

## Regulator Assessment: Qualifying Regulatory Provisions

**Title of proposal:** Thematic review: Principals and their Appointed Representatives (ARs) in the General Insurance (GI) sector

**Lead regulator:** FCA

**Date of assessment:** 27 February 2017

**Commencement date:** 22 July 2016

**Origin:** Domestic

**Does this include implementation of a Cutting Red Tape review?** No

**Which areas of the UK will be affected?** Whole of UK

### Brief outline of proposed new or amended regulatory activity

A principal is an authorised firm that has accepted responsibility in writing for the authorised activities of an unauthorised person called an appointed representative (AR). This means the AR uses the regulatory permissions of its principal to undertake regulated activities and is not authorised in its own right. By doing so, the principal accepts responsibility for anything the AR has done or omits to do.

The review of principals and their ARs assessed the extent to which principals understood and complied with their regulatory responsibilities, including those to their customers where products and services were being delivered by their ARs. We considered whether any of the shortcomings identified were impacting customers and whether they resulted in potential or actual customer detriment.

The role of the principal in providing an appropriate control framework is critical in ensuring its ARs sell insurance products in a compliant manner and deliver fair customer outcomes. Our main concern was 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 in this review sold a wide range of products (including home, motor, travel, guaranteed assess protection (GAP), warranty and commercial combined) via a range of distribution methods to retail and small business customers.

We found significant shortcomings in the control and oversight of ARs by many of the principals 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.

This review assessed principal firms' compliance with rules and guidance that were clear and long standing and did not introduce any new or amended regulatory requirements on firms.

The report in which we published the findings of the review, is a factual account of what we found and throughout the report we extensively cross referenced our findings to the relevant rules and guidance in the Handbook.

### **Which type of business will be affected? How many are estimated to be affected?**

Any authorised firm with regulatory permissions to sell general insurance products in the UK and who have appointed representatives. The number of firms affected is estimated to be 1,668.

<b>Price base year</b>	<b>Implementation date</b>	<b>Duration of policy (years)</b>	<b>Business Net Present Value</b>	<b>Net cost to business (EANDCB)</b>	<b>BIT score</b>
2016	2016	10	-3.2	0.4	2.0

### **Please set out the impact to business clearly with a breakdown of costs and benefits**

**Note** – for all cost estimates below we have assumed the changes will be applied by experienced compliance staff at an estimated rate of £48/hour. The 2016 Robert Half salary guide estimates that a compliance manager in the risk and compliance function of a financial services company based in London earns between £70,000 and £104,000 per annum. Based on working 8 hours per day for 260 days each year our rate equates to £100,000 per annum and is therefore considered a suitably prudent figure for the purposes of our estimates.

#### **Familiarisation costs and gap analysis costs**

We expect all principal firms operating in general insurance (GI) sector that have appointed ARs, to read the report and undertake a gap analysis, to determine if they are compliant with regulatory requirements as set out in TR 16/6.

We estimate that at a reading rate of 100 words per minute\*, it will take 2.7 hours to read the report. At an assumed cost rate of £48/hour, we estimate the cost of familiarisation for 1,668 principals firms in the GI sector to be £215K.

The findings in TR16/6 consist of 81 paragraphs and each paragraph requires a gap assessment. Several paragraphs in the report relate to one particular area and using the gap analysis submitted by one firm as an example, the total number of areas identified for assessment was 75.

On average, each paragraph consists of 6 lines and we estimate it would take 10 minutes to re-read each paragraph (following familiarisation) and write up the area to consider, 10 minutes to check if there is a control in place for each area and 10 minutes to summarise the existing control or write up a proposed control. This makes a total of 30 minutes for each of the 75 areas to be assessed which equals 37.5 hours per firm.

Based on this, it will take the 1,668 firms affected 62,550 hours to undertake the gap analysis and at an assumed cost rate of £48 per hour, we have estimate a one off cost to firms of £3.0m.

#### **Remediation costs**

The shortcomings we identified in the report relate to rules and obligations that are clear and longstanding. We consider that this report creates no on-going costs for business because the expectations set out in it are wholly inherent in the existing rules and add no new obligations to those rules for any firms. Where shortcomings were identified, throughout the report we have referenced the sections of our Handbook that the shortcoming related to. We then summarised our expectations of principals firms in section 5 of the report.

Below we demonstrate how these expectations are linked to existing rules and guidance and create no new regulatory burden of principal firms. We have grouped expectations where they relate to same rules and guidance.

Expectations set out in the report	Existing rules and guidance
<p><b>Para 5.31, bullet point 1</b> Consider the impact of ARs on their own business model and ability to meet threshold conditions.</p>	<p>The expectation to continue to meet threshold conditions is set out in SUP 12.4.2R. The impact on own business model is in Cond 2.7 Business Model of the Threshold Conditions in the Handbook.</p>
<p><b>Para 5.31, bullet point 2</b> Assess the solvency and suitability of their ARs</p> <p><b>Para 5.2</b> 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 <i>required</i>.</p>	<p>Sup 12.4.2R (2) requires that when a firm appoints an AR that it establishes that the AR is solvent and suitable. The expectation under Para 5.2 is taken directly from SUP 12.4.4G. Also, Annexes 1 and 2 to SUP 12 provides guidance to firms on assessing solvency and suitability and SUP 12.4.5B R requires firms to put in place a contract where the AR has multiple principals</p>
<p><b>Para 5.31, bullet point 3, 5, 6</b></p> <ul style="list-style-type: none"> <li>• Take reasonable steps to put in place an appropriate risk management framework to identify and manage the risks ARs present to their business;</li> <li>• Have adequate controls over their ARs' regulated activities for which the firm has responsibility; and</li> <li>• 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</li> </ul>	<p>These three expectations are requirements set out under SUP 12.4.2R (3) and in SYSC 3.1, SYSC3.2 and SYSC 4.1, requiring firms to have in place appropriate systems and controls to identify, manage and monitor the risks they are exposed to.</p>
<p><b>Para 5.31, bullet point 7, 8</b></p> <ul style="list-style-type: none"> <li>• Ensure that the ARs are fit and proper to deal with customers in their name</li> <li>• Ensure that customers dealing with the ARs are afforded the same level of protection as if they had dealt with the firm itself</li> </ul>	<p>These two expectations are regurgitation of SUP12.1.3G of the Handbook and is the main purpose of SUP 12.</p>
<p><b>Para 5.31, bullet point 5</b> Put in place compliant contractual arrangements with their ARs; and</p> <p><b>Para 5.3</b> 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.</p>	<p>These two expectations are taken directly from SUP 12.5 which provides guidance on required contract terms, and states that for the AR appointment to be effective the firm must put in place a written contract</p>
<p><b>Para 5.4</b></p>	<p>This expectation is taken from SUP</p>

<p>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.</p>	<p>12.4.2R (3) supported by SYSC 3.1, SYSC 4.1.1R, 4.1.2R and SYSC 4.1.2A G</p>
<p><b>Para 5.5</b> 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 all elements of the ARs' activities, including ensuring that the ARs' sales activities are compliant with PRIN and ICOBS.</p>	<p>The expectation to control the activities of ARs are set out in SUP 12.4.2R and states that the firm must have control over the AR activities and reference SYSC 3.1 and SYSC 4.1 which set out the controls activities</p>
<p><b>Para 5.6</b> 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</p>	<p>This expectation comes from all of the foregoing above expectations. The overriding purpose of SUP12 as set out under Para 5.31, bullet point 7, 8 and particularly from SUP12.1.3G, SUP12.4.2R (3) and (4). This reminds principal firms that they are required to meet their obligations and ensure that their ARs comply with the relevant regulatory requirements, including Principle 6 to treat their customers fairly.</p>

We consider that this publication creates no remediation costs for business because the expectations set out in it are wholly inherent in the existing rules and add no new obligations to those rules for any firms.

As compliance with regulatory requirements is a given under the Enterprise Act, any costs incurred by firms to bring themselves to a compliant standard, beyond familiarisation and gap analysis costs, are not included. Therefore we have estimated a cost to business for remediation to be zero.

\* "EFTEC (2013), "Evaluating the cost savings to business from revised EA guidance – method paper".

**Please provide any additional information (if required) that may assist the RPC to validate the BIT Score.**

The link to the published report TR16/6 can be found here: <https://www.fca.org.uk/publication/thematic-reviews/tr16-06.pdf>

Link to Robert Half salary centre: <https://www.roberthalf.co.uk/news-insights/salary-centre-2016>