



## FCA Thematic Review: Principals and their appointed representatives in the general insurance sector

### Introduction

In order to conduct regulated activities in the UK, firms need to be directly authorised or operate under a legitimate exemption from regulation. One such exemption is becoming an appointed representative (AR) of a directly authorised firm.

Under an AR arrangement the authorised firm, known as the principal, “has regulatory responsibility for the AR”, so any actions or omissions by the AR are treated by the FCA as having been done, or omitted to be done, by the principal itself. Therefore, the FCA Handbook contains specific provisions relating to ARs, which the principal firm must comply with.

In its 2015/16 Business Plan the FCA committed to reviewing the role and actions of principals in ensuring they have robust procedures in place to select and effectively monitor the activities of ARs in the general insurance sector. The FCA also wanted to test principals’ understanding of their regulatory responsibilities to customers of ARs. Although this specific review focuses on general insurance, the FCA also confirm that the principles and the expectations apply to all AR arrangements, regardless of sector.

The structure of this thematic review involved: an online survey of 190 general insurance principals with five or more ARs; a sample of 15 principal firms, providing regulatory cover for 783 ARs, for more detailed work; visits to 14 principals with 25 ARs where interviews with senior management were conducted and processes, controls, customer files and monitoring documentation were reviewed.

The FCA 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.”*

### Key findings

- Business model and risk management: Almost of half of the principals in the sample were unable to evidence identification and consideration of the risks from their AR’s activities, and



the impact on their own business models, which resulted in ARs acting outside of the principals' scope of permission and expertise.

- Governance and oversight:
  - ➔ Principals failed to consider: the solvency and suitability of the AR; the impact on their own compliance with regulatory obligations; or the adequacy of their own systems and controls, resources and technical knowledge, which lead to inadequate monitoring and oversight of ARs.
  - ➔ Short comings in the setting up of the operational framework were found: contracts didn't comply with SUP 12.5; multiple principal arrangements existed without an appropriate agreement in place; and there was improper application of the approved persons regime in respect of individuals within ARs.
  - ➔ Over half the principals in the sample were unable to demonstrate consistent and adequate control over their ARs' activities and availability of adequate resources to monitor ARs and enforce their compliance with relevant requirements.
- Customer outcomes:
  - ➔ The failings by principals increased the risks to customers because the firms were unable to ensure compliance by their ARs with relevant regulations, notably those contained in PRIN (Principles for Businesses) and ICOBS (Insurance Conduct of Business Standards).
  - ➔ Examples of actual and potential mis-selling and consumer detriment resulting from ARs' actions were seen in a third of principals.
  - ➔ A lack of understanding and improper application of the client money rules was also found.
- A key issue present in almost half of the principal firms in the sample was a reluctance (due to an imbalance of power) to challenge the actions of an AR. The FCA believes this lack of challenge raises doubts about the ability of the principals to effectively oversee the conduct of their ARs.
- The FCA states the issues identified were serious and widespread, and the FCA took early supervisory intervention to protect the interests of customers in 5 of the 15 firms involved in the review. This intervention involved: preventing each principal from taking on any new ARs; instructing firms to cease sales activities; requesting action plans from firms to address the issues identified; and requesting two section 166 skilled persons reports. One principal has ceased its activities and left the general insurance sector.

## Next steps

All principals, and firms considering becoming principals, should consider the findings of the review and address any weaknesses/gaps in their systems and controls. To assist firms, the FCA has included good practice examples and guidance on suitable controls in the review publications - summary paper, slide presentation and videos.

In summary, principals' controls should include the following:



- At selection stage, an assessment of whether the AR fits within the principal's risk appetite.
- Extensive due diligence on the firm and senior management prior to, and during, AR appointment.
- Consideration by the principal of: conflicts of interests, close links and controllers of ARs; solvency and suitability of ARs; remuneration and incentives schemes operated by ARs; and fitness and propriety of ARs' senior management.
- Before contracting with an AR the principal should conduct an internal assessment of its own expertise and resources for monitoring and oversight to ensure appointment is appropriate.
- Ensuring a contract is in place, before the AR begins to conduct activities, between each AR and its principal, which complies with the relevant rules in SUP 12.5 and clearly outlines the activities for which the principal is taking regulatory responsibility and the activities ARs are not permitted to conduct.
- Where the AR contract permits multiple principal arrangements, requiring the AR to seek advance consent from the existing principal before entering into a new AR-principal arrangement and ensuring a multiple principal agreement is in place between all principals.
- Proper application and enforcement of the approved persons regime for relevant individuals within ARs and the client money rules.
- Effective monitoring of ARs and generation of sufficient/meaningful management information to enable the identification of key risks and trends within the AR network. Principals should ensure they can evidence follow-up and action taken where issues have been identified.
- Assessment of ARs' finances prior to and during appointment and the training and competence of AR staff.
- Ensuring ARs treat their customers fairly.
- Procedures for the efficient termination or suspension of ARs, which also ensures appropriate ongoing customer protection.

In relation to the general insurance specific review the FCA sent a letter to the CEOs of all relevant principals setting out its expectations. Additional work is planned for firms in the wider survey sample and the FCA will also consider the need for further regulatory action and whether changes to its rules and processes are needed.

Links to the FCA's [thematic review](#), [slide presentation](#) and [videos](#) are contained herein.

*This note is intended as a summary only. It is not full and/or firm specific advice and it is the responsibility of each regulated firm to ensure they fully consider relevant FCA publications.*

*For further information, please contact Gem Compliance Consulting Ltd.*