

London Market insurance principles and practices

Update bulletin: March 2016

Please find enclosed the following updates to your copy of the 2016–17 edition of the **LM2: London Market insurance principles and practices** study text:

Chapter 4: example 4.1 in section C updated.

Chapter 5: major changes to section D to reflect the new Senior Insurance Managers Regime (SIMR); self-test questions 9 and 10 updated.

Chapter 6: section F1 and self-test question 8 both updated to reflect the new Insurance Distribution Directive (IDD).

Self-test answers for chapters 5 and 6 updated as necessary.

Chapter 4, section C, page 4/6

Amend example 4.1 to read (amendments in **bold type**):

Example 4.1

If a member had written premiums of £500,000 in a year, the contribution that it would make to the Central Fund would be **£1,500** (i.e. $0.3\% \times £500,000$).

The member does not need to pay this as a separate levy but it is taken from the premiums.



Chapter 5, section D, pages 5/9 to 5/13

Replace the section with the following:

D Regulation of individuals within firms

In this final section, we will be looking at another aspect of financial services regulation – where the regulator seeks to ensure that appropriate personnel are involved in the running of authorised firms, such as insurers and intermediaries.

Reinforce

Refresh your knowledge concerning the regulation of insurers and intermediaries from earlier studies (e.g. *LM1* chapters 6 and 8).



D1 Senior Insurance Managers Regime for insurers

Previously, insurers were regulated through the Approved Persons Regime (APR). This saw **approved persons** performing **controlled functions** within **authorised persons** (who were in fact firms).

However, with the introduction of Solvency II and the overarching desire to bring the insurance sector in line with the regulatory reforms already in place within the banking sector, it is now felt by the regulators that the previous concepts of approved persons are no longer fit for purpose.

As of 7 March 2016, the new **Senior Insurance Managers Regime (SIMR)** has come into effect. It is intended to:

- strengthen the regulatory regime applicable to individuals; and
- toughen the governance and vetting regime at firm level.

The SIMR has the aim of identifying and approving those senior persons who are responsible for running an insurance company or who have responsibility for a key function. It introduces the concept of **governance maps**, which confirm the allocation of all responsibilities and bring in new conduct standards and fitness requirements.

The regime affects all insurers who fall under the scope of Solvency II, as well as Lloyd's and Lloyd's managing agents and UK branches of overseas (non-EU) insurers.

Looking forward, this change in regulation seems to be paving the way for a further change in 2018, when the SIMR will be replaced within the insurance sector by the **Senior Managers and Certification Regime (SMCR)**. The UK Treasury ultimately wants this future regime to apply to all sections of the financial services industry.

The PRA has primary regulatory control for the approval of those persons who perform a **significant influence management function (SIMF)**, historically known as a controlled function. These roles include:

- chief executive officer (CEO);
- chief financial officer (CFO);
- chief risk officer (CRO);
- head of internal audit;
- chief actuary;
- chief underwriting officer (CUO); and
- for Lloyd's only, the underwriting risk oversight function.

There are two levels of these SIMFs, the lower of which are those persons who perform a 'key function'. Solvency II requires firms to have 'an effective system of governance' and lists the following as being 'key functions':

- A risk management function.
- A compliance function.
- An internal audit function.
- An actuarial function.

In addition, the PRA has identified a number of other functions which it believes that a regulated firm should consider as 'key'. For example, investment, claims management, IT and reinsurance.

However, the regulators also make clear that this is not an absolute list and firms should consider what is appropriate for their business.

Anyone in the business who holds either an SIMF or a key function has to be approved by the PRA.

The higher level of SIMFs are those persons who perform a 'significant influence function'. These are regulated by the FCA, in addition to the PRA, and are defined as including:

- directors not otherwise PRA approved;
- compliance officers;
- anti-money laundering officers;
- apportionment and oversight;
- customer functions;
- significant management functions not otherwise approved by the PRA; and
- CASS operational oversight function.



Be aware

CASS is the FCA client money rules

Firms will have to allocate a number of prescribed responsibilities between those who hold regulated roles and, in some cases, non-executive directors. These responsibilities include:

- ensuring that the firm has complied with the obligation to satisfy itself that persons performing a key function are fit and proper;
- leading the development of the firm's culture and standards; and
- embedding that culture and standards in the day-to-day management.

Useful website

To find out more, read the LMA's guidance on the SIMR which can be accessed at: <http://www.lmalloyds.com/simr>



Unsurprisingly, there are new conduct standards developed by the PRA to support this change in regulation, as outlined below. These are quite similar to the previous standards for approved persons, but introduce a new responsibility for conduct of any responsibilities which have been delegated and another relating to the PRA's insurance objective. Anyone who holds a key function or has significant influence must follow all the standards, whereas those only performing a key function must follow standards 1 to 3.

PRA conduct standards

1. You must act with integrity.
2. You must act with due skill, care and diligence.
3. You must be open and cooperative with the FCA, the PRA and other regulators.
4. You must take reasonable steps to ensure that the business of the firm for which you are responsible is controlled effectively.
5. You must take reasonable steps to ensure that the business of the firm for which you are responsible complies with the relevant requirements and standards of the regulatory system.
6. You must take reasonable steps to ensure that any delegation of your responsibilities is to an appropriate person and that you oversee the discharge of the delegated responsibility effectively.
7. You must disclose appropriately any information of which the FCA or PRA would reasonably expect notice.
8. When exercising your responsibilities, you must pay due regard to the interests of current and potential future policyholders in ensuring the provision by the firm of an appropriate degree of protection for their insured benefits.

Each firm is responsible for considering whether individuals have followed the standards, as part of its analysis as to whether individuals are fit and proper.

The FCA also has standards, of which some are very similar to the previous regime for those performing controlled functions. As with the PRA standards, a number of these standards have to be followed by all PRA/FCA approved persons and some (the second tier) are only for those who hold a significant influence function.

First tier – individual conduct rules

1. You must act with integrity.
2. You must act with due skill, care and diligence.
3. You must be open and cooperative with the FCA, the PRA and other regulators.
4. You must pay due regard to the interests of customers and treat them fairly.
5. You must observe proper standards of market conduct.

Second tier – significant influence function holder conduct rules

1. You must take reasonable steps to ensure that the business of the firm for which you are responsible is controlled effectively.
2. You must take responsible steps to ensure that the business of the firm for which you are responsible complies with the relevant requirements and standards of the regulatory system.
3. You must take reasonable steps to ensure that any delegation of your responsibilities is to an appropriate person and that you oversee the discharge of the delegated responsibility effectively.
4. You must disclose appropriately any information of which the FCA or PRA would reasonably expect notice.

The FSA historically gave examples of the kinds of behaviour that would not support their previous principles. Whilst these do not cover all the new conduct rules, they still offer some helpful guidance as to what the regulators are keen to avoid within the market. See the table below, where ‘approved person’ has been abbreviated to AP:

Table 5.1: Controlled functions: historic examples of unacceptable behaviour

Principle	Behaviour that is not acceptable
Acting with integrity	<p>Deliberately misleading or attempting to mislead a customer, firm or the regulator.</p> <p>Deliberately recommending a product for a customer where the AP knows they cannot justify its suitability for the customer.</p> <p>Deliberately failing to inform a customer, firm or the regulator that their understanding of a material issue is incorrect.</p> <p>Deliberately preparing inaccurate or inappropriate records or returns.</p> <p>Deliberately misusing the assets or confidential information of a customer or firm.</p>
Acting with due skill, care and diligence	<p>Failing to inform a customer or the firm of material information when the AP was aware or ought to have been aware of the information and the need to provide it.</p> <p>Recommending an investment for a customer without reasonable grounds to believe it is suitable.</p> <p>Providing advice on transactions without a reasonable understanding of the risk exposure of the transaction to the customer.</p> <p>Failing to disclose a conflict of interest.</p> <p>Failure to provide control over a customer’s assets – this includes failure to make timely payments!</p>
Observing proper standards of market conduct	<p>Insider dealing.</p> <p>Misusing market information.</p>
Dealing with regulators in open and co-operative way	<p>Failing to answer regulators’ questions or attend meetings/provide documents.</p> <p>Not reporting information internally or directly to the regulator where it is reasonable to assume it would be of material interest, whether they have asked questions or not.</p>
Taking reasonable steps to ensure that the business is organised in such a way as to be able to be controlled effectively	<p>Failing to apportion responsibilities for all areas under your control as an AP.</p> <p>Failure to apportion responsibilities clearly.</p> <p>Failure to share load appropriately among all directors and senior managers.</p>
Exercising due skill care and diligence in the management of the firm	<p>Failing to ensure that you are adequately informed about the affairs of the business.</p> <p>Delegating authority without reasonable grounds for believing that those to whom it is delegated are capable.</p> <p>If something is delegated, failing to maintain an appropriate level of understanding about that area.</p>
Ensuring compliance with the relevant requirements and standards of the regulatory regime	<p>Failing to take reasonable steps to implement (either personally or through a compliance function) adequate systems of control to comply with relevant requirements of regulators.</p> <p>Failing to take reasonable steps to monitor.</p> <p>Failure to take reasonable steps to inform themselves as to why significant breaches (suspected or actual) of regulatory requirements may have arisen.</p> <p>Failure to take action, in terms of a review, after breaches are identified.</p>

The testing and verification of individuals as fit and proper persons is even more important than it was under previous regulatory regimes, with the new focus being very much on personal responsibility.

Individuals will need to show that they:

- possess the necessary levels of competence, knowledge and experience;
- hold the necessary qualifications; and
- can demonstrate integrity.

Firms must ensure that they perform checks before presentation of any application to the regulators. This could include taking references from previous employers.

'Grandfathering' will apply to all approved persons who are performing the corresponding role under the existing regime immediately prior to 7 September 2016, and who have complied with the notification requirements.

Activity

If you were putting together a test to measure someone's competence to hold a 'key function' in your organisation, what elements of their character would you consider important?

Write your thoughts here and see if they agree with the points made below:



D1A Approved persons regime for intermediaries

For those regulated firms that are not insurers, i.e. intermediaries and brokers, the pre-existing approved persons regime still exists. This applies the concept of approved persons performing controlled functions and significant influence functions.

Brokers and intermediaries are only regulated by the FCA and so this regulator manages the whole process. The FCA requires individuals who are put forward for such roles to satisfy its 'fit and proper' test and to comply with the Statements of Principle and the Code of Practice.

Being fit and proper is a benchmark measure that the regulators use and it will continue to be used even for those individuals who have been approved in the past. The test requires:

- honesty, which includes openness with self-disclosure, integrity and reputation;
- competence and capability; and
- financial soundness.

However, the regime for intermediaries may change at some point in the future.

Useful website

For more information about the approved persons regime, see https://www.the-fca.org.uk/approved-persons?field_fcasf_sector=unset&field_fcasf_page_category=unset



D2 Compliance officer

In regulating the insurance and financial services sector, the regulators prescribe a number of key roles that must be performed by a director or senior manager in financial services firms (including insurers and those involved in insurance mediation or broking). One such role is carrying out the compliance oversight function. The person performing this job is known as a compliance officer and must report to the governing body (usually the board of directors) of the firm. A compliance officer is still considered to have a central role under the new regulatory framework and holds a significant influence function so is regulated by both the PRA and FCA.

Meaning of the word compliance

Compliance has the same meaning in this context as it does in general English, being the concept of ensuring that rules are followed.



The exact scope of the duties of a compliance officer varies from one firm to another. However, their main role is to ensure that their firm abides by UK law and the rules and regulations set down by the regulator. The FCA and PRA have taken over many areas of the old FSA Handbook and Sourcebooks.

The compliance officer role is vital to insurers and intermediaries because there are serious consequences of failing to abide by the regulatory rules. The range of functions undertaken by a compliance officer usually includes:

- communication of the company's policies including the organisation of any associated training;
- completion of regulatory returns such as governance, finance and complaints;
- reviewing company procedures to ensure they are appropriate and compliant;
- maintaining the company's compliance manual; and
- checking that all stages of the business process are being conducted in accordance with the compliance manual.

Depending upon the size of the company, the compliance officer's role may be a 'hands on' role or it may involve oversight of some of the functions, with the work being carried out by other individuals. It is permissible for the tasks themselves to be carried out by an external compliance consultant. However, the responsibility and accountability of the compliance officer within the company cannot be delegated.



Activity

Identify the compliance officer in your firm and try to find out how many of the functions listed above fall into their remit.
Write your notes here:

D3 Money Laundering Reporting Officer (MLRO)

Money laundering is a serious issue within the financial services sector and the London Market is no exception. All organisations have to ensure that they have money laundering checks and procedures in place and an individual nominated as the Money Laundering Reporting Officer (MLRO). This is also a significant influence function within the UK regulatory framework and so is regulated by both the PRA and FCA.



Activity

Have you been asked to attend money laundering training in the last two years?
Do you know who the MLRO is in your organisation?



Question 5.5

A key function in a regulated firm is one that:

- a. is part of the effective system of governance.
- b. handles the relationship with the regulator.
- c. contributes to its profits.
- d. has to be a director.

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Chapter 5, self-test questions, page 5/16

Amend questions 9 and 10 to read (amendments in **bold type**):

- Identify three roles within an organisation that are **PRA control functions**.
- Give an example of a **significant influence** function that should be carried out by a **regulated** person.

Chapter 6, section F1, pages 6/11 to 6/12

Replace the final four paragraphs with the following:

The EU has now updated the IMD because the Directive is actually applied differently in each EU country. This has led to fragmented insurance markets in the EU, with significant gaps and inconsistencies, in particular regarding the information requirements imposed on sellers of insurance products.

This has increased the problem of customers having a poor understanding of the risks, costs and features of insurance products. The collapse in consumer confidence during the financial crisis has also given new prominence to level-playing field and consumer protection issues.

Insurance Distribution Directive (IDD)

On 22 February 2016, the **Insurance Distribution Directive (IDD)** came into force. EU member states have two years from that date to bring the provisions into their national law before the IMD will be repealed.

Whilst some of the areas of scope remain the same, the IDD applies to a wider range of entities. This is because it uses the term, 'insurance distributor', as opposed to 'insurance intermediary'.

As a result, the IDD now applies to the following:

- All sellers of insurance products, including those who sell directly to customers.
- Any person whose activities consist of assisting with the administration and performance of insurance contracts. This includes those acting for insurers, for example, by performing claims management activities.
- Ancillary insurance intermediaries. However, the regime for these organisations has a lighter touch. Furthermore, an ancillary organisation will be excluded from the regulation completely if the insurance is complementary to the goods or services provided. This is provided that the insurance covers, for example, breakdown, loss or damage to goods or other risks linked to travel booked with the provider, and where the premium is less than £600.

There are a number of 'carve-outs' within the definition of 'insurance distribution', two of which were already present in the previous IMD. These are:

- the mere provision of information on an incidental basis to a customer in the context of another professional activity, if no further steps are taken to assist the customer in concluding an insurance contract;
- the management of claims as an insurer on a professional basis and the provision of loss adjusting services; and
- the mere provision of data and information on potential policyholders to insurance intermediaries or insurers, if no further steps are taken to assist a customer in concluding an insurance contract.

It is anticipated that the new regime will ease the procedure for cross-border entry to markets within the EU, but, in turn, it introduces stricter and more specific professional requirements. These will be linked to the ability of the regulator to control and assess the knowledge and the competence of employees in regulated organisations.

Under the IDD, there are two general principles:

- Distributors must always act honestly, fairly and professionally in accordance with the best interest of customers.
- All information provided by distributors must be fair, clear and not misleading.

Furthermore, in relation to any remuneration received, distributors must disclose:

- the nature of the remuneration; and
- the basis for that remuneration (fee/brokerage, etc.).

In the UK, intermediaries are already obliged to provide information of this nature to both consumers and commercial customers. However, the IDD is more detailed in its requirements surrounding the nature of the disclosure and the basis of remuneration.

Chapter 6, self-test questions, page 6/16

Amend question 8 to read (amendment in **bold type**):

8. What are the basic requirements for a broker under the **Insurance Distribution Directive (IDD)**?

Chapter 5 self-test answers, page v

Replace answers 9 and 10 with the following:

9. Three from: CEO, CFO, CRO, head of internal audit, chief actuary, CUO and underwriting risk oversight function (Lloyd's only).
10. Examples of a significant influence function are: directors not otherwise PRA approved, compliance officers, anti-money laundering officers, apportionment and oversight, customer functions, significant management functions not otherwise approved by the PRA and CASS operational oversight function.

Chapter 6 self-test answers, page vi

Replace answer 8 with the following:

8. Under the IDD, the broker must disclose the nature and the basis of the remuneration.