

Financial Conduct Authority

August 2025 update:

This review is historical. See [What we publish](#) for more information and current views.



Thematic Review

TR16/6

# Principals and their appointed representatives in the general insurance sector



July 2016



# Contents

<b>1</b>	Executive summary	2
<b>2</b>	Our approach	8
<b>3</b>	Our findings	11
<b>4</b>	Our actions	30
<b>5</b>	Our expectations	31
<b>6</b>	Next steps	33
<b>Annex</b>		
<b>1</b>	Existing rules and guidance for principals	34

# 1.

## Executive summary

### Overview

- 1.1** The UK general insurance sector is a mature and competitive market providing a diverse range of products to customers using a variety of distribution methods. Insurance products can be sold directly to customers by insurers or distributed via intermediaries. General insurance mediation activities<sup>1</sup> are regulated activities in the UK, so firms undertaking these activities must be authorised or exempt.<sup>2</sup>
- 1.2** In the UK general insurance sector, there are approximately 400 insurers and 5,100 intermediaries that are directly authorised. 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.
- 1.3** ARs are exempt from the general prohibition<sup>3</sup> because they undertake regulated activities<sup>3</sup> under the supervision of an authorised firm acting as their 'principal'<sup>4</sup>. 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.<sup>5</sup> 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.
- 1.4** In our supervisory work, we 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. Additionally, our previous work on another element of general insurance distribution (TR 15/7 – Delegated authority: Outsourcing in the general insurance market)<sup>6</sup> found that firms did not always understand and meet their regulatory obligations. Consequently, one of the key priorities in our 2015/16 Business Plan<sup>7</sup> was to review the role of ARs in the distribution of general insurance products. We stated that we would consider the role and work of the principal firm in ensuring that it has robust systems and controls (supported by adequate resources) to select and oversee its ARs effectively, including their sales practices and provision of post-sale services.
- 1.5** We also wanted to assess the extent to which principals understood and complied with their regulatory responsibilities to their customers, where products and services were being delivered by their ARs. Critically, we wanted to see whether any shortcomings that we found were impacting customers, and whether they resulted in potential or actual customer detriment.

1 <https://www.handbook.fca.org.uk/handbook/glossary/G566.html>

2 SUP 12.2.1G

3 Section 19 of FSMA

4 Where the word "firm" is used throughout this report this should be read as "principal firm" as ARs are exempt and not considered a firm as defined in the Handbook

5 SUP12.3.1G

6 <http://www.fca.org.uk/your-fca/documents/thematic-reviews/tr15-07>

7 <http://www.fca.org.uk/static/channel-page/business-plan/business-plan-2015-16.html>

- 1.6** In carrying out this work, we assessed:
- whether principals had considered the impact of appointing ARs on their business and core activities and had taken reasonable steps to put in place appropriate risk management frameworks to enable them to manage the risks associated with appointing ARs, and
  - whether principals could demonstrate that they had adequate oversight and control over the activities of their ARs, and particularly over their sales activities, to enforce compliance with relevant requirements.
- 1.7** Our work addressed all phases of the relationship, from the initial selection and appointment of ARs, through set-up and contracting, to the ongoing oversight and termination of ARs.

### Our approach

---

- 1.8** We initially conducted an online survey of 190 principals operating a network<sup>8</sup> 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. These 190 principals were UK authorised general insurers and general insurance intermediaries; they reported that they had over 6,000 ARs with 75,000 individual representatives operating at 15,000 locations, selling over 10 million policies (predominantly to retail customers), and generating annual revenues of over £500 million.
- 1.9** We then selected a sample 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. We requested and reviewed further information from this sample of principal firms to enable us to gain greater insight into their businesses and the activities of their ARs.
- 1.10** Finally, we visited 14 principals<sup>9</sup> and 25 ARs. During these visits, we met with and interviewed senior management and staff, reviewed policies and procedures, contractual documentation (including terms of business agreements (TOBAs)), customer-facing documentation (including sales scripts) and customer files, and listened to sales calls.
- 1.11** This report sets out our findings and how they relate to the rules and guidance as set out in the Handbook and Financial Services and Markets Act 2000 (FSMA) requirements, with which authorised firms are required to comply. In particular, we considered Chapter 12 of the Supervision Manual (SUP); our 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); Training and Competence (TC); The Fit and Proper test for Approved Persons (FIT); and Statements of Principle and Code of Practice for Approved Persons (APER). In Annex 1, we have set out the key provisions in the Handbook relied upon in this review.<sup>10</sup>

---

<sup>8</sup> SUP 12.2.6G.

<sup>9</sup> One of the 15 principals voluntarily ceased its activities and left the general insurance market since our review commenced.

<sup>10</sup> Throughout the report, we have inserted footnote references to our Handbook. These footnotes are not intended to be an exhaustive list of our rules and guidance for a particular issue, and other Handbook rules and guidance may also be relevant depending on the circumstances.

## What we found

**1.12** The findings of our review fall under three main headings:

### Business models and risk management

**1.13** We considered principal firms' business models and risk management frameworks and found that almost half of the principals in our 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. This resulted in some ARs conducting activities outside their principal's core areas of expertise, where the principal lacked the ability or resources to oversee them effectively.

**1.14** These principal firms could not consistently demonstrate that they had met the regulatory requirements<sup>11</sup> 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

**1.15** In relation to governance and oversight, we found that over half of the 15 principals included within our 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. Some of these principal firms did not appear to have understood the full extent of their obligations for ensuring that their ARs complied with relevant regulatory requirements, particularly in relation to their sales activities.<sup>12</sup>

- When considering the appointment of new ARs, we found that 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.<sup>13</sup>
- At appointment stage and when contracting the relationship, we 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.<sup>14</sup> We saw examples of contracts that were not fully compliant with the relevant requirements<sup>15</sup> as well as shortcomings in categorising ARs, setting up multiple principal arrangements<sup>16</sup> and implementing the approved persons regime.<sup>17</sup>

11 SUP 12.4.2R; COND2.4; COND2.5; COND2.7; SYSC 3; SYSC 4.1.1R; SYSC 4.1.2AG; SYSC 4.1.10AG; SYSC 7.1.2AG; Principle 3.

12 SUP 12.4.2R; COND2.4; COND2.5; COND2.7; SYSC 3; SYSC 4.1.1R; 4.1.2AG; SYSC 4.1.10AG; SYSC 7.1.2AG; PRIN; ICOBS.

13 SUP 12.4.2R – SUP 12.4.5G; COND2.4; COND2.5; COND2.7; SYSC 4.1.1R; 4.1.2AG; SYSC 4.1.10AG; SYSC 7.1.2AG

14 SYSC 4.1.1R

15 SUP 12.5.

16 SUP 12.4.5A-G.

17 SUP 12.6.8G; SUP10A.1.16R.

- In relation to ongoing oversight, we found that 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.<sup>18</sup>

### Customer outcomes

- 1.16** A key 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.<sup>19</sup> However, in many of the principals in our sample, the shortcomings that were apparent 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 – notably the requirements of PRIN and ICOBS.
- 1.17** In a third of the principal firms, we saw examples of potential mis-selling and customer detriment as a result of ARs' actions, 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. At the ARs of one principal firm, there was significant evidence of the mis-selling leading to actual customer detriment, with some customers buying warranty insurance products under which they were clearly ineligible to claim as a result of poor sales practices and insufficient information being provided during many of the sales calls. We also saw potential customer detriment arising from shortcomings in some principals' understanding and application of the client money rules.<sup>20</sup>
- 1.18** Our more detailed findings are set out in Section 3 of this report.

### What concerns do we have?

- 1.19** 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. In five of the 14 firms, we identified material risks to customers arising from their poor practices, which left us with no alternative but to take early supervisory intervention actions to protect the interests of customers.
- 1.20** Our main concern is 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 in our review sold a wide range of products (including home, motor, travel, guaranteed asset Protection (GAP)<sup>21</sup>, 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. The role of the principal in providing an appropriate control framework is critical in ensuring these ARs sell insurance products in a compliant manner and deliver fair customer outcomes.

<sup>18</sup> SUP 12.4.2R; COND2.4; COND2.5; COND2.7; SYSC3; SYSC4.1.1R; SYSC 4.1.2AG; SYSC 4.1.10AG; SYSC7.1.2AG; PRIN; ICOBS.

<sup>19</sup> SUP 12.1.3G.

<sup>20</sup> CASS 5.

<sup>21</sup> <https://www.handbook.fca.org.uk/handbook/glossary/G3465g.html>

- 1.21** It should be noted that while practices were predominantly poor, the shortcomings that we identified were not universal across the sample of principal firms included in the review. A minority of principal firms within the sample had a good understanding of their ARs and were able to demonstrate how they effectively managed, monitored and mitigated the risks arising from their activities.

### Our actions

---

- 1.22** As set out above, we found significant shortcomings in the control and oversight of ARs by many of the principal firms included in our review. The resultant failings in the sales processes and practices of many of the ARs increased the risk of mis-selling and gave rise to instances of actual and potential customer detriment. These shortcomings relate to rules and obligations that are clear and longstanding, so where we have found material issues and potential breaches of our rules, we have taken timely actions to address the issues identified.
- 1.23** Thus far we have taken early intervention actions in relation to five of the 15 principal firms in our sample. These actions include agreeing the imposition of requirements on their regulatory permissions, asking principal firms to cease sales activities and commissioning two FSMA section 166 skilled persons reports to assess whether detriment has been suffered by customers from mis-selling and consider the adequacy of systems and controls. We are also considering the need for customer redress. In taking these actions, we have held principal firms accountable for the issues identified, both those resulting from their own actions and those arising from the activities undertaken by their ARs.
- 1.24** Please refer to section 4 of this report for further details of our actions taken.

### Our expectations

---

- 1.25** We expect principals to be able to demonstrate that they consistently comply with their regulatory obligations<sup>22</sup> 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, and
  - 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.

---

<sup>22</sup> Including, but not limited to: SUP 12.4.2R; COND2.4; COND2.5; COND2.7; SYSC3;SYSC 4.1.1R; 4.1.2 AG; SYSC 7.1.2AG; PRIN; ICOBS;



- 1.26** We note that the principal firm's regulatory obligations to control their ARs' activities are no less than for the principal's own activities, so we expect their controls and oversight to encompass all elements of the ARs' activities, including ensuring the sales activities are compliant with PRIN and ICOBS.
- 1.27** We expect principals 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.<sup>23</sup>
- 1.28** 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. We expect 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.
- 1.29** Our expectations of principal firms are set out in more detail in section 5 of this report.

### Next steps

---

- 1.30** We are sending a Dear CEO letter to the chief executive officers of principal firms with ARs operating in the general insurance sector, setting out our expectations and what actions we expect them to take to address the issues raised in this report.
- 1.31** We are sharing our findings with the sector and will continue to work with the principal firms included in our detailed review, to address and resolve the issues identified, using the full range of regulatory tools as appropriate.
- 1.32** We are planning to perform additional work with some of the principal firms in the wider survey sample that were not included in our more detailed work. This will focus on principal firms that we believe to be higher risk, as well as those about which we had concerns regarding the quality of data provided to us.
- 1.33** We will consider the need for further thematic or supervisory work, and expect that this will remain an area of supervisory focus.
- 1.34** We will 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 an adjustment of our approach to authorisations.
- 1.35** Our next steps are set out in more detail in section 6 of this report.

---

<sup>23</sup> Principle 6.

## 2. Our approach

### What was the scope of the review?

---

- 2.1** We set out to assess the following:
- Whether principals had considered the impact of appointing ARs on their business and core activities and had taken reasonable steps to put in place appropriate risk management frameworks to enable them to manage the risks associated with appointing ARs.
  - Whether principals could demonstrate that they had appropriate and effective governance and oversight, including adequate resources, policies and processes, for the selection, appointment, monitoring and termination of their ARs.
  - Whether principals had put in place appropriate policies and practices to ensure consistent and fair outcomes for customers. This included review of the sales practices, the controls in place for the protection of client money and the provision of post-sale activities by the ARs, to determine if they could give rise to any actual or potential customer detriment.
- 2.2** In undertaking the above assessments, we looked at whether principals fully understood their regulatory obligations and how these obligations were relevant and applicable to each of their individual ARs.

### How did we carry out our review?

---

- 2.3** We identified a sample of 190 principals that had a network<sup>24</sup> of ARs operating primarily in the general insurance market. We asked each principal to complete an online survey regarding their firm and their ARs, which requested information about their business model and size, AR activities, revenues, customer numbers, product types, sales methods, governance structures, and resources devoted to oversight and monitoring of their ARs.
- 2.4** In addition, we asked principals to submit existing information held by them for each of their ARs individually. We sought information on:
- revenue
  - sales methods
  - products sold

---

<sup>24</sup> Sup 12.2.6G.

- number of sites from which the AR operated
- number of individual representatives carrying out regulated activities on behalf of the AR
- multiple -principal arrangements, and
- complaints

**2.5** We then selected a sample of 15 principals for further review and analysis using the information provided and other available data. This was done using a risk-based approach to represent a diverse range of business models, products distributed, sales methods and sizes of AR networks.

**2.6** We then issued a further information request asking for more detailed information on the principals' arrangements relating to governance, risk management, compliance, contract management, remuneration and incentives, client money, and professional indemnity cover. This was to facilitate an in-depth desk-based analysis of the principal and its ARs, to help select which ARs to visit and to prepare for visits to the principals and selected ARs.

**2.7** Finally, we visited 14 principals and 25 ARs. During these visits, we met with and interviewed senior management and staff, reviewed policies and procedures, contractual documentation (including TOBAs), customer-facing documentation (including sales scripts) and customer files, and listened to sales calls.

**2.8** This allowed us to gain further insight into the principals' and ARs' business models, operations, governance and risk management structures, control frameworks and oversight arrangements in order to consider their effectiveness. We were also able to use the sales calls and customer files to assess whether the ARs were complying with relevant regulatory obligations to treat customers fairly, thus enabling customers to achieve fair outcomes.

**2.9** In performing our work, we assessed the 15 principals (and the activities of their ARs) against the rules and guidance as set out in the Handbook and against FSMA requirements, with which authorised firms are required to comply. In particular, we considered Chapter 12 of the Supervision Manual (SUP 12); our Principles for Businesses (PRIN); Senior Management Arrangements, Systems and Controls (SYSC); Threshold Conditions (COND); Insurance: Conducts of Business Sourcebook (ICOBS), Client money: insurance mediation activity (CASS 5); Training and Competence (TC); The Fit and Proper test for Approved Persons (FIT); and Statements of Principle and Code of Practice for Approved Persons (APER).

**2.10** We have set out in more detail the key elements of the Handbook that we have relied on in this review in Annex 1. We particularly noted the provisions of SUP12.4.2R, which are at the core of principals' obligations in respect of their ARs:

*'Before a firm appoints a person as an appointed representative .....and on a continuing basis, it must establish on reasonable grounds that:*

*1) the appointment does not prevent the firm from satisfying and continuing to satisfy the threshold conditions*

*2) the person*

*– is solvent*

*– is otherwise suitable to act for the firm in that capacity*

- *has no close links which would be likely to prevent the effective supervision of the person by the firm*

*3) the firm has adequate*

- *controls over the person's regulated activities for which the firm has responsibility (see SYSC 3.1 or SYSC 4.1)*
- *resources to monitor and enforce compliance by the person with the relevant requirements applying to the regulated activities for which the firm is responsible and with which the person is required to comply under its contract with the firm (see SUP 12.5.3 G (2))*

*4) the firm is ready and organised to comply with the other applicable requirements contained or referred to in this chapter.'*

**2.11** Additionally, throughout the report, we have inserted footnote references to our Handbook. These footnotes are not intended to be an exhaustive list of our rules and guidance for a particular issue, and other Handbook rules and guidance may also be relevant depending on the circumstances.

**2.12** The review focussed only on principals operating a network of ARs primarily in the general insurance sector and did not consider specifically either introducer appointed representatives (IARs) or the activities of ARs in other regulated sectors.

## 3. Our findings

**3.1** We report the main findings of our review under the following headings:

- Business model and risk management
- Governance and oversight
  - Due diligence and appointment
  - Set-up and contracting
  - Ongoing oversight and termination
- Customer outcomes

### **Business model and risk management**

---

**3.2** In performing our review, we assessed whether principals had considered the impact of appointing ARs on their business and core activities and had taken reasonable steps to put in place appropriate risk management frameworks to enable them to manage the risks associated with appointing ARs.

**3.3** In particular, we considered whether these principals could demonstrate that they:

- understood the nature, scale and complexity of the risks arising from the activities of their ARs and, in particular, the risks these activities presented to customers
- had appropriately assessed these risks when deciding to appoint ARs, and
- had taken reasonable steps to put in place an appropriate risk management framework to identify, assess and manage the risks their ARs presented to their business and to customers

These matters all directly relate to the regulatory requirements<sup>25</sup> for firms in relation to ARs set out within our Handbook – most notably within SUP 12, COND, SYSC and PRIN (see Annex 1).

**3.4** We found that half of the principals in the sample were unable to demonstrate that they had considered how their potential ARs' activities aligned to their existing activities or whether they had adequate resources to oversee these ARs and enforce compliance with the AR contract and regulatory requirements. In some cases, particularly where the AR activities contributed only a small proportion of the firm's total revenues, the decision to appoint ARs appeared to be

<sup>25</sup> SUP 12.4.2R; COND;SYSC 3; SYSC 4.1.1R; SYSC 4.1.2 AG;SYSC 4.1.10AG; SYSC 7.1.2AG; PRIN; ICOBS.

opportunistic rather than strategic, and the AR activities did not clearly align with the principal's business model, core activities and skillsets. In these scenarios the principals were often less able to oversee the ARs effectively as they lacked the resources or expertise to do so, creating additional risks for the ARs' customers.

- 3.5** The majority of the 15 principals were unable to demonstrate consistently that they had taken reasonable steps to ascertain how the appointment of ARs would impact their current business model and core activities, including whether they had adequate resources to oversee the AR and enforce compliance with the AR contract and regulatory requirements. These shortcomings generated significant risks for both the principals and customers, and we found that in many cases the principals did not appear to have recognised these risks or taken appropriate actions to manage them.
- 3.6** In some firms, the activities of the ARs were more clearly aligned to those of the principal, who therefore understood the risks that these activities presented. These firms were generally better able to demonstrate that the activities of their ARs met their risk appetite and that they had put in place adequate systems and controls to manage these activities.
- 3.7** The shortcomings that we identified in the business model and risk management framework manifested in several different scenarios.

#### **Diversification through ARs – Wholesale intermediaries becoming retailers**

- 3.8** Five firms in our sample acted primarily as wholesale insurance intermediaries (either Managing General Agents (MGAs) or wholesale brokers), distributing insurance products to customers through other authorised firms, including via delegated authority. Three of these firms had diversified from their core activities by taking on ARs who distributed retail products directly to customers (the other two firms already had some retail activities). These firms did not appear to have identified the additional sales risks that they were taking responsibility for, having regarded this as another way of delegating authority. They did not seem to understand that their ARs' activities were part of their own regulated activities or be capable of meeting their full regulatory responsibilities for ensuring that the sales made by the ARs were compliant.

#### **Examples 1 and 2**

One London market wholesale broker had appointed ARs selling warranty insurance via outbound calls. As the distribution of retail products was not a core business activity of this principal, they did not understand the risks that this activity presented and had not put in place appropriate policies and procedures to ensure the delivery of fair outcomes for customers. We saw evidence of mis-selling by a number of their ARs.

An MGA had appointed ARs involved in a variety of retail sales activities, including telephone sales of warranty and home emergency products. The distribution of retail products was not a core business activity of this principal and they did not fully understand either the regulatory framework around these sales activities or the risks involved. As a consequence of these shortcomings, we saw outsourced activities constituting unauthorised activity and evidence of mis-selling. The unauthorised activities included a third party making sales who was not exempt or authorised, and an AR making advised sales where this principal did not have permission to advise.

**Sustainability of model – Insufficient revenues to support controls**

- 3.9** The majority of firms in our sample did not appear to have adequately considered the full costs of operating a compliant AR network. These include the cost of putting in place appropriate systems and controls and appointing staff with the right skills to oversee and monitor the ARs. Some of these firms were unable to articulate or evidence a clear strategy and approach to the selection of ARs, and had not undertaken any cost benefit analysis when taking on ARs. In one case, the firm admitted that they had seen ARs as a ‘cash-free investment’, while another acknowledged that they had seen it as a way to ‘grow revenue without investing resources’. When we questioned firms about the level of oversight and costs, about around one-third accepted that if they increased the level of oversight to address the risks posed, they would find that it was not financially sustainable to have some or all of their ARs. Some of these firms were already seeking to reduce or rationalise their AR activities.

**Growth of network – Lack of resource, understanding and control**

- 3.10** Some of the firms within the sample had grown their AR networks rapidly and could not demonstrate that they had employed sufficient people with the appropriate skills, knowledge and expertise necessary to manage the risks that the growth in the network presented. Furthermore, some of the firms in our sample had altered or broadened their model as they had grown, which often led to additional risks, but had not made any changes to manage those risks; for example, by taking on new ARs with a different client or product base, or allowing some ARs to transact business without using a core system used by the principal’s other ARs.

**Example 3**

One firm operated as a product provider for retail products and as principal for a network of ARs distributing these products. In pursuit of rapid growth, the principal had appointed a variety of different businesses as ARs and did not fully understand how all of these ARs and related third parties were involved in distributing their products. This resulted in some parties performing sales activities that were not authorised or exempt, and were therefore not subject to effective oversight.

**Umbrella network – Acting as compliance consultant not principal**

- 3.11** Three of the principals in our sample operated an ‘umbrella’ network where the primary purpose of the business was to operate a network of ARs. This model is not inconsistent with our regulatory framework, but can create issues when a firm regards itself as primarily offering a compliance service to its ARs, rather than as an authorised firm owning all of the regulatory risks arising from its ARs’ activities. Within our sample, these principals did not always have full knowledge or control of the activities being performed by their ARs, so could not always show that they met their regulatory obligations to oversee these ARs, including mitigating the risks to customers.

**Example 4**

One principal had limited knowledge of the arrangements in place between its ARs and the insurers and MGAs who manufactured and supplied the insurance products sold by these ARs. This principal had not considered the terms of business agreements (TOBAs) with these insurers and MGAs, so was unable to assess whether there was client money (and to protect this as required) or to check that the terms of any risk transfer granted were being complied with.

### Governance and oversight

- 3.12** In our review, we considered whether each principal had put in place appropriate governance and systems and control frameworks to demonstrate control over its business activities, including those of its ARs. Our work assessed whether the controls in place were consistent with the nature, scale and complexity of the risks inherent in the business model and of the firm's activities, particularly those carried out by its ARs. Our work considered the initial appointment of ARs, the set-up and contracting of the relationship, and the ongoing oversight of their activities.<sup>26</sup>
- 3.13** We found that those principals in our sample who did not appear to fully recognise the risks that the appointment of ARs posed to their business had often failed to put in place appropriate governance and risk management frameworks for the appointment and ongoing monitoring of their ARs. Additionally, even where principals had a better understanding of the risks resulting from appointing ARs, there were often shortcomings in the way they implemented or operated their control frameworks.
- 3.14** In approximately half of the principals we reviewed, the shortcomings in governance and control we observed resulted in a material risk of customer detriment in some or all of their ARs, with a number of examples where this had already crystallised. These shortcomings manifested in all stages of the process of appointing and overseeing ARs.

### Due diligence and appointment

#### Selecting and appointing ARs – What will the AR do and can the principal control it?

- 3.15** We assessed whether principals had appropriate and effective policies and procedures, supported by adequate resources, for the selection and appointment of ARs.
- 3.16** Before a principal appoints an AR, it is required to reasonably establish that the appointment would not prevent it from satisfying certain conditions; these include threshold conditions and being able to exert effective control over the AR's activities.<sup>27</sup> The extent to which principals were able to demonstrate that they had done this varied widely. There are three core elements that need to be assessed when considering appointing ARs:
- impact on the principal
  - solvency and suitability of ARs, and
  - adequacy of controls and resources

#### Impact on the principal – Effect of ARs on wider business

- 3.17** Our rules require principals considering the appointment of new ARs to assess the impact on their own business. To do this, principals need to perform appropriate due diligence to fully understand the activities the AR would undertake and the level of risk this presents, both to the principal and to customers.
- 3.18** The majority of the principals in our sample could not evidence that they had appropriately considered the impact on their own business of taking on new ARs and had not established

<sup>26</sup> SUP 12.4.2R; SUP 12.6.11AR; COND;SYSC 3:SYSC 4.1.1R; SYSC 4.1.2 AG; SYSC4.1.10AG; SYSC 7.1.2AG ;PRIN; ICOBS.

<sup>27</sup> SUP 12.4.2R; SUP 12.6.11AR.



a risk-based approach for the appointment and ongoing monitoring of ARs. In many cases, they applied a 'one-size-fits-all' approach to appointment, without appropriate regard for the specific activities being performed by the AR and the resultant risks.

**3.19** Additionally, the level of due diligence performed by principals was in many cases relatively limited, and in some instances did not appear to meet the relevant regulatory requirements. We found that many of the principals had not assessed and documented the risks the ARs' proposed activities posed to the business. Below are some examples of areas which we found that principals had not addressed in their due diligence and appointment processes, nor considered whether they needed to make any changes to their control frameworks.

- The fit of ARs with the principal's own business model and activities.
- The type of products sold, the sales process and method of sale, and the needs of and risks to customers.
- The remuneration of the sales agents and any risks this created.
- The additional costs of appointing the AR.
- The experience and capabilities of the AR and its management.
- Conflicts of interest that could arise from the appointment of the AR (e.g. through close links).
- Availability of staff with the right skills to monitor and oversee the AR (and enforce compliance with the contract).
- Any relationship with parties in the value chain (e.g. insurer or product provider) that could prevent the principal from properly overseeing the AR.
- Their own experience, knowledge and operational capabilities.

**3.20** These areas all have a direct bearing on the ability of the principal to satisfy the threshold conditions, to have 'adequate controls over the person's regulated activities for which the firm has responsibility' and to 'monitor and enforce compliance with the relevant requirements applying to the regulated activities for which the firm is responsible'.<sup>28</sup> A failure to properly assess these matters in due diligence and appointment processes therefore creates real risks for both the principal (as it may result in regulatory breaches) and for customers purchasing products from the AR (because the principal with responsibility for the activity may not be able to control this activity effectively).

---

<sup>28</sup> SUP 12.4.2R

**Example 5**

A small London market wholesale intermediary with limited resources had appointed ARs whose activities spanned a wide range of products, distribution methods and customers. Some of these were aligned to the firm's own core activities whilst others were not. This firm had performed limited non-tailored due diligence work and was unable to evidence that it fully understood all of the different activities of each of its ARs. We identified additional activities and product lines in one of its ARs that the firm had not fully considered, with these activities giving rise to potential mis-selling to retail customers. The firm acknowledged that it had not understood the full range of activities this AR was undertaking and lacked the resources to oversee all of them effectively, so agreed to cease some of these activities immediately.

**Solvency and suitability of the AR**

- 3.21** SUP 12.4.3G and 12.4.4G provides guidance to principals regarding assessing the financial position and the suitability of an AR, including considering the solvency of the AR, whether the AR is fit and proper, and the fitness and propriety and financial standing of owners and managers of the AR.
- 3.22** We found that while most principals had carried out some basic checking prior to contracting with the AR, this was often a tick-box exercise considering solely narrow financial measures that provided no real understanding of the suitability of the AR. In some larger networks, where there were large numbers of existing ARs and frequent turnover of ARs, this exercise had not assessed all of the individual risks of the AR. Furthermore, even this basic checking was done only at appointment of a new AR and not on an ongoing basis.
- 3.23** In addition, we found that the assessment of the solvency and suitability of the AR was usually focused exclusively on the legal entity with little or no evidence of checks being undertaken on the owners or key senior management, either at appointment or on an ongoing basis.
- 3.24** These shortcomings in assessing the solvency and suitability of the AR and its senior management, both at appointment and on an ongoing basis, expose both the principal and the customers of the AR to significant risks.

**Adequacy of controls and resources – Assessment at appointment**

- 3.25** Before taking on an AR, the principal should also make an assessment of its own controls and resources to ensure that these will be adequate to monitor the AR and enforce compliance with regulatory obligations and its contract.<sup>29</sup> In the majority of the firms we reviewed, there was little or no evidence of any formal assessment of the adequacy of their own systems and controls and resources when deciding to appoint new ARs.
- 3.26** Approximately half of the firms within the sample did not appear to fully understand this requirement, and a similar number of firms acknowledged that they needed to devote additional resources to the oversight of their existing ARs, despite having appointed new ARs within the previous six months. We expect firms to ensure that they have adequate resources to oversee their existing ARs effectively before taking on additional ARs.

<sup>29</sup> SUP 12.4.2R (3); SUP 12.6.11AR.

### Set-up and contracting

---

**3.27** We assessed how effective principals were in setting up an appropriate operational framework for each AR at appointment, considering both regulatory and contractual issues, including those around multiple principal agreements. In the majority of principals in the sample, we found shortcomings in the set-up of the operational framework for the AR, with the main issues identified relating to contracting, categorising the activities of the AR, professional indemnity insurance (PII), approved persons, and multiple principal arrangements.

#### **Contracting – Were AR contracts compliant and effective?**

**3.28** In order for the AR appointment to be effective, the principal must enter into a written contract with the AR. Appropriate contracts accurately capture the nature and extent of the relationship between the principal and AR. They provide clarity on the responsibilities of each party and the regulated activities that the AR is allowed to undertake, facilitating effective supervision of the AR by the principal. They also contribute to an open and cooperative relationship between a regulated firm and the FCA (as required by PRIN).

SUP 12.5 of the Handbook sets out the required contract terms for all ARs. Below is a summary of the key requirements:

- The contract should clearly set out the activities that the AR is permitted to carry out.
- The terms should be designed to enable the principal to comply properly with any requirements or the limitations of its permission.
- The contract must ensure that the AR will cooperate with the FCA and allow access to the firm's auditors.
- The contract should allow the principal to terminate the contract in certain circumstances, (but termination should not be automatic).

**3.29** We found that the contractual arrangements put in place by some of the principals were not always fully compliant with our rules. In many cases, these contracts were generic and failed to appropriately capture the scope and nature of the activities being performed. Also, the contracts did not always include appropriate parameters and limitations around these activities. For example, many contracts did not detail the full range of regulated activities that the AR was carrying out on behalf of the principal or what the AR was not permitted to do. In some instances, this lack of clarity resulted in the AR conducting regulated activities that the principal had not intended to permit them to undertake.

**3.30** Contractual arrangements that do not fully reflect the relationship do not create a basis for effective ongoing oversight. Additionally, we saw a number of examples where, while the contract was appropriate, it had not been actively used as the basis for overseeing the AR relationship and activities.

**Example 6**

One principal in our review had amended a standard form TOBA to try to meet the relevant requirements set out in our Handbook, rather than preparing an AR contract properly reflecting both our requirements and the activities being performed. This agreement did not appear to appropriately meet some of the key requirements set out in the Handbook. This created a material risk that the AR was not properly appointed and was conducting regulated activities as an unauthorised firm, with the risks that entails for the principal, the AR, and the customers.

**AR activities – Appropriately categorised**

**3.31** We also found examples where the overall set-up of the AR relationship did not meet our requirements or was not consistent with the activities being performed. This included a number of cases we identified where IARs<sup>30</sup> (which were not a focus of our review) of principal firms within our review were performing a wider range of regulated activities than those permitted.<sup>31</sup>

**3.32** In some cases, this appeared to have arisen as a result of errors in appointing and setting up the AR. In other cases, this appeared to stem from shortcomings in the principal's understanding or application of the strict limitations around the activities that IARs are allowed to perform. Both of these issues were a cause for concern as they raised questions about either the competence or understanding of the principal, as well as their ability to effectively oversee the activities of their ARs.

**Multiple principal arrangements – Not always identified and agreed**

**3.33** An AR may operate under more than one principal but if it does so all the principals must enter into a written agreement (a multiple principal agreement).<sup>32</sup> This agreement should clearly set out which regulatory activities each principal has accepted responsibility for, as well as identifying the lead principal.<sup>33</sup>

**3.34** Our wider survey of 190 firms (with over 6,000 ARs) reported that 110 ARs had multiple principals. However, our analysis of the Financial Services Register showed that over 230 of these ARs had multiple principals. This suggests that for more than half of the ARs in our survey sample who had multiple principals, their principals may not have a valid multiple principal agreement in place. This was corroborated by one firm who noted that other firms were contracting with their ARs without first contacting them as the existing principal to understand the scope of their relationship with the AR, or to put in place a multiple principal agreement.

**3.35** A failure to put in place multiple principal agreements generates risks for both principals and customers. It creates a lack of clarity over who is responsible for each of the activities of the AR potentially leading to gaps in oversight and control, and a lack of clear ownership for any issues arising, including those resulting in customer detriment.

<sup>30</sup> <https://www.handbook.fca.org.uk/handbook/glossary/G584.html>

<sup>31</sup> IARs activities are limited to effecting introductions and distributing non-real time financial promotions.

<sup>32</sup> SUP 12.4.5BR; SUP12.4.5C

<sup>33</sup> SUP 12.4.5D

### Professional indemnity insurance (PII) – Appropriate cover for AR activities

- 3.36** MIPRU 3 requires insurance intermediaries to hold PII<sup>34</sup> against any liability that may arise as a result of the conduct of itself, its employees and its ARs.<sup>35</sup>
- 3.37** We reviewed the principals' PII policies and found that one of the 15 firms' policies did not explicitly provide cover for the conduct of their ARs as required by MIPRU 3.2.4R. In this case, the firm was not aware of this omission, which was a cause for concern given that this principal was an insurance intermediary.
- 3.38** Where firms do not put in place appropriate PII to cover all of their activities, this creates material risks for both the principal (potential regulatory breaches of MIPRU and COND) and customers of the AR, who would not receive the additional protection intended to be provided by this cover.

### Approved persons

- 3.39** Where an AR is appointed solely to distribute general insurance (or credit-related) products as an ancillary to its primary non-regulated activity (e.g. motor dealer ARs selling GAP insurance or travel agent ARs selling travel insurance), then the AR is only required to have one director as an approved person. Where this is not the case – for example, where the AR's primary or only activity is selling insurance – then all persons in the AR carrying out a controlled function must be approved.<sup>36</sup>
- 3.40** Approximately a quarter of the principals in our sample had appointed ARs whose primary or only activity was the distribution of general insurance. We found that almost all of the ARs to whom this was applicable had approval for one director only, evidencing that their principals had not ensured that they have the required approval for all persons carrying out a controlled function.

### Ongoing oversight and termination of ARs

- 3.41** We considered whether the principals within the sample could demonstrate that they had appropriate and effective governance and oversight, supported by adequate resources, for the ongoing monitoring of their ARs' activities, including at point of termination.
- 3.42** Our rules require principals to ensure that regulatory standards are met in relation to the regulated activities carried out by their ARs (which are acting on their behalf and for which they have accepted responsibility in writing) and to ensure the ongoing suitability and solvency of the AR. To enable the principal to effectively oversee their ARs, they need to have adequate resources including staff with the necessary skills, knowledge and expertise.<sup>37</sup>
- 3.43** Principals should establish a risk-based approach for ongoing monitoring of their ARs and the monitoring programme should be commensurate with the level of risk that each AR presents. It should consider the terms of the AR contract, ongoing suitability and solvency of the AR, product type, sales method, sales volumes, target market, and the number of sites and representatives involved in the AR's activities.<sup>38</sup>

<sup>34</sup> We are currently conducting a review of PII for general insurance intermediaries.

<sup>35</sup> MIPRU 3.2.4R

<sup>36</sup> SUP12.6.8G(2); SUP10A.1.16R

<sup>37</sup> SUP12.4.2R; SUP 12.6; COND; SYSC 5.1.1R.

<sup>38</sup> SUP 12.4.2R; SUP 12.6.11AR; COND; SYSC 3; SYSC 4.1.1R; SYSC 4.1.2 AG; SYSC 4SYSC4.1.10AG; SYSC 7.1.2AG; PRIN; ICOBS.

- 3.44** Where principals have adequate resources and appropriate monitoring, this is more likely to enable them to identify shortcomings at their ARs and to take ownership for actions to correct these, helping to ensure that customers are treated fairly and any remedial activity is performed.
- 3.45** We found that the majority of principals in our sample were unable to demonstrate and evidence that they had consistently exercised adequate control over their ARs' activities. The main reasons for shortcomings in oversight were the failure to identify the risks that each of their ARs presented, a lack of resource and the absence of appropriate risk-based monitoring.
- 3.46** We saw a wide range of different examples of shortcomings in oversight within the sample of firms we reviewed.

#### **Adequate resources – Lack of skilled and independent resource**

- 3.47** We found that the majority of the 15 principals did not have adequate resources to effectively monitor and oversee the activities of their ARs and enforce compliance with the contract. These firms often lacked sufficient staff with the necessary skills, knowledge and expertise, and we found that many individuals with responsibility for the appointment and monitoring of ARs had little or no regulatory knowledge or training. Additionally, there was frequently a lack of clear policies and procedures to provide guidance to these individuals and insufficient support to enable them to perform their oversight role effectively.
- 3.48** Approximately half of the principals failed to separate ongoing monitoring from the management of the commercial relationship with their ARs, who were often regarded primarily as a client rather than as an AR performing regulated activities. In some cases, the same person was responsible both for ensuring that the AR complied with their regulatory obligations and for managing and developing the commercial relationship, creating a potential conflict of interest.

#### **Example 7**

An intermediary was introduced to a number of warranty ARs (previously with another principal) by a third party individual. The intermediary decided to appoint these ARs (who all sold their products via outbound sales calls) and the individual was employed to manage these ARs. Responsibility for appointment and monitoring procedures was given to this individual who had introduced the ARs and who was incentivised based on business volumes produced by these ARs. The individual was also responsible for the due diligence performed on additional, similar ARs, added to the firm's network at a later date. The firm was unable to provide evidence of appropriate due diligence and effective ongoing monitoring of these ARs, and had failed to identify and manage the conflicts of interest arising in the individual's role. We identified significant shortcomings in the oversight of these ARs, including a failure to identify and address customer detriment arising from mis-selling.

**Example 8**

Another wholesale intermediary relied on one of its ARs to monitor the activities of some of its other ARs. In this instance, the principal had not performed appropriate quality assurance on the work undertaken and had not identified or taken steps to manage the potential conflicts of interest given that these ARs had common ownership or aligned interests.

- 3.49** We also found that about half of the principals in our sample could not demonstrate that they had considered the adequacy of their resources as their AR networks grew in size or complexity.

**Example 9**

One intermediary with a network of retail ARs had only one person allocated on a part-time basis to overseeing a network of over 50 ARs operating at 172 locations with 2,761 individual representatives. We saw significant shortcomings in the oversight of this network with a lack of appropriate resources and MI to monitor compliance and customer outcomes. This resulted in the issue of incorrect customer documents and some independent representatives inadvertently operating outside the regulatory perimeter as they were neither authorised nor exempt.

**Monitoring framework – Risk-based and comprehensive?**

- 3.50** We found that all of the firms in the sample had recognised the need to have some form of monitoring in place, but the effectiveness of the monitoring frameworks and activities varied widely. Over half of the firms in the sample could not demonstrate that they had considered the relative risks posed by the different ARs in their networks, and applied a ‘one-size-fits-all’ monitoring programme that did not vary according to risk.<sup>39</sup>
- 3.51** We found that many firms focused their monitoring on the training and compliance of the individual representatives/sales agent and did not have effective processes in place to monitor<sup>40</sup>:
- whether the AR and its senior management continued to be fit and proper
  - the financial position of the AR (on at least an annual basis)
  - the quality of the sales process (e.g. through file reviews or observed sales)
  - the quality of advice given to customers (if applicable)
  - key performance indicators
  - reward and incentives policies and any conflicts of interest, and
  - compliance with the terms and restrictions set out in the AR’s contract.

<sup>39</sup> SUP 12.6.7G; SYSC 3; SYSC 4.1.1R; SYSC4.1.2AG; SYSC4.1.10A.

<sup>40</sup> SUP 12.4.2R; SUP 12.4.4G; SUP 12.6.1R; SUP 12SUP12.6.2–4G; SUP 12SUP12.6.11AR; COND 2.5; PRIN; ICOBS.

- 3.52** Our review found that the monitoring undertaken by the majority of the firms in our sample was not sufficient to appropriately identify areas of potential customer detriment, including mis-selling. Furthermore, we saw instances where issues were identified but no appropriate action was taken. This appeared to be due to either a failure to understand the significance of the issues identified, a lack of appropriate resources to address the concerns, or a reluctance (due to an imbalance of power<sup>41</sup>) to challenge the actions of the AR.
- 3.53** We found that many of the firms in our sample relied on IT systems with clearly defined processes and procedures as the primary means to control certain activities of their ARs. These systems were often helpful in providing a clear sales process and an appropriate audit trail, but in some cases these firms placed undue reliance on the systems' controls and performed limited other oversight of the ARs. This was despite material risks remaining that were not clearly addressed by the system (such as mis-selling by deviating from the appropriate script or process).
- 3.54** We also saw principals appoint ARs whose activities were not consistent with their other ARs, or allow certain ARs to operate outside of the normal systems or use the system in a different way. This resulted in the principal being less able to demonstrate appropriately adjusted controls for these ARs, creating additional risks for them and the ARs' customers.<sup>42</sup>

#### Examples 10 and 11

Three of the principals within our sample were involved in the sale of GAP and other motor-related insurances via ARs. All of these principals provided systems that their ARs were required to use. However, there was a lack of appropriate additional monitoring around the sales processes and activity. In one of the ARs that we reviewed, we found evidence of mis-selling or inconsistent signature records within customer documentation. This was identified by our testing, but the principal involved was not previously aware of these issues. This demonstrated that reliance on system controls only, without carrying out sufficient supporting monitoring work, can expose both principals and customers to a material risk of mis-selling.

Another principal, which was acting as an umbrella for a network of broker ARs, required the large majority of these ARs to transact business using its core broking system, which provided an audit trail of the actions taken that the principal could use to monitor its ARs activities. This principal had also appointed some ARs whose business activities could not be efficiently and effectively transacted using the same system and processes. This principal was much less able to demonstrate its control and oversight of these business activities, and had not made adjustments to its monitoring activity to reflect these increased risks. Additionally, we had concerns about inconsistent use of the system, process work-arounds and the use of non-approved versions of key sales documentation, which the principal either was not aware of or tolerated.

As result, customers were not always given appropriate information to make an informed decision, or bought products that may not be suitable for their needs or under which they were ineligible to make a claim.

<sup>41</sup> See paragraph 3.59.

<sup>42</sup> COND 2.7.11.



### Monitoring – Collection and use of MI

- 3.55** Appropriate management information (MI) can play a key role in enabling principals to identify trends and issues, and to manage risks to the network, its ARs and its customers.<sup>43</sup> This is particularly important where there are a large numbers of ARs and the principal is trying to take a risk-based approach to monitoring, as good MI can help allow them to focus their work on key risk areas.
- 3.56** We found that the majority of principals in our sample did not have adequate and appropriate MI to enable them to identify key risks and trends within their AR network. They were therefore unable to take timely action to mitigate problems as they arose, or to assess the effectiveness of the actions taken to address issues.
- 3.57** Many ARs used sales targets and incentives. We found that most principals within the sample did not have MI in relation to these arrangements and their impact upon sales. This lack of appropriate MI and the absence of regular review and monitoring meant that many of these incentive arrangements created the risk of unfair treatment of customers. This risk was exacerbated where principals firms did not have appropriate and complete MI on complaints and claims received by their ARs, thereby restricting their ability to assess whether their customers were achieving fair outcomes.

### Monitoring – Financial assessments, visits and feedback

- 3.58** Our wider survey of 190 principals showed that approximately 10% of their ARs (650) had not had a financial assessment carried out within the previous year. Additionally, these principals had over 6,000 ARs at 15,000 sites but according to the data submitted, principals had conducted only 1,360 compliance visits in the previous financial year.
- 3.59** The limited extent of the checks and visits undertaken results in significant risks for principals, ARs and customers. In addition, a large number of principals could not show that they had provided appropriate feedback or set out actions to their ARs following a monitoring visit where issues had been identified.

#### Example 12

A principal firm submitted to us an AR audit undertaken by the relevant insurer as evidence of monitoring of its ARs, because it had no evidence of its own monitoring activity. We found that the principal had failed to take any actions to ensure that the AR had implemented the recommendations of the audit report, which was designed to address serious concerns around the AR's sales practices and processes in selling products to retail customers. We found evidence of mis-selling within this AR, some of which could have been prevented or limited if the principal had either performed appropriate monitoring itself or acted upon the findings of the insurer's audit.

<sup>43</sup> SYSC 3; SYSC4.1.1R; SYSC4.1.10AG.

**Imbalance in relationship – Ability to challenge and oversee ARs**

- 3.60** One of the key issues we identified, which was relevant to approximately half of the principals, was an imbalance in the AR relationship, often where the AR was a larger entity that owned the customer relationship. In some of these cases, the ARs were able to dictate the terms of the engagement with the principal in a way that raised material doubts about the ability of the principal to effectively oversee the conduct of the AR. The nature of such a relationship creates tension with the fact that it is the principal that holds the permission for performing regulated activities and is therefore responsible for ensuring that its ARs' activities are compliant.
- 3.61** This was particularly relevant where the ARs were retail entities whose main focus was not on regulated activities, especially where their revenues and resources were much greater than those of the principal. This was also a concern in some instances where the AR appeared to have been appointed as part of a wider distribution arrangement, without any consideration of the additional risks posed to the principal, by accepting responsibility for the sales activities.

**Example 13**

A principal with a network of motor dealer ARs had identified instances of mis-selling within one of these ARs, including an example where customer documentation had been falsified. When this was discovered the principal had not ensured that the employee involved was subject to appropriate disciplinary and remedial measures as the AR objected to this action. Additionally, the principal did not undertake or oversee the process of contacting relevant customers and assessing the need for remedial actions or redress, with this work undertaken by the AR.

**Training and competence**

- 3.62** For the majority of the principals within our sample, training and competence of the sales agents was regarded as important and was an area of focus for the principal, but the quality of training and competence regimes across principals and their AR networks varied widely. In one particular case, we saw a very effective training and competence regime, with significant evidence collated to show that this was delivering the intended outcomes for customers. However, while other principals stated that training was a priority for them, the majority of them either did not assess competence or did not consider whether the training was implemented in practice and was delivering fair customer outcomes.
- 3.63** Another weakness we 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. In some instances, the training also seemed to focus predominantly on using the systems and processes to maximise sales rather than training staff with regard to customer outcomes and the risks around mis-selling.

**Example 14**

One principal had put in place a comprehensive training and competence regime for their ARs, who sold retail general insurance products face-to-face and over the phone to a range of customers, some of whom might be vulnerable. This firm's training was broad and paid appropriate regard to the full range of risks and issues presented by the sales activities and other services being delivered. This training and competence regime was supported by ongoing monitoring of competence delivered via a range of methods.

**Termination of AR relationship**

- 3.64** AR contracts should provide principals with the right to terminate the agreement in certain situations, including where the principal has reasonable grounds to be concerned over the suitability of its AR but is unable to rectify the issue. Termination should not, however, be automatic<sup>44</sup>, as principals need to take appropriate steps to mitigate any risks to customers. The principal is responsible for ensuring that outstanding regulated activities and obligations to customers are properly completed and fulfilled, and that customers are informed of any relevant changes.<sup>45</sup>
- 3.65** Some principal firms notified us when an AR's appointment was terminated but did not always do so within the specified time period.<sup>46</sup> Additionally, we found that a number of principals did not understand their ongoing obligations<sup>47</sup> to customers when an AR's appointment was terminated, and were unable to explain how they would be able to meet these obligations. Approximately half of the principals we reviewed did not have access to the complete records of all of their ARs (including customer records), and in the event of termination might be unable to ensure that outstanding regulated activities and obligations to customers were properly completed and fulfilled.

**Example 15**

During our review, one principal became aware of significant problems, including mis-selling to retail customers, by some of its ARs. The principal initially sought an immediate termination of its ARs' appointment despite the fact that it did not have full access to the records of the ARs or the ability to deliver the relevant products and services to the retail customers in accordance with its obligation as principal. The firm and its senior management did not appear to understand the full extent of their ongoing responsibilities to the firm's customers.

44 SUP 12.5.4G; SUP12.6.1R (2.)

45 SUP 12.8.3R.

46 SUP 12.8.1R.

47 SUP 12.8.3R; SUP12.8.4--5G.

### Customer outcomes

- 3.66** A key 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 are therefore no less likely to receive fair outcomes) as if they were purchasing products from the authorised firm itself.<sup>48</sup> Customer outcomes were therefore a core focus of our review of principal firms' systems and controls.
- 3.67** We assessed whether principals had put in place policies and practices with adequate resources to ensure the consistent delivery of fair outcomes for customers.<sup>49</sup> This included a review of the controls in place around the sales practices, the provision of post-sale activities, and the protection of client money within the principal and its ARs to determine if these mitigated the risk of actual or potential customer detriment.
- 3.68** We expect all firms to be able to consistently show that fair outcomes for their customers are at the heart of their business.<sup>50</sup> However, our work revealed that the majority of principals in our sample were not able to demonstrate that customers of their ARs were consistently receiving fair outcomes, as they had not put in place adequate systems and controls to ensure this was the case. In almost half of the principals within the sample, we saw evidence of shortcomings in processes and controls that gave rise to material risks of customer detriment. In four of the firms, we saw crystallised examples of mis-selling, unauthorised business, or other customer detriment.
- 3.69** The shortcomings we found in a principal's controls and ARs' practices created most risk of customer detriment where they related to sales activities or the protection of client money.

### Sales activity – Understanding and control of AR sales practices

- 3.70** We found that most of the principals in our sample did not consistently exercise effective oversight and control of their ARs sales practices. Our 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 we found had not previously been identified by the principal.
- 3.71** In some cases, the principal firms did not appear to realise the extent of their regulatory responsibilities for the sales activities of their ARs. The principal is as responsible for the regulated sales (and any mis-selling) of its ARs as they are for sales made by their own employees. We found examples of ARs selling products that their principal had no experience of selling and where none of the approved persons at the principal firm (including those with responsibility for insurance mediation activities) could offer any insight into these activities. In a number of cases, the principal's approved persons were unable to explain the basis of their confidence in the AR's ability to sell products in a compliant manner.

### Post-sales activities

- 3.72** We found that less than a quarter of the principals could evidence that they had put in place appropriate processes for assessing outcomes for customers, supported by complaints and claims MI, to identify issues and perform root cause analysis. As a result, these principals were better able to demonstrate that they had made changes to sales processes, products, complaints handling and claims handling, to improve customer outcomes.

<sup>48</sup> SUP 12.1.3G.

<sup>49</sup> SUP 12.4.2R; COND2.4; COND2.5; COND2.7; SYSC 3; SYSC4.1.1R; 4.1.2AG; SYSC 4.1.10AG; SYSC7.1.2AG; PRIN; ICOBS; CASS 5.

<sup>50</sup> Principle 6.

- 3.73** All of the principals we visited had a formal complaints procedure, however the majority did not have effective processes and MI to consistently identify, record and monitor complaints. In addition, in many cases, complaints about the product itself and claims handling were dealt with by the product provider or underwriter. In these cases, the principal did not have any MI on these claims and complaints to understand whether its customers were receiving fair outcomes.

#### **Example 16**

The approved person at one AR admitted that our planned visit had prompted a review of its complaints procedure. He stated that prior to this, the staff would not have understood how to identify an expression of dissatisfaction or the need to record it. The AR revised the procedure and, as a result, the number of complaints recorded and those referred to its principal had risen substantially.

#### **Client money and risk transfer**

- 3.74** In almost half of the principals in the sample, we found shortcomings in the understanding of the arrangements required to operate risk transfer effectively or provide adequate protection for client money. In addition to the rules set out in CASS 5, there is a guide (issued by the FSA) on our website relating to the protection of client money for insurance intermediaries, including a chapter on its application to firms with ARs<sup>51</sup>, so the shortcomings we found in this regard are concerning.
- 3.75** Many of the agency agreements and TOBAs between the principal and the insurers provided for risk transfer to the principal (i.e. gave authority to the principal to hold money as agent) but some prohibited this authority being extended (delegated further) to sub-agents (which would include ARs). As a result, several principals, through their ARs, were neither holding money as agents of the insurer nor following the rules in CASS 5 regarding periodic segregation and reconciliation.<sup>52</sup> This has the effect of putting the principal in breach of the CASS rules.
- 3.76** In a third of the principals, we saw examples of TOBAs agreed directly between an AR and the MGA or insurer supplying the product, where the principal was not directly involved in the distribution chain. In some of these cases, we found that the principal had not reviewed these TOBAs, but was nevertheless operating on the assumption that all monies were covered by a risk transfer arrangement. Such working assumptions, unverified by reference to the governing risk transfer agreement, create the risk that the arrangements may give rise to client money that is not subject to appropriate protection.

#### **Products and distribution methods – Areas of additional risk**

- 3.77** We found significant shortcomings when we reviewed some principal and ARs' sales processes and practices for three products: warranty insurance, travel insurance and GAP. These shortcomings related to factors including consideration of the target market (including risks around vulnerable customers), sales scripts, sales processes and sales practices.
- Warranty insurance products – Mis-selling and customer detriment**
- 3.78** Two of the principals in our 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

<sup>51</sup> <https://fca.org.uk/static/fca/documents/fsa-client-money-guide.pdf>

<sup>52</sup> SUP12.6.5R; CASS5.5.18R; CASS5.5.23R.

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.

### Example 17

Our review of sales processes and calls identified serious failings at two principals that sold warranty products through their ARs including:

- Sales scripts used by the ARs of both principals were found to be non-compliant.
- At one AR, all sales calls made in the previous two months were non-compliant due to key sections of the script (which had been automated using a pre-recorded message) not being delivered, as the recorded message had not been working. Additionally, the approved person at this AR did not know whether the sale was advised or non-advised, and we found examples of calls where agents appeared to make recommendations, even though the principal did not have regulatory permission to provide advice.
- In some cases, the sales agents were not using the script appropriately and did not provide the customer with appropriate information about the product to make an informed decision. There were some examples where they made false and inaccurate representations about the product or did not disclose the key exclusions.
- The sales agents at some of these ARs routinely mis-represented themselves by claiming to be (or creating the impression of being) from the firm that initially sold the appliance to the customer.
- The target market and potential need for the product was not always clearly identified. In one case, the data purchased simply showed that the customer owned a television set but the AR was targeting the customers to sell them satellite box and dish warranty insurance products.
- The sales calls made by the ARs of one of these principals were sometimes pressurised and did not seek appropriate consent from potentially vulnerable customers.

These serious failings resulted in examples of actual mis-selling and customer detriment.

### Travel insurance

- 3.79** Some ARs within the review sold travel insurance to customers with pre-existing medical conditions 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 pre-existing medical condition, the customer was expected to contact another party separately. In some cases, the principal had no process in place for identifying customers with pre-existing medical conditions 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 pre-existing medical conditions. In one firm, this risk had crystallised for one of their customers but the firm had not made any changes to its business

practices as a result of this. It is not clear how processes that result in products being sold to customers who may be ineligible to claim are consistent with the firm's regulatory obligations.<sup>53</sup>

### **Guaranteed asset protection (GAP)**

- 3.80** In September 2015, we implemented product specific rules regarding GAP products, including deferred opt-in (ICOBS 6A.1.6 R). The three principals in our sample with ARs selling GAP had put in place controls and processes to comply with the rule changes. However, we found that these controls were not consistently effective within the principals and ARs.
- 3.81** Our review of files 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 our 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.

<sup>53</sup> ICOBS 5.1; ICOBS 6.1.5R; ICOBS 6.16G; ICOBS 6ICOBS6.1.7G.

## 4. Our actions

- 4.1** As set out above, we found significant shortcomings in the control and oversight of ARs by many of the principal firms included in our review. The resultant failings in the sales processes and practices of many of the ARs increased the risk of mis-selling and gave rise to instances of actual and potential customer detriment.
- 4.2** These shortcomings relate to rules and obligations that are clear and longstanding, so where we have found material issues and potential breaches of our rules, we have taken timely actions to address the issues identified. In taking action, we have held principal firms to account for the issues we have identified, both those resulting from the principal's own actions or omissions and those arising from the shortcomings of their ARs.
- 4.3** To date, we have taken the following early intervention actions in relation to five of the 15 principal firms and their ARs included within the review:
- We have 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.
  - We have 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 of the principal firms.
- 4.4** One principal has ceased its activities and left the general insurance sector since our review commenced.



## 5. Our expectations

- 5.1** We expect principals to be able to demonstrate that they consistently comply with their regulatory obligations<sup>54</sup> 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 firm has responsibility
  - have adequate resources in place to monitor and enforce compliance with the relevant requirements applying to the regulated activities for which the firm is responsible
  - ensure that the ARs are fit and proper to deal with customers in their name, and
  - ensure that customers dealing with the ARs are afforded the same level of protection as if they had dealt with the firm itself.
- 5.2** In due diligence and at appointment, when assessing the solvency and suitability of the AR, the principal needs to consider the owners, directors and managers, as well as the entity itself. We also expect the firm to also establish whether the AR has multiple principals and ensure that an appropriate agreement is put in place where *required*.
- 5.3** When establishing contractual arrangements with its AR, the principal must ensure that these clearly set out the scope of the activities permitted and provide a suitable basis for effective oversight.
- 5.4** In order to put in place adequate controls (including in relation to their ARs), we expect firms to assess the nature, scale and complexity of the business, the diversity of its operations (including geographical diversity), the volume and size of its transactions, and the degree of risk associated with each area of its operation.<sup>55</sup>
- 5.5** We note that the principal firm's regulatory obligations to control the activities of its ARs are no less than for the firm's own activities, so we expect their controls and oversight to encompass

<sup>54</sup> Including, but not limited to, SUP 12.4.2R; COND2.4; COND2.5; COND2.7; SYSC 3; SYSC 4.1.1R; 4.1.2 AG; ; SYSC 7.1.2AG; ;PRIN; ICOBS.;

<sup>55</sup> SYSC 3; SYSC 4.1.1R; 4.1.2 AG; SYSC 7.1.2AG

all elements of the ARs' activities, including ensuring that the ARs' sales activities are compliant with PRIN and ICOBS.

- 5.6** We expect principals to be able to demonstrate that they are consistently meeting these requirements so that their customers who receive products and services delivered by the ARs are being treated fairly, buying products appropriate to their needs and requirements, and receiving fair outcomes.<sup>56</sup>
- 5.7** 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. We expect 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.

---

<sup>56</sup> Principle 6.

## 6. Next steps

- 6.1** We are sending a 'Dear CEO' letter to the chief executive officers of relevant principal firms setting out our expectations and what actions we expect them to take to address the issues raised in this report.
- 6.2** We are 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.
- 6.3** We are planning to perform additional work with some of the firms in the wider survey sample who were not included in our more detailed work. This will focus on firms that we believe to be higher risk and those where we had concerns regarding the quality of data provided to us.
- 6.4** We are continuing to work with the firms included in our detailed review. We will provide individual feedback to these firms, setting out any actions required as a result of our findings in order to address and resolve our concerns. We will continue to use our range of regulatory tools and interventions, including the use of our Enforcement powers, and are actively considering the need for customer redress in a number of cases.
- 6.5** We will consider the need for further thematic or supervisory work, and expect that this will remain an area of supervisory focus.
- 6.6** We will 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 our approach to authorisations.
- 6.7** We will engage actively with the sector to discuss how best to take these matters forward, including via engagement with relevant trade bodies.

# Annex 1

## Existing rules and guidance for principals

FSMA and our Handbook rules supplemented by guidance, set out the extent of the obligations to which firms are subject.

We have set out the key requirements applicable to principals and their ARs. These are not intended to be an exhaustive list of regulatory and legal obligations, and other regulatory and legal obligations may also be relevant depending on the circumstances.

1. Sections 19 and 39 of the Financial Services Markets Act 2000 (FSMA)
2. The Supervision Manual (SUP) – in particular, SUP 10A and SUP 12
3. Principles for Businesses (PRIN)
4. Senior Management Arrangements, Systems and Controls (SYSC)
5. Threshold Conditions (COND)
6. Statements of Principle and Code of Practice for Approved Persons (APER)
7. The Fit and Proper test for Approved Persons (FIT).
8. Training and Competence (TC)
9. General Provisions (GEN)
10. Prudential Sourcebook for Mortgage and Home Finance Firms, and Insurance Intermediaries (MIPRU)
11. Insurance: Conduct of Business Sourcebook (ICOBS)
12. Client Assets (CASS)
13. Dispute Resolution: Complaints (DISP)

### **The general prohibitions under the FSMA: exemption from the need to be authorised**

- 1.1 There is a general prohibition that a person may not carry out a regulated activity in the UK – or purport to do so – without being an authorised person or otherwise exempt.<sup>57</sup> An AR acts

<sup>57</sup> S19 FSMA 2000.

as agent of an authorised principal and, as a result of section 39 of the FSMA, is exempt from the need for authorisation.

- 1.2** Any firm or person can be an AR provided he is not authorised, and he must enter into a contract with an authorised principal. He will then be an exempt person in respect of any regulated activity conducted by that business for which his principal has accepted responsibility in writing, providing certain conditions are met.<sup>58</sup>
- 1.3** An AR may only act within the confines of its principal's Part A permissions<sup>59</sup>; if it wishes to carry out regulated activities outside this scope, it must become authorised in its own right for all regulated activities that it wants to undertake, as it cannot be authorised in respect of some activities and exempt for others.

### SUP 10A

---

- 1.4** The rules in SUP 10A<sup>60</sup> require ARs carrying out regulated activities in relation to general insurance business to apply the FCA approved persons regime in respect of the FCA's governing functions only. This means that anyone who is appointed to hold a governing function in the AR (director, non-executive director, partner, CEO) must be approved by the FCA. The exception to this, is where the AR's principal purpose is to carry out activities other than regulated activities (i.e. regulated activities are secondary to the principal purpose of the business: e.g. a motor dealer selling a GAP product), then the AR needs to have only one person appointed to a governing function to be an FCA approved person.

### SUP 12

---

- 1.5** SUP 12 gives guidance (on how the provisions of section 39 of the FSMA works) to a firm that is considering appointing an AR, including the conditions that must be satisfied for a person to be appointed as an AR, and on the implications for the principal of appointing an AR.
- 1.6** It also sets out the FCA's rules, and guidance on these rules, that apply to a firm before it appoints, when it appoints, and when it has appointed an AR. The main purpose of these rules is to make the principal responsible for ensuring that the AR is fit and proper to deal with clients in its name, and to ensure that clients dealing with the AR have the same level of protection as if they had dealt with the firm itself.<sup>61</sup>

### SUP 12 : Responsibility

---

- 1.7** The principal provision, reflecting the primary legislation, is that the firm is responsible, to the same extent as if it had expressly permitted it, for anything that the AR does or omits to do in carrying on the business for which the firm has accepted responsibility.<sup>62</sup>

<sup>58</sup> S.39(2) FSMA 2000; S.39(1) FSMA 2000; FSMA 2000 (ARs) Regulations 2001 (SI 2001/1217); SUP 12.2.2 G (2.)

<sup>59</sup> SUP 12.4.1A G.

<sup>60</sup> SUP 10A.1.15R; SUP 10A.1.16R.

<sup>61</sup> SUP 12.1.3 G.

<sup>62</sup> SUP 12.3.1G; SUP 12.3.2 G

## SUP 12: Appointment and continuing obligations

- 1.8** SUP 12 sets out the responsibilities of principals and provides guidance regarding how to manage the risks posed by ARs to the principal and to the regulatory structure. A principal is required to establish on reasonable grounds – before appointing an AR and on an ongoing basis – that it has given due consideration to the impact of the appointment on itself, and that the AR meets, and continues to meet, certain conditions.
- 1.9** The principal must consider the impact on itself, and on a continuing basis establish that:
- the appointment will not prevent itself from satisfying the Threshold Conditions (particularly those relating to adequate resources, suitability and business model, and including an analysis of any close links with its ARs)<sup>63</sup>;
  - it has/ will have adequate controls over the AR's activities<sup>64</sup>; and
  - it has/ will have adequate resources to monitor and enforce compliance by the AR with relevant requirements.<sup>65</sup>
- Having done so, the principal must satisfy itself at appointment, and on a continuing basis, that the AR<sup>66</sup>:
- is solvent
  - is otherwise suitable to act for the principal, and
  - has no close links that would be likely to prevent adequate supervision by the principal.
- 1.10** There is extensive guidance to principals to assist them in satisfying the above conditions.<sup>67</sup> The AR should be fit and proper and so should its controllers, directors, partners, proprietors and managers (including their good character, competence and financial standing), following the process set out in the Fit and Proper Test for Approved Persons, and the guidance set out in the Annexes to SUP 12.
- 1.11** There are further requirements where a principal does not seek to restrict its AR from acting for another principal. These concern the checks that the principal should make<sup>68</sup> and the required matters that must be included in the written multiple principal agreement that must be entered into by each principal.<sup>69</sup>
- 1.12** In addition, before appointing a person to be an AR to carry on insurance mediation activity, a firm must ensure that the person will comply on appointment, and continue to comply - in relation to insurance mediation activity - with the rules in MIPRU that require them to be able to demonstrate the knowledge and ability necessary for the performance of their duties and be of good repute.<sup>70</sup>

63 Paragraphs 2D, 2E and 2F of Schedule 6 to FSMA, Threshold Conditions sourcebook (COND)

64 This requirement amplifies Principle 3, under which a firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems, and is further detailed in the SYSC rules.

65 SUP 12.4.2 R

66 SUP 12.4.2 R; SUP 12.4.3–5 G.

67 SUP 12.4.3 G; SUP 12.4.4. G; SUP 12.4.5 G; SUP 12 Annexes 1 and 2.

68 SUP 12.4.5A (G.)

69 SUP 12.4.5B R; SUP 12.4.5C R.

70 SUP 12.4.8AR; MIPRU 2.3.1 R and 2.3.3 R.

- 1.13** In order for an AR to carry out certain regulated activities relating to a contract of insurance, it must be included in the Financial Services Register as carrying on insurance mediation activities before it can commence doing so.<sup>71</sup>

### Notifications

---

- 1.14** Principals have obligations to notify the FCA of changes in the conditions of the appointment of their ARs in accordance with the rules set out, including in relation to termination. The time periods for notification vary, but if certain events occur, notification must be made immediately.<sup>72</sup>

### Record keeping

---

- 1.15** A principal must make, and keep for three years from the date of termination of the contract, details of the AR's name, the contract, the date and reason for terminating the contract, and details of any arrangements with multiple principals. It should also make and retain records in relation to training and competence for relevant individuals, including those performing controlled functions.<sup>73</sup> Further, where applicable, the principal should also satisfy itself that the AR is making and keeping relevant records in accordance with the rules in the Handbook, including those in relation to its financial position, and that it has full access to those of the AR's records that relate to its performance of regulated activities.<sup>74</sup>

### Principles for Businesses (PRIN)

---

- 1.16** The Principles for Businesses<sup>75</sup> are fundamental obligations with which all authorised firms must comply.
- Principle 1 **Integrity**: A firm must conduct its business with integrity.
  - 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 4 **Financial prudence**: A firm must maintain adequate financial resources.
  - Principle 5 **Market conduct**: A firm must observe proper standards of market conduct.
  - Principle 6 **Customers' interests**: A firm must pay due regard to the interests of its customers and treat them fairly.

---

<sup>71</sup> SUP 12.4.9G.

<sup>72</sup> SUP 12.8.2 G.

<sup>73</sup> SUP 12.9.1 R and SUP 12.9.2 R; SUP 12.9.4 G; SUP 10; SUP 10C; TC.

<sup>74</sup> SUP 12.9.3 G.

<sup>75</sup> PRIN 2.1.1 R.

- Principle 7 **Communication with clients**: A firm must pay due regard to the information needs of its clients, and communicate information to them in a way which is clear, fair and not misleading.
- Principle 8 **Conflicts of interest**: A firm must manage conflicts of interest fairly, both between itself and its customers and between a customer and another client.
- Principle 9 **Customers: relationships of trust**: A firm must take reasonable care to ensure the suitability of its advice and discretionary decisions for any customer who is entitled to rely upon its judgment.
- Principle 10 **Clients' Assets**: A firm must arrange adequate protection for clients' assets when it is responsible for them.
- Principle 11 **Relations with regulators**: A firm must deal with its regulators in an open and cooperative way, and must disclose to the appropriate regulator appropriately anything relating to the firm of which that regulator would reasonably expect notice.

### Systems and Controls Sourcebook (SYSC)

- 1.17** All of the 15 principals in our sample were authorised insurance intermediaries. An intermediary must have robust governance arrangements, which include a clear organisational structure with well-defined, transparent and consistent lines of responsibility. Furthermore, it must have effective processes to identify, manage, monitor and report the risks it is (or might be) exposed to, and internal control mechanisms.<sup>76</sup> These should be proportionate to the nature, scale and complexity of the risks inherent in the business model and of the firm's activities<sup>77</sup> including those relating to its network of ARs.
- 1.18** Where the intermediary is acting as a principal of a network of ARs, it is highly likely that the complexity of the risks inherent in the business model and of the firm's activities will be increased. Principals should also recognise that, by nature of the agency relationship into which they enter when they appoint ARs, they should take reasonable steps to avoid undue additional operational risk arising out of this arm's length relationship, and should take care to maintain the quality of the firm's internal control.<sup>78</sup>
- 1.19** Where an insurer is acting as a principal, SYSC 3 applies.
- 1.20** These requirements are further strengthened in relation to a principal taking on an AR; it is required to establish on reasonable grounds that it has adequate controls over the AR's regulated activities for which it has responsibility and adequate resources to monitor and enforce compliance.

<sup>76</sup> SYSC 4.1.1R.

<sup>77</sup> SYSC 4.1.2A G.

<sup>78</sup> SYSC 8.1.1A G.



---

### Threshold Conditions (COND)

---

- 1.21** All firms are subject to the Threshold Conditions. For firms whose business model includes the appointment of ARs<sup>79</sup>, the following are likely to be the most relevant:
- COND 2.4 Appropriate resources
  - COND 2.5 Suitability
  - COND 2.7 Business model

---

### Training and Competence Sourcebook (TC)

---

- 1.22** SUP 12 makes clear to principals that the rules and guidance relating to training and competence in SYSC<sup>80</sup> and TC apply to its ARs (if they are individuals), and to employees of its ARs, in the same way as they are applied to its own employees.<sup>81</sup> In the general insurance sector, TC requirements apply to firms or individuals that provide advice to customers in relation to non-investment insurance contracts. A principal should ensure that, where its ARs are providing advice to retail customers in relation to the products they sell, that the ARs have adequate arrangements in place to ensure that the individuals providing advice are competent – i.e. that they have the skills, knowledge and expertise needed to discharge their responsibilities, including that they achieve a good standard of ethical behaviour.

---

### MIPRU

---

- 1.23** Where a principal appoints an AR, it must ensure before the appointment (and on an ongoing basis) that the AR complies with the provisions regarding knowledge and ability, and good repute, in the same way as if the AR were an authorised firm.<sup>82</sup> Thus, the principal must establish that a reasonable proportion of those in the management structure of the AR who are responsible for insurance mediation, and any of those individuals directly involved in insurance mediation, demonstrate the knowledge and ability necessary for the performance of their duties.
- 1.24** Furthermore, the principal must establish that all of those in the AR's management structure, and all staff directly involved in insurance mediation, are of good repute. In order to achieve this, the principal must make criminal records and bankruptcy checks against each, paying particular attention to offences of dishonesty, fraud, financial crime, and other offences under legislation relating to banking and financial services, companies, insurance and consumer protection.
- 1.25** In addition, MIPRU imposes the requirement on insurance intermediaries to carry sufficient PII, ensuring that firms have adequate resources to meet claims arising out of any breach in the duty of an authorised firm, its employees and its ARs.

---

<sup>79</sup> Paragraphs 2D, 2E, 2F of Schedule 6 to the FSMA, Threshold Conditions sourcebook (COND)

<sup>80</sup> SYSC 5.

<sup>81</sup> Sup 12Sup12.6.10G and 12.6.11G.

<sup>82</sup> SUP 12.4.A R; MIPRU 2.3.1 R and MIPRU 2.3.3 R.

- 1.26** MIPRU requires that the principal's PII incorporate terms that make provision, inter alia, for any liability that it may be liable for as a result of the conduct of its ARs.<sup>83</sup> This requirement amplifies COND 2.4 relating to adequate resources, as well as Principles 3 and 4, which require a firm to take reasonable care to organise and control its affairs responsibly and effectively with adequate risk management systems. The obligation is continuous and ongoing.

### ICOBS

---

- 1.27** All of the AR networks that we reviewed contained ARs who carried out insurance mediation activity in relation to general insurance products and were in contact with the customer; as such, the rules and guidance contained in ICOBS applies.

### CASS 5

---

- 1.28** CASS 5 requires insurance intermediaries operating as principals to ensure that an AR does not hold client money unless it complies with the rules regarding provision for periodic segregation and reconciliation. Furthermore, it must take reasonable steps to ensure that if client money is received by the AR, it is paid into a client bank account of the principal, or forwarded to the firm. Information relating to client money and ARs is set out in Part 4 of the FSA Guide to Client Money for General Insurance Intermediaries published in March 2007.<sup>84</sup>

### DISP

---

- 1.29** DISP Chapter 1: Treating complainants fairly contains rules and guidance to firms on how they should deal with complaints promptly and fairly, including complaints that should be referred to the Financial Ombudsman Service.

---

<sup>83</sup> MIPRU 3.2.4R.

<sup>84</sup> <https://fca.org.uk/static/fca/documents/fsa-client-money-guide.pdf>

**Financial Conduct Authority**



**PUB REF: 005275**

© Financial Conduct Authority 2016  
25 The North Colonnade Canary Wharf  
London E14 5HS  
Telephone: +44 (0)20 7066 1000  
Website: [www.fca.org.uk](http://www.fca.org.uk)  
All rights reserved