LLOYD'S MARKET ASSOCIATION

INSIGHT CONSENSUS INFLUENCE

FCA TR15/7 Thematic review on delegated authority – Outsourcing in the GI market	
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1. Overview of the Thematic Review

This FCA report is the culmination of the FCA's 2014 review of 12 insurance providers, across the spectrum of firms, including Managing Agents, and how they manage the risks associated with delegation of underwriting and claims handling. Although the FCA did find examples of good practice, it also found some failings in the way delegated authorities are managed. Some of these failings can be attributed to insurance providers not recognising that such authorities are outsourcing agreements and not adhering to the relevant FCA requirements.

The FCA has made it clear that it considers the delegation of underwriting or claims handling to constitute outsourcing of those functions.

The FCA states that its principle concern is the increased risk of poor consumer outcomes arising from the division of responsibility that occurs in outsourcing underwriting and claims functions. It should be noted that following commencement of the Thematic Review, Lloyd's introduced the Conduct Risk Management Standard (MS11), compliance with which should allow managing agents to address many of the failings.

A summary of the FCA findings is provided below. A more detailed analysis of the findings, cross referenced with the relevant Minimum Standards, where applicable, is provided in section 2. Identified issues are discussed in section 3.

The FCA recognises that delegated authorities can be beneficial to customers through allowing insurance providers to access products and markets. However, the FCA warns that providers must take steps to understand the risks that an extended "chain" can present. This is a theme that reverberates throughout the report.

Summary of findings:

- Lack of clarity around assessment of conduct risk of third parties operating under a delegated authority of various kinds,
- Confusion around what constitutes outsourcing arrangements
- Inconsistency in the measure of whether customers receive fair and equitable outcomes
- Lack of a clear strategy or controls in the outsourcing of claims functions
- Lack of clarity around MI from third parties, both in what is needed and the quality of what is being currently received and analysed
- Over-reliance on audit outcomes by internal/external parties and poor oversight of audit scopes and audit quality
- Lack of control between insurers and intermediaries on allocation of responsibilities
- Poor (sometimes non-existent) oversight and monitoring of product appropriateness for the customer by insurers, mainly down to poor/incomplete MI
- Shortcomings in Complaints management, handling and outcomes
- Lack of understanding/oversight /appreciation of the risks within the distribution chain
- Lack of appropriate senior managerial oversight of Delegated Authority arrangements within insurer organisations.

2. Detailed FCA findings

FCA finding	Relevant section of MS11	Other Lloyd's requirements	Notes/Outstanding issues
Insurer assessment of conduct risk, third party selection and due diligence (TR15/7, Page 13)			
Lack of clear risk appetite due to non-recognition of outsourcing contracts.		MS3 GOV 5.1 Delegated Underwriting Code of Practice (page 2) & Section 3.2	See LMA paper on outsourcing for relevant requirements.
Inconsistent due diligence of prospective third parties, driven partly by non-recognition of outsourcing contracts.	CR 15.1 to CR 15.11 (DU) Appendix 4 of MA Code of Practice (Mar 15) - CPB Questionnaire CR 16.1 & CR 16.2 (TPAs)	MS3 GOV 5.1	See LMA paper on outsourcing for relevant requirements.
Lack of effective governance and reporting lines at senior level.	CR 2.5 CR 2.6 CR 13 Table 2		
Insurer consideration of product – product due diligence and renewal (page 15)			
Lack of understanding of bespoke products designed by external parties (e.g. broker led) leading to lack of oversight of product appropriateness.	CR 7.1		This relates to HPR products. However CR 6 states that in relation to non-HPR products, CR 7 should be considered, as appropriate.
Lack of historical performance data (e.g. claims ratios) leading to lack of oversight of product performance.	CR 7.1		This relates to HPR products. However CR 6 states that in relation to non-HPR products, CR 7 should be considered, as appropriate. The due diligence for an existing product would include historical data.
Insurer control over outsourced claims functions (page 17)			
Lack of control over outsourced claims functions, e.g. selection and due diligence of new TPAs, MI collection, etc.	CR 16.1 (Due diligence) CR 11.1 & CR 11.2 (performance) CR 13.1 to CR 13.5 & Table 1 (claims section) Y4847 (Conduct MI)		

Inappropriate incentives which could create a COI (e.g. profit commissions to intermediaries responsible for claims handling).	CR 2.7 CR 11.2		
Lack of oversight of sub-delegation			See “Agreement terms” under section 3.2 of LMA paper on outsourcing.
Insurer oversight, monitoring and MI (page 19)			
Lack of monitoring and MI relating to consumer outcomes.	CR 13.1 to CR 13.5 &Table 1 Y4847		
Lack of appreciation of the need to oversee delegated functions.	CR 7.6	MS3 GOV 5.1	It is implicit within CR 7.6, that delegated functions require oversight.
Audit of outsourced partners (page 22)			
Over-reliance on audit as an alternative to initial due diligence and ongoing monitoring.	CR 15.1 to CR 15.11 (DU) CR 16.1 & CR 16.2 (TPAs)		See section 3.
Scope of audits too wide with insufficient resources.	CR 15.6 CR 15.7 CR 15.10		
Audits not focussed on consumer outcomes.	CR 15.10		
Unclear responsibilities for audit remedial actions.			UW 3.4 - Management and Monitoring of Delegated Authorities. Managing Agency Code of Practice (Mar 2015), Section 6.4.
Allocation of responsibilities (page 23)			
Unclear responsibilities for tasks, including MI generation, review and actions.	CR 6.1 CR 7.1 CR 8.3 CR 13.1 CR 13.2		FCA SYSC 13.9.5. MA Code of Practice (Mar 2015), Section 8, Appendix 4. MS11 is clear that MAs must maintain a certain responsibility towards product design regardless of product owner.

Product design (page 24)			
Lack of clear ownership of product design (provider vs distributor).	CR 8.3		MA Code of Practice (Mar 2015), section 1b, Appendix 4. CR 7.1.
Lack of evidence of customer considerations in product design.	CR 6.1		
Product delivery, oversight and monitoring (page 27)			
Insufficient ongoing review of products, including: • No process for product review • Focus on financial performance • Limited evidence • Shortcomings in claims processes • Insufficient MI • Lack of MI analysis and sharing in the business • Reactive assessment driven by customer complaints	CR 14.1 to CR 14.7 CR 3.1 CR 11.1 (claims) CR 13 Table 1 Y4847		
Complaint handling (page 29)			
Lack of awareness of number of, and reasons for, complaints.	CR 12.1 to CR 12.4		
Variable complaint handling processes.	CR 12.1 to CR 12.4		
Lack of root cause analysis.	CR 12.1 to CR 12.4		
Product distribution (page 30)			
Lack of consideration of the risks associated with distribution channels.	CR 5.4 CR 10.1	MS3 GOV 5.1	FCA SYSC 13.9.4 G

3. Issues

Delegated Authorities as outsourced functions

It is clear that the FCA considers the delegation of underwriting and/or claims handling to constitute outsourcing of those functions. This is in accordance with the LMA's 2013 Paper on outsourcing.

In addition, Lloyd's Delegated Underwriting Code of Practice states that managing agents need to have regard to relevant FCA/PRA requirements and guidance for outsourcing, including the provisions at SYSC 3.2, SYSC 8 and SYSC 13. In Section 3.2, the Code goes on to state that managing agents need to satisfy themselves that they have the control and resources (both systems and individuals with suitable experience and skills) to enter into and manage delegated underwriting arrangements effectively, and that their strategy needs to take account of the impact of the outsourcing arrangements to Coverholders on the Managing Agent's business and the reporting and monitoring arrangements to be implemented.

Both the SII definition of outsourcing (page 16 of the LMA Outsourcing paper) and FCA SYS 13.9.3 point out the regulator's view that the requirements and responsibilities on insurers are unaffected by the regulatory status of the outsourced provider. Therefore, MAs should not dis-apply outsourcing requirements simply because a coverholder is FCA regulated.

Scope and application of the FCA's findings

The ongoing requirements concerning fair treatment of customers, including the effective use of MI, may have greatest resonance with high-product risk products, but the FCA's Thematic Review, and findings, concern delegation of underwriting and claims generally.

MAs should consider how they gain comfort that non-high product risk products are performing as expected and that all their customers are consistently achieving fair outcomes. Again the Lloyd's Conduct Standards will assist since they are designed to protect the interests of all customers and not only customers being sold High Product Risk products.

Lloyd's Market Bulletin Y4847 on conduct MI relates only to High Product Risk binding authority business. Although TR15/7 relates to delegated authorities, many of the themes can be read across to other business, e.g. line slips, as well as open market business, and managing agents should consider what suite of MI would be required in order to demonstrate an appropriate conduct framework for that business. In doing this managing agents need to ensure that the data they seek from third parties is relevant and proportionate to the product risk.

In paragraph 3.48 of the FCA report, the FCA suggests that there were many instances of insurance providers not considering, or even requesting, MI despite it being available at the service provider. Managing agents should not assume that coverholders do not hold, or cannot produce, MI, and in order to meet Lloyd's MS11 managing agents need to take action now to ensure collection (and use) by 1/1/2016.

Audits

The FCA notes a tendency for audits to cover far too broad a scope. The end result being that the time allowed for audits often does not deal with any of the key issues to a necessary depth. The FCA findings on this mirror the comments of various coverholders to the chairman of Lloyd's at the recent American Association of Managing General Agents conference where they also complained that auditors were being asked to use the whole Lloyd's audit scope and were therefore not particularly focused on their challenges or reviews.

Managing agents should consider focusing audits on specific areas identified during the due diligence stage or through their relationship with a coverholder. Managing agents should ensure that audits are not used as a substitute for appropriate due diligence which should have been performed as part of the consideration as to whether to enter into the outsourcing contract or for subsequent monitoring of the arrangements. The focus of audits can be rotated so as to cover all elements throughout a multi-year cycle.

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