

May Newsletter
Issue 5/2010

Editorial

The FSA's anti-bribery and corruption report shows that it is extremely serious in driving this initiative forward. The report notes that it is considering whether further regulatory action is required going forward. There are some basic steps you should take: make sure the Board is aware of this report. At the very least provide Board members with the executive summary, which adequately provides the FSA's overall findings. Make sure you have a procedure for taking on any third party, producing broker or otherwise; ensure that you can distinguish between those that could be a higher risk to your business; make sure that payments to third parties are monitored and controlled to identify 'odd' payments. If you do get the chance read the report, if only to get a view on the approach that the FSA is taking.

In this issue:

- FSA presentations
- Bribery Act 2010
- Anti-bribery and corruption in commercial insurance broking – FSA report

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

Chris Keene on
020 7369 5375 /
07775 610006

FSA presentations

The FSA has made presentations to members of LIIBA. The presentations covered what it is currently interested in and what it will be interested in for the rest of 2010. Its current hot topics are as follows:

Threshold Condition 4 – As we know a 'Dear CEO' letter was sent by the FSA to insurance intermediaries back in February this year expressing its concerns so we're not going to repeat all that information here. However the presenters did make some interesting points: firstly in their experience where there was a poor approach to TC4 there were also poor governance arrangements in place. Secondly where there was poor knowledge surrounding PII cover there was also a link with poor governance arrangements.

They made two comments about PII:

- 1) that certain firms were not compliant with the detailed PII rules; and
- 2) in any adverse financial climate this is likely to lead to more claims.

The FSA expressed concern that when firms were asked the question some were not able to identify what their biggest PI exposure was. Something to bear in mind for those that may get a visit!

Risk management – the FSA noted that firms should be setting their own risk appetite ie what is a firm's tolerance for certain adverse issues materialising. This could be for example having a 5% failure in contract certainty figures or for example IT systems being inaccessible for two hours. Once the tolerance levels have been set then this can be tested against actual performance. One area where there should be a zero tolerance level, the FSA noted was that of financial crime!

Risk management is an area that Boards need to focus on and this issue

should feature higher up the Board agenda rather than being left as an additional item at the end of a Board meeting.

As per PII above one of the questions the FSA likes to ask is 'what is your risk appetite'? Again firms need to make sure that senior management are in a position to answer this question.

Bribery Act 2010

The Bribery Act has received Royal Assent and it is expected to come into force between June and October this year. There are some major changes from the existing legislation:

- 1) There now does not have to be a requirement for dishonest or corrupt intent;
- 2) The burden of proof has now shifted to businesses to avoid conviction; and
- 3) Penalties have increased to up to 10 years in prison and/or an unlimited fine.

The new crime is now a 'failure to prevent' bribery so firms now have to demonstrate that they have adequate systems to prevent corrupt practices.

In the insurance industry we already know that the FSA has a very keen interest in financial crime including bribery and corruption, which was the basis of the Aon fine last year. Therefore in theory firms should be alert to the fact that they need adequate systems and controls to prevent bribery.

Because the definition of 'bribery' is now so wide there are certain quarters that are concerned about areas such as profit commissions or volume overrides and the like where these types of arrangements could fall within the definition. However this Act is in its infancy and therefore we need to monitor when it comes into force prior to taking any action. If it does impact on the areas mentioned then we hope that the FSA will provide guidance in this area. We understand

that LIIBA has approached the new Government to get a dialogue going and to seek clarity on the new Act for the insurance industry.

Anti-bribery and corruption in commercial insurance broking – FSA report

The FSA has produced its final report that looks at reducing the risk of illicit payments or inducements to third parties in order to obtain or retain business. This follows the FSA publishing its interim findings in September 2009. The report is very comprehensive and also provides examples of good and poor practice. So if you feel that your firm has adequate procedures then it may be worth considering your own internal procedures against the examples of good and poor practice to see whether further action needs to be taken.

It is worth pointing out that from this work the FSA has commissioned a skilled persons report on a particular firm to assess past payments to third parties. It has also issued a formal private warning to another firm after it became aware that third party payments were being made without an adequate business case being established and documented.

The FSA noted some areas of common concern:

Firstly there appeared to be poor understanding amongst senior managers about bribery and corruption risk within their firms;

Secondly firms did not appear to implement a risk based approach when carrying out their own procedures;

Thirdly firms made a poor response to significant bribery and corruption events which should have led them to reassess the adequacy of their preventative systems and controls; and

Lastly there was very weak due diligence on, and monitoring of third

party relationships and payments with a “worrying lack of documentary evidence of due diligence taking place”.

Below are a few ideas on what firms need to consider:

1) Senior management need to ensure that they understand the bribery and corruption risks that face their business and in particular the individual that is responsible for overseeing those risks. Bribery and corruption is a big issue for the FSA and firms need to address this as part of their obligations to mitigate financial crime risks. Therefore financial crime needs to be addressed at Board level to some degree as well as having related risks set out on the risk register.

Management information can be used to help monitor some of those risks. This could include collating information on new third party arrangements being set up or unusually high levels of commission being paid. Firms should also focus on particular areas of the world where there is a perceived higher risk of bribery and corruption.

2) Because firms deal with different types of business from different areas of the world the FSA wants firm to consider risk adopting a risk based approach to risk mitigation. Therefore when firms are setting up their systems they need to be able to distinguish higher risk firms where further work investigatory work may need to be carried out to mitigate those risks. When determining what is higher risk firms need to think about such issues as where business emanates from, whether payments are made to individuals, whether there is a convincing business case for payments to be made.

3) The FSA was very disappointed that out of seventeen firms it visited only six carried out what it considered to have been an adequate review of systems and controls. Some firms did not understand how bribery and corruption risks were relevant to their

business. Therefore as noted previously Boards need to understand how bribery and corruption could affect their business and then be able to identify ways of controlling those risks with the tools available such as MI, procedures and some form of internal audit.

4) Level of due diligence – this is the area where potentially firms need to change their ways. It is not acceptable anymore to take the view that ‘X has had a relationship with them for years so they must be ok’! Firms need to carry out checks on any new relationship rather than relying on others; the checks need to be documented; there needs to be an independent check of the due diligence carried out to ensure that due consideration has been given to the risks rather than too much emphasis being put on the financial benefits of the relationship; and reviews of third party arrangements need to be ongoing, not just at the beginning of the relationship.

Firms cannot use a system where one size fits all – this does not identify higher risk entities and also potentially wastes time carrying out work on third parties that do not merit extra work.

In conclusion the FSA noted that “broker firms have approached higher risk business involving third parties far too informally and many firms are still not operating at acceptable standards. These firms need to do more to ensure they minimise the risk of becoming involved in bribery or corruption, unwittingly or otherwise. At present, we judge that the serious weaknesses identified in some broker firms’ systems and controls mean there is a significant risk of illicit payments or inducements being made to, or on behalf of, third parties to win business.” The report can be found at http://www.fsa.gov.uk/pubs/anti_bribery.pdf.