of the principal itself<sup>4</sup>. Regardless of the supplementary commercial arrangements that may exist between the principal firm and the appointed representative, the principal has full responsibility (including for any liabilities that might arise) for ensuring that the appointed representative complies with our rules: a breach by the appointed representative is a breach by the principal firm. By way of example, where we identify examples of mis-selling within an appointed representative, it is the principal firm that we will contact in



the course of any regulatory intervention. The principal will also be responsible from a regulatory perspective for resolving any issues identified and ensuring that any customers who have suffered detriment receive appropriate redress. It would then be a matter for the principal firm whether to look to its contractual arrangements with the appointed representative to make any appropriate recovery.

We expect you to be aware of and to meet your obligations, and to comply with the rules set out in the Handbook, particularly Chapter 12 of the Supervision Manual (SUP), Principles for Businesses (PRIN), Senior Management Arrangements, Systems and Controls (SYSC), Threshold Conditions (COND), Insurance: Conducts of Business Sourcebook (ICOBS) and Client money: Insurance mediation activity (CASS 5). There is further guidance on our expectations of principal firms and appointed representatives both generally, and specifically in relation to insurance intermediaries, contained on our website.

### **Action required**

We expect you to consider the contents of the thematic report, and assess whether you can demonstrate how you are meeting our requirements in relation to your appointed representatives, as set out in our Handbook. You should ensure that you identify and address any shortcomings in your firm's risk management frameworks, processes and practices in relation to meeting your responsibilities and obligations for your appointed representatives.

Yours sincerely,

Simon Green

Director

General Insurance & Protection Supervision Division