

**July Newsletter**  
**Issue 7/2010**

Editorial

The work that the Competition Commission did on the London subscription market has brought up some interesting challenges for brokers. In practice the market tends to dictate how a risk is placed, whether on a horizontal or vertical basis and particularly in a competitive market the price will be driven down not up. The difficulty arises from formalised audit trails of the broking process. We understand that questionnaires will be sent to clients, brokers and insurers to follow up on the initial report findings, although a timetable is unknown. But beware - if weaknesses are found fines can be levied up to 10% of a group's annual turnover. A sobering thought!

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Further information on the issues in this newsletter, or any other issues which concern your business, can be obtained from

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**Enhancing auditors' contribution to regulation**

The FSA together with the Financial Reporting Council has published a Discussion Paper "Enhancing the auditor's contribution to prudential regulation". The point of a Discussion Paper is to stimulate debate rather than set out conclusions (as in a Consultation Paper) on the role of auditors. It applies to all regulated firms but there is a specific section on an auditor's role in auditing a firm's client asset arrangements.

Through its supervisory work the FSA has established evidence of material weaknesses in some of the client asset auditor reports it has received. Evidence of this includes:

- auditors providing unqualified, 'clean', reports despite the regulated firm subject to audit having made significant material client assets breaches;
- the auditors' reports reporting on the wrong chapters of the FSA Handbook;
- failure to do the client assets audit or part of the audit because of the auditor not being aware of, or not understanding, the client assets audit requirements; and
- errors within some client assets audit reports, such as the auditor not signing or dating the report, quoting the wrong FSA Firm Reference Number, or referring to another firm within the body of the auditor report.

However what the paper does not make clear is the differences in the responsibilities in the role of an auditor when auditing client money arrangements for an insurance intermediary. The paper notes that the FSA partly relies on external independent assurance to gain comfort that its client asset regime has been implemented appropriately, which is achieved by "the firms' auditors reporting to the FSA periodically ...". However this is contrary to the rules for insurance intermediaries which require that the auditor delivers the report to

the firm. It is for the firm to decide whether the contents need to be reported to the FSA. Any auditor does have responsibilities to report certain matters to the FSA but these relate to sufficiently serious breaches of the rules.

In view of the concerns that the FSA has noted above (which I think are probably fair in certain quarters) it may be that the FSA may amend its stance in relation to submission of auditors reports for insurance intermediaries. If it does it needs to ensure that these documents will be reviewed rather than filed somewhere!

**Subscription Market Practices – EU Competition**

Brokers will already be aware of the EU's Competition Directorate's (DG Comp) inquiry in 2008 which raised the principal concern that there was 'an absence of an opportunity for the following market to compete'. European principles ("the BIPAR principles") were developed to address these concerns which seemed to satisfy DG Comp initially. However they noted that they will be monitoring the situation going forward and if we don't act they have a very big stick to hit us with!

As a result of this LIIBA has produced a training module on general competition law and practical ways of addressing the concerns. The aim is for brokers when placing co-insured risks with following markets to place the supporting markets at differential terms to the leader and ensuring that the price cannot be aligned upwards. It is therefore up to the broker to decide whether it is in the interests of his client whether to reveal the leader's quote to the following market. In an ideal world individual terms can be received from different markets (vertical placement) with a separate signing page for each market so that the leader's terms are not automatically followed (horizontal placement).

For horizontal placements there is a perceived risk that the price is set at an uncompetitively high level. Therefore if this route is followed brokers need to

make it very clear why this method of placement has been used.

The key point is to make sure that discussions and decisions made with the client on how to place the risk must be formalised to ensure there is a visible audit trail for decision making.

### **Insurance Conduct of Business Sourcebook – post implementation review**

In 2008 ICOB was replaced by ICOBS. ICOBS reflected a more principles based approach to general insurance as well as adding new rules for protection products where it was considered that the ICOB rules did not address certain market failures that were identified. The FSA undertook to review ICOBS to assess whether the changes had been effective.

Under ICOBS the requirement to provide a policy summary was removed. From the review the FSA found that firms were still using this document and concluded that this provision appears to be the most appropriate method. Similarly the rules on claims handling were amended to a more ‘outcomes focussed’ standard, requiring claims to be handled promptly and fairly, and not to reject any claims unfairly. The FSA noted that there was no evidence to suggest that any changes made had led to consumer detriment.

The requirement for insurers to provide status disclosure details had been removed in ICOBS. Some firms felt that this removed the level playing field between insurers and brokers and this would cause confusion for consumers when purchasing a product from an insurer. The FSA noted that from their limited survey there was no evidence of consumer detriment.

### **Insurance Premium Tax**

As announced in the Budget, the standard rate of IPT will increase to 6% and the higher rate to 20% with effect from 4<sup>th</sup> January 2011. However unlike the previous rate rises there are no transitional provisions for the industry.

LIIBA notes that this presents some interesting challenges for brokers, insurers and clients. It reports that the tax point for IPT is technically the date

when the insurer’s accounts show the premium due to the insurer. In the absence of transitional provisions the inception date is not relevant for IPT purposes. The tax point may be interpreted differently by insurers, for example some, including Lloyd’s, utilise the signing date of the premium. This means that premiums signed post 4<sup>th</sup> January 2011 will be subject to IPT at the higher rate even if the risk incepts prior to that date. Other insurers may have different tax points.

LIIBA is discussing the matter with Lloyd’s to try and agree on a common approach if the Treasury fails to implement transitional provisions.

### **Financial Services Compensation Scheme (FSCS)**

As some of you may have noticed when receiving your fees notice from the FSA there has been a significant increase in the FSCS levy. Unfortunately the budget for 2010/11 has increased by approximately 9 times, which is as a result of the number of firms that were selling PPI products closing and the FSCS had to step in to pay the compensation due as well as costs payable in the future.

Following strong BIBA lobbying the FSA has commenced a review of the FSCS funding model due to the model being unfair on insurance brokers and the fact that the problems were not caused by insurance brokers but by those from the secondary market such as credit brokers. The FSA is planning to consult on this issue and hopefully any new rules will be in place by the time the new fees will be in place for next year.

### **FSA’s Small Wholesale Insurance Firms newsletter**

The FSA has produced its second issue of this newsletter. It doesn’t contain anything new (anti bribery and corruption/small firms financial crime review) but on the front page Tony Brooke Taylor, Head of the Wholesale Insurance Department tells us that he is leaving the FSA for pastures new (Aviva). Worryingly his replacement is one Andrew Bulley. Hopefully not ‘Bulley by name .....’!

### **Data security risk**

The FSA in their recent newsletter on Financial Crime noted that most up-to-date photocopiers are fitted with hard disks that save details of information put through the photocopier. Therefore if the photocopier is changed and personal information is left on the hard drive it could fall into the wrong hands and therefore expose a firm to data security risk.

### **Insurance Guarantee Scheme – European Consultation**

The European Commission has launched a public consultation on options to improve protection for insurance policyholders, including the possibility of setting up Insurance Guarantee Schemes for all Member States. Insurance Guarantee Schemes (IGS) provide last-resort protection to consumers when insurers are unable to fulfil their contract commitment. Currently only 12 countries in the EU operate one or more general IGS.

The lack of harmonised IGS arrangements in the EU hinders effective and equal consumer protection. It may also impede the functioning of the internal insurance market by distorting cross-border competition. Therefore the development of harmonised insurance guarantee schemes could contribute towards remedying these existing deficiencies.

In the consultation the Commission sets out a coherent framework for EU action on IGS protection for policyholders and beneficiaries. In particular, it proposes introducing a directive to ensure that all Member States have an IGS that complies with certain basic criteria (such as insurance policies to be covered, geographical scope and funding).

### **A new approach to financial regulation**

Just off the presses is HMT’s consultation on the way forward for regulation. I will go into more detail in my next newsletter but the bottom line is insurance intermediaries will be regulated by the Consumer Protection and Markets Authority and it will be responsible for conduct of business regulation and supervision of all firms.