



Chartered  
Insurance  
Institute

# P66 – Delegated authority

## Diploma in Insurance

April 2018 Examination Guide

### SPECIAL NOTICE

Candidates entered for the October 2018 examination should study this Examination Guide carefully in order to prepare themselves for the examination.

Practise in answering the questions is highly desirable and should be considered a critical part of a properly planned programme of examination preparation.

## P66 – Delegated authority

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## IMPORTANT GUIDANCE FOR CANDIDATES

### Introduction

The purpose of this Examination Guide is to help you understand how examiners seek to assess the knowledge and skill of candidates. You can then use this understanding to help you demonstrate to the examiners that you meet the required levels of knowledge and skill to merit a pass in this unit.

### Before the examination

#### Study the syllabus carefully

This is available online at [www.cii.co.uk](http://www.cii.co.uk) or from Customer Service. All the questions in the examination are based directly on the syllabus. *You will be tested on the syllabus alone*, so it is vital that you are familiar with it.

There are books specifically produced to support your studies that provide coverage of all the syllabus areas; however you should be prepared to read around the subject. This is important, particularly if you feel that further information is required to fully understand a topic or an alternative viewpoint is sought. The reading list which can be found with the syllabus provides valuable suggestions.

#### Read widely

It is vital that your knowledge is widened beyond the scope of one book. *It is quite unrealistic to expect that the study of a single study text will be sufficient to meet all your requirements.* While books specifically produced to support your studies will provide coverage of all the syllabus areas, you should be prepared to read around the subject. This is important, particularly if you feel that further information is required to fully understand a topic or an alternative viewpoint is sought. The reading list which can be found with the syllabus provides valuable suggestions.

#### Make full use of the Examination Guide

This Examination Guide contains a full examination paper and model answers. The model answers show the types of responses the examiners are looking for and which would achieve maximum marks. However, you should note that there are alternative answers to some question parts which would also gain high marks. For the sake of clarity and brevity not all of these alternative answers are shown.

This guide and previous Examination Guides can be treated as 'mock' examination papers. Attempting them under examination conditions as far as possible, and then comparing your answers to the model ones, should be seen as an essential part of your exam preparation. The examiner's comments on candidates' actual performance in each question provide further valuable guidance. You can purchase copies of the most recent Examination Guides online at [www.cii.co.uk](http://www.cii.co.uk). CII members can download free copies of older Examination Guides online at [www.cii.co.uk/knowledge](http://www.cii.co.uk/knowledge).

**Know the structure of the examination**

Assessment is by means of a three hour paper.

**Part 1** consists of 14 compulsory questions, worth a total of 140 marks.

**Part 2** consists of 2 questions selected from 3, worth a total of 60 marks.

Each question part will clearly show the maximum marks which can be earned.

**Read the current Diploma in Insurance Information for Candidates**

Details of administrative arrangements and the regulations which form the basis of your examination entry are to be found in the current Diploma in Insurance Information for Candidates brochure, which is *essential reading* for all candidates. It is available online at [www.cii.co.uk](http://www.cii.co.uk) or from Customer Service.

## In the examination

### The following will help:

#### Spend your time in accordance with the allocation of marks

- The marks allocated to each question part are shown on the paper.
- If a question has just two marks allocated, there are likely to be only one or two points for which the examiner is looking, so a long answer is a waste of time.
- Conversely, if a question has 12 marks allocated, a couple of lines will not be an adequate answer.
- Do not spend excessive time on any one question; if the time allocation for that question has been used up, leave some space, go on to the next question and return to the incomplete question after you have completed the rest of the paper, if you have time.

#### Take great care to answer the question that has been set

- Many candidates leave the examination room confident that they have written a 'good' paper, only to be surprised when they receive a disappointing result. Often, the explanation for this lies in a failure to fully understand the question that has been asked before putting pen to paper.
- Highlighting key words and phrases is a technique many candidates find useful.
- The model answers provided in this Examination Guide would gain full marks. Alternative answers that cover the same points and therefore answer the question that has been asked would also gain full marks.

#### Tackling questions

Tackle the questions in whatever order feels most comfortable. Generally, it is better to leave any questions which you find challenging until you have attempted the questions you are confident about. Candidates should avoid mixing question parts, (for example, 1(a)(i) and (ii) followed by 2(b)(ii) followed by 1(e)(i)) as this often leads to candidates unintentionally failing to fully complete the examination paper. This can make the difference between achieving a pass or a narrow fail.

It is vital to label all parts of your answer correctly as many questions have multiple parts to them (for example, question 1(a) may have parts (i), (ii) and (iii)). Failure to fully distinguish between the separate question parts may mean that full credit cannot be given. It is also important to note that a full answer must be given to each question part and candidates should not include notes such as 'refer to answer given in 1(b)(i)'.

#### Answer format

Unless the question requires you to produce an answer in a particular format, such as a letter or a report, you should use 'bullet points' or short paragraphs. The model answers indicate what is acceptable for the different types of question.

Where you are asked to perform a calculation it is important to show **all** the steps in your answer. The majority of the marks will be allocated for demonstrating the correct method of calculation.

Provided handwriting is legible, candidates will **not** lose marks if it is 'untidy'. Similarly, marks are not lost due to poor spelling or grammar.

### **Calculators**

If you bring a calculator into the examination room, it must be a silent, battery or solar-powered, non-programmable calculator. The use of electronic equipment capable of being programmed to hold alphabetical or numerical data and/or formulae is prohibited. You may use a financial or scientific calculator, provided it meets these requirements. The majority of the marks will be allocated for demonstrating the correct method of calculation.

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## EXAMINER COMMENTS

**Question 1**

This was a very well answered question by the majority of candidates. Many achieved full marks, explaining four methods in sufficient detail to gain all three marks for all four types of revenue.

**Question 2**

Most candidates correctly identified five considerations but not all provided an outline.

**Question 3**

For part (a), few candidates provided an answer of sufficient depth to gain all the marks. Part (b) was not well answered with many candidates not directly answering the question.

**Question 4**

There were three marks available for each part of this question. Few candidates provided sufficiently detailed answers to gain all the marks available.

**Question 5**

Candidates needed to provide more detailed answers in order to gain all the marks on this question. Some missed the key issue that this question was in relation to documentation issuance and not about record keeping.

**Question 6**

The majority of candidates identified audit and bordereaux correctly but not many managed to write answers in sufficient detail to gain all eight marks.

**Question 7**

Although some good answers were given for this question candidates, in general, found this hard. The strongest answers matched the marks available with the instructions and verbs in the question.

**Question 8**

Whilst many candidates identified four considerations, few gave sufficient explanations to gain all the marks.

**Question 9**

Four marks were available for each explanation and very few candidates provided answers in sufficient depth to gain all the marks.

**Question 10**

Four marks were available for each explanation however, not many candidates produced answers in sufficient depth to gain all the marks.

**Question 11**

Both parts of this question were answered well by candidates.

**Question 12**

Generally, this was not a well answered question, particularly part (b) where candidates often did not make the connection between monitoring and forecasting.

**Question 13**

There were some very good answers to this question with many candidates identifying all the advantages and disadvantages required.

**Question 14**

This was one of the least well answered questions. Candidates responses would have benefited from more detail on contract certainty to gain more than half the marks available.

**Question 15**

The candidates who chose to answer this Part II question produced high quality answers.

**Question 16**

This was a very well answered question however, candidates are reminded of the importance of reading the question carefully, matching their answers to the breakdown of the marks and to leave sufficient time to answer Part II questions.

**Question 17**

Many candidates wrote more than was required on parts (a) and (b) and therefore did not leave sufficient time to answer part (c) fully which is where the majority of the marks were available. Where answers are split into different parts, candidates are reminded to look carefully at the breakdown of the marks and plan their answers accordingly.





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# P66

## Diploma in Insurance

### Unit P66 – Delegated authority

April 2018 examination

#### Instructions

- Three hours are allowed for this paper.
- **Do not begin writing until the invigilator instructs you to.**
- **Read the instructions on page 3 carefully before answering any questions.**
- Provide the information requested on the answer book and form B.
- You are allowed to write on the inside pages of this question paper, but you must **NOT** write your name, candidate number, PIN or any other identification anywhere on this question paper.
- The answer book and this question paper must **both be handed in personally by you** to the invigilator before you leave the examination room. **Failure to comply with this regulation will result in your paper not being marked and you may be prevented from entering this examination in the future.**

## Unit P66 – Delegated authority

### Instructions to candidates

Read the instructions below before answering any questions

- **Three hours** are allowed for this paper which carries a total of 200 marks, as follows:

Part I	14 compulsory questions	140 marks
Part II	2 questions selected from 3	60 marks

- You should answer **all** questions in Part I and two out of the three questions in Part II.
- You are advised to spend no more than two hours on Part I.
- Read carefully all questions and information provided before starting to answer. Your answer will be marked strictly in accordance with the question set.
- The number of marks allocated to each question part is given next to the question and you should spend your time in accordance with that allocation.
- You may find it helpful in some places to make rough notes in the answer booklet. If you do this, you should cross through these notes before you hand in the booklet.
- It is important to show each step in any calculation, even if you have used a calculator.
- If you bring a calculator into the examination room, it must be a silent, battery or solar-powered non-programmable calculator. The use of electronic equipment capable of being programmed to hold alphabetic or numerical data and/or formulae is prohibited. You may use a financial or scientific calculator, provided it meets these requirements.
- Answer each question on a new page. If a question has more than one part, leave six lines blank after each part.

## PART I

## Answer ALL questions in Part I

Note form is acceptable where this conveys all the necessary information

1. Explain **four** ways a coverholder-managing general agent can create revenue. (12)
  
2. Identify and outline **five** considerations a coverholder-managing general agent should review regularly when managing the operation of a delegated underwriting authority agreement. (10)
  
3. (a) Define the term service company. (3)  
  
(b) Explain briefly what a Lloyds managing agent must confirm when setting up a service company as part of the application process, in relation to reporting of data. (3)
  
4. (a) Define the term consortium. (3)  
  
(b) Explain briefly the potential difference between a consortium agreement and the contents of a lineslip. (3)
  
5. Explain the importance of good record keeping for a coverholder-managing general agent, in relation to issuing documentation. (10)
  
6. Describe the main mechanisms used by an insurer to monitor coverholder-managing general agent management of a delegated authority. (8)
  
7. (a) Explain briefly why international business is important to insurers in relation to delegated authority business. (3)  
  
(b) Identify and explain briefly **three** matters an insurer should consider when writing international risks via a coverholder-managing general agent. (6)

8. Explain briefly **four** matters a Lloyd’s managing agent should consider before final sign-off of a new coverholder-managing general agent. (8)
9. Explain **three** matters that those with underwriting authority, under a binder, should consider when setting up a binder. (12)
10. Explain **three** roles a broker could take in the delegated authority process, other than being the coverholder-managing general agent. (12)
11. (a) Explain briefly how claims handling authority might be delegated in a typical delegated authority agreement. (4)
- (b) Explain briefly **three** matters which would automatically be referred to insurers, under a typical delegated authority agreement, where an element of claims handling authority has been delegated. (6)
12. (a) Explain why an insurer would compare potential profitability forecasts with actual performance when monitoring a delegated authority agreement. (8)
- (b) Explain why an insurer would compare potential business growth forecasts with actual performance when monitoring a delegated authority agreement. (5)
13. (a) Explain briefly **three** benefits for an insurer of delegating claims handling to a third party administrator (TPA). (6)
- (b) Explain briefly **four** disadvantages for an insurer of delegating claims handling to a TPA. (8)
14. (a) Describe briefly contract certainty as defined by the London Market Group. (4)
- (b) Explain the London Market Group’s guidelines on contract certainty in relation to binding authorities, and the consequences of poorly constructed wordings. (6)

**PART II**

**Answer TWO of the following THREE questions**  
**Each question is worth 30 marks**

- 15.** You are a manager for an insurance broker specialising in commercial business who is considering requesting a delegated underwriting and claims authority agreement from one of your insurers, a large, well known insurer. You have a profitable and extensive portfolio of risks placed with this insurer on an open market basis, although, at present, you only place your larger commercial risks with this insurer, choosing to place your smaller commercial risks with a range of other insurers.

A proportion of your clients choose to insure their commercial risks with your insurance broker, due to affinity relationships you hold with trade and membership groups.

Before preparing a business plan to present to the insurer, you have conducted research into two specific areas with your marketing manager and your head of compliance. The areas you have most concern with are how you will market and develop the business once the delegated authority is granted and secondly, how you will handle the practical flow of premium and claims funds.

- (a)** Explain how you might market the delegated authority business to take advantage of the existing and potential opportunities both internally and externally. **(12)**
- (b)** Explain briefly the importance of contractual transparency for you as a coverholder and for the insurer should the delegated authority proceed. **(5)**
- (c)** Explain the flow of premiums and claims funds and the importance of dedicated accounts. **(13)**

- 16.** You are the Underwriting Manager for a new managing general agent (MGA). Prior to your appointment, you were a senior underwriter for the insurer who the MGA has entered into a delegated underwriting authority with.

The Chief Executive Officer (CEO) of the MGA has asked you to prepare a training programme for all staff involved in operating the delegated authority. In particular, the CEO of the MGA has asked you to focus on the underwriting process to ensure best practice is achieved.

The CEO has also asked you to establish a robust monitoring procedure to ensure that the delegated authority is well managed.

- (a)** Explain the key elements of the underwriting process which you would incorporate in your training programme, including a diagram of the underwriting process. **(15)**
- (b)** Explain **five** areas where service levels could be set to allow performance and operational control to be monitored and managed. **(15)**

- 17.** You have recently been appointed as underwriting manager for the property division of a UK-based insurer. The property division distributes its products on an open market basis through a network of brokers and also to a small number of large property management companies. The property division has the strategic objective of increasing the amount of business written by 50% over the next three years, whilst maintaining its current cost base. The property division has not ruled out writing risks in overseas territories despite their lack of experience.

You have experience of delegated authority agreements and decide to write a business plan which would see you enter into several delegated authority agreements.

- (a)** Explain briefly the benefits for the property division of offering delegated authority agreements. **(5)**
- (b)** Explain briefly the challenges you might face if you decide to distribute your products through delegated authority agreements. **(5)**
- (c)** Describe the practical steps you would need to take to set-up, and then operate a delegated authority with another party on an ongoing basis. **(20)**

## TEST SPECIFICATION

April 2018 Examination – P66 Delegated authority	
Question	Syllabus learning outcome(s) being examined
1	3 – Understand the setting up of delegated authorities
2	5 – Understand the management of underwriting by the coverholder/managing general agent (MGA)
3	1 – Understand the business benefits and risks for the use of delegated authorities 3 – Understand the setting up of delegated authorities
4	1 – Understand the business benefits and risks for the use of delegated authorities 4 – Understand contracts of delegation and contracts of insurance
5	7 – Understand key business support functions within the coverholder/MGA
6	8 – Understand the monitoring and auditing of the delegated authority by the insurer
7	2 – Understand the legal and regulatory framework related to delegated authorities
8	2 – Understand the legal and regulatory framework related to delegated authorities
9	3 – Understand the setting up of delegated authorities
10	3 – Understand the setting up of delegated authorities
11	4 – Understand contracts of delegation and contracts of insurance 6 – Understand the management of claims by the coverholder/MGA
12	8 – Understand the monitoring and auditing of the delegated authority by the insurer
13	6 – Understand the management of claims by the coverholder/MGA
14	4 – Understand contracts of delegation and contracts of insurance
15	6 – Understand the management of claims by the coverholder/MGA 7 – Understand key business support functions within the coverholder/MGA
16	5 – Understand the management of underwriting by the coverholder/managing general agent (MGA) 8 – Understand the monitoring and auditing of the delegated authority by the insurer
17	1 – Understand the business benefits and risks for the use of delegated authorities 2 – Understand the legal and regulatory framework related to delegated authorities

**NOTE ON MODEL ANSWERS**

The model answers given are those which would achieve maximum marks. However, there are alternative answers to some question parts which would also gain high marks. For the sake of clarity and brevity not all of these alternative answers are shown. An oblique (/) indicates an equally acceptable alternative answer.

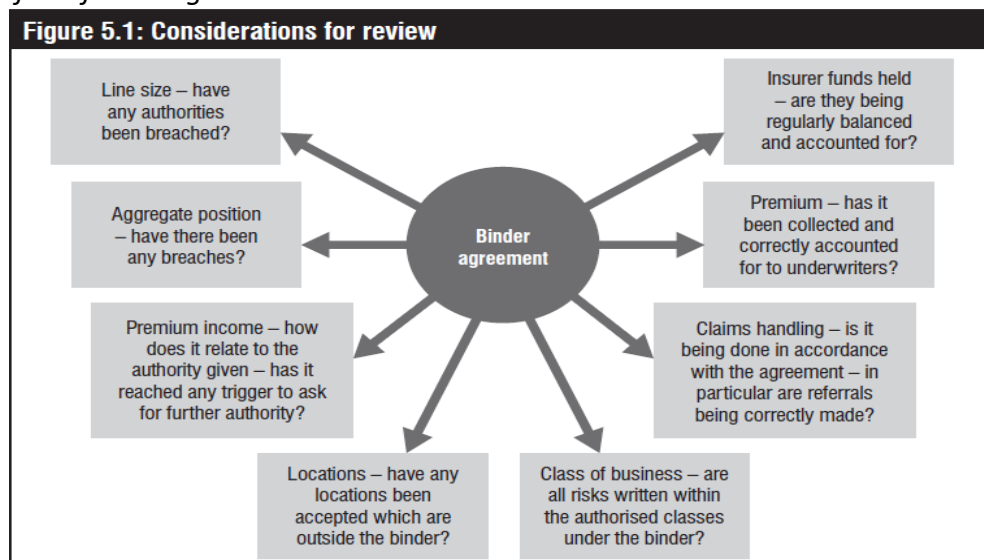
**Model answer for Question 1**

Any four of the following:

- Commissions – the simplest way for a coverholder-managing general agent (MGA) to take revenue from a contract is to charge a commission relating to each risk written. This should be agreed beforehand within the delegated underwriting agreement and might vary between classes if different classes are handled under one agreement.
- Profit commissions – by building in profit commission over and above the standard risk based commission, the insurers insert an incentive into the contract whereby the coverholder-MGA will benefit more from choosing risks carefully and pricing them properly. The risk with this type of commission is that the coverholder-MGA may, potentially, desire to maintain profitability by not paying valid claims.
- Overrides – are a form of commission based on a volume measurement of risks placed to the contract. Obviously, this presents a risk, as exchanging quality for quantity is not always a good business decision to be making. Overrides are potentially a source of a conflict of interest where the coverholder is a broker.
- Brokerage – if the coverholder is also a broker, then it can potentially earn brokerage in the normal way as a commission from the insurers with whom it places the business. This is notwithstanding that it also has the ability, under the binder, to earn commissions.
- Fees – coverholder-MGAs can earn extra fees by providing additional services for their clients. They could provide risk management services to insured clients or earn fees for document issuance services under a binder contract.

**Model answer for Question 2**

Any five of the following:





**Model answer for Question 3**

- (a)** A service company can be defined as a coverholder-managing general agent which is part of the same group of companies as the insurer delegating the authority. It may well trade under a different name, but the key issue is that the service company is part of the same group.
- (b)** Managing agents setting up service companies have to confirm, as part of the application process, that they can comply with all the reporting requirements. Therefore, they must ensure that the data captured by their service company includes all the data, particularly regulatory data, required. Trying to backload data after set-up to enable reporting at the level of detail required by Lloyd's can be difficult.

**Model answer for Question 4**

- (a)** A consortium is a delegated authority where the authority is given to one of the insurers involved in the consortium and which is set up by the insurers. One key feature is that the whole arrangement is set up by the insurers involved and not using a broker.
- (b)** Consortium agreements tend to be more of a bespoke arrangement between the participating underwriters than a lineslip. However, on the whole, they contain exactly the same contents as a lineslip. This is because they set out the extent of the authority given to the consortium leader and the requirements for information to be provided to the other participants.

**Model answer for Question 5**

Central to the management of a portfolio is knowing what risks have been accepted. The focus here is on keeping copies of the documentation issued and, more importantly, of any amendments or endorsements to that documentation, which might occur at any point during the life of the contract of insurance. As we have seen, any situation where the client receives documentation that is somehow not quite in line with the actual risk this will cause, at best, confusion and at worst a customer complaint. It may also cause a serious errors and omissions issue for the broker or coverholder-managing general agent (MGA) if both parties are using their copies of the documentation, not realising that they are not, in fact, the same.

As well as the original accurate capturing of data/records, it is also vitally important to have procedures in place to ensure that data/records are backed up. This will ensure that, should there be any problems at the main office, records are not lost.

Should information relating to any aspect of the delegation of authority have to be produced in evidence, either because of a dispute relating to the insurance contract or to the contract of delegation, all relevant information should be passed to lawyers to ascertain what has to be shared with the opposing side. Different legal systems address data and records which are not on paper differently, so care should be taken not to destroy any evidence such as by deleting e-mails, as this could be interpreted as trying to hide something.

Under the Insurance Act 2015, the record keeping and flow of information between any coverholder-MGA and the insurer took on new significance. Under Section 5 of the Act, which applies to non-consumer business, the insurer is deemed to know something, 'only if it is known to one or more of the individuals who participate on behalf of the insurer in the decision whether to take the risk, and if so on what terms (whether the individual does so as the insurer's employee or agent, as an employee of the insurer's agent or in any other capacity)'.

**Model answer for Question 6**

The main mechanism used to monitor performance is the audit process. This can be both formal and informal and can be undertaken by the insurer itself or outsourced to a third party.

If any part of the authority is delegated to others, such as third party administrators, then the audit process should involve them as well. Audit should not be viewed as a last line of defence but as a method of spotting potential issues at an early stage and remediating them.

Each insurer is at liberty to put together its own audit framework. The framework provided by the Lloyd's standard audit can be used industry wide to illustrate the topics that need to be covered. The advantage of standardised reporting is that it is easier on the provider of the data, and also the recipient in terms of analysing what is received.

The Financial Conduct Authority review also highlighted a number of insurers who were using audit as an alternative to establishing certain behaviours at the outset, such as undertaking due diligence at the start of relationships, establishing robust performance standards, and measuring coverholder-managing general agents' performance on an ongoing basis.

Within the audit template, auditors are given guidance as to the key topics that need to be addressed and the underlying information and questions that are relevant to each topic.

**Model answer for Question 7**

- (a) For many insurers, the use of coverholder-managing general agents (MGA) will be to access more business within their own jurisdiction. However, for others, the primary reason coverholder-MGAs are used is to access business from other parts of the world. This is either because it might not otherwise come into their market, or because it is too small to warrant them writing it individually, even if they were presented with it. For these insurers, the importance of ensuring that they comply with the appropriate international requirements, whatever they might be, cannot be underestimated: they do not want to find themselves being held responsible for something that they should have checked beforehand.
- (b) *Any three of the following:*
- Regulations – what must the coverholder-MGA comply with locally and if there are any intermediaries involved, are they authorised?
  - Tax – what is required locally, what type and what class, who pays?
  - Financial issues – any exchange control or currency issues with the location.
  - Pre-placement considerations – is the insurer authorised in that location, are there any sanctions?
  - Routes into the market – can binders be used in the location of the risk, what are the licensing issues?
  - Documentation – what language should be used, do the regulators need to approve the wording?
  - Processing and servicing – what are the taxation and reporting requirements, are there specific complaints procedures to follow?

**Model answer for Question 8**

*Any four of the following:*

- The insurance market for the class(es) of business proposed in the territory(ies) applied for.
- Expected rates and loss ratios, along with reasons and assumptions.
- An explanation of how the proposed business will fit with and complement the managing agent's overall business plan.
- An authorised person(s) responsible for reviewing the output of the due diligence process to ensure the coverholder-managing general agent (MGA) meets internal and Lloyd's standards and for ensuring the proposal is within the internal strategy for delegated underwriting.
- Internal approval of a coverholder-MGA should be given at board level or as a minimum by two directors, one of whom would usually be director of underwriting, the Chief Executive Officer or the chair of the delegated underwriting committee. At least one of these persons should be independent of the person responsible for introducing the coverholder-MGA to the managing agent. The sign off should either be cross functional or have evidence that cross functional due diligence has been done.
- Board reporting relating to new coverholder-MGAs should be timely and accurate.

## Model answer for Question 9

*Any three of the following:*

### Who will actually hold the underwriting authority?

The coverholder-managing general agent (MGA) has to ensure that the person who holds the authority is given the tools necessary to enable them to carry out their role. A more important consideration is that if that person leaves the organisation they will need to be replaced. The permission of the insurers will then need to be obtained for the new person, for them to have the authority to bind.

### Mix of business being accepted

If, for example, the binder provides for both property and casualty to be written, the agreement might provide for the acceptable ratio between the two classes over the entire contract. A coverholder-MGA has to ensure that it has the monitoring structures in place to ensure that any balance provided for in the contract of delegation is maintained. Even if there is no express split between classes contained in the binding authority agreement, it would still be good business practice to ensure a balanced book.

The type and size of risks being accepted should also be considered and monitored as part of balancing the portfolio. A book of business made up solely of one type of risk is unbalanced and might suffer adversely from one type of loss. A better balance might be achieved by mixing the retail units with some office type risks.

### Marketing and acquisition of risks

It is important to constantly consider whether the strategy set out in the business plan for marketing, and the expectations of the likely conduits through which business is going to be received, are actually proving themselves in reality. If the marketing ideas are not providing the inwards flow of potential new business desired, then the coverholder-MGA should assess quickly whether other options are viable.

An area linked to marketing and acquisition of risk, which was highlighted in the 2015 Financial Conduct Authority's thematic review of delegated authority, 'Delegated Authority: Outsourcing in the General Insurance Market, July 2015', is where products are being developed and marketed by the coverholder-MGA with little or no input or engagement from the insurer. Of particular concern were those products which, because of their likely customer base, were felt to be high risk. Insurers are not considering the customer in enough detail and whether, for example, there is any risk of them being sold an unsuitable product. A good coverholder-MGA/MGA will be aware of the issues with conduct risk and will be engaging in behaviour that protects the customer but a less diligent one might not.

### Premium

Writing business that is unprofitable is not evidence of good management of an underwriting portfolio. For those binders that are prior submit or pre-agreed rates, the risk remains firmly with the insurers. However, for those binders that give full rating and decision making authority to the coverholder-MGA, the challenge remains with it to ensure premium adequacy.

As with other matters, there may be reference in the binder agreement to required average premiums. Even if there is not, there should be analysis of risks written to ensure that the rates being achieved are monitored, and a careful scrutiny made of whether the premium achieved is adequate for the risk being accepted. This is particularly important for business that is renewing to measure whether any change in the risk is reflected in the price obtained going forward. The insurer will also have a view on renewal success and rate strength expectations.

#### Locations

Any insurer should be keen to know in what locations it is accepting risks and where there might be a danger of aggregation of risks or exposures. For binders writing static risks, such as property, the issue is more to do with ensuring that the location related information is captured. For binders accepting mobile risks, such as recreational vessels, cargo or travel, there can never be any certainty before the incidence of a claim as to where risks may have aggregated together.

The binder agreement may have set out specific requirements as to the extent of any aggregate acceptable. This can either be in relation to specific locations, or in relation to the potential for particular natural catastrophe events in certain locations. A key part of location related portfolio management is inspection and survey work, which might include specific activities such as flood mapping, if property risks are being accepted in areas known to be susceptible to such risks.

#### Profitability

While this is not going to be immediately obvious, a coverholder-MGA should be paying close attention to the claims figures. It needs to ensure that the loss ratios presented as part of the business plan are manifesting themselves or if there is a wider problem that should be addressed sooner rather than later. The types of problem that might arise is an unforeseen issue with a wording. Good portfolio management would involve addressing that issue with the insurers and being able to quickly see which risks were attached to the binder using that wording. This will enable the insurers to consider what, if anything, they feel should be done.

**Model answer for Question 10**

*Any three of the following:*

Identifying coverholders

If an insurer wishes to enter into a delegated underwriting contract, it might ask a broker whether it is aware of anyone operating in the location/type of business in which it is interested. Insurers know that brokers have contacts and relationships with numerous organisations around the world and might be able to recommend someone with whom they are already doing business as a broker, or where personnel from a coverholder have set up a new organisation and might be worth talking to. A retail coverholder will bind its own business. However, there is a separate category called wholesale coverholders who bind business produced by their sub-brokers or agents.

Identifying suitable capacity

Conversely, a potential coverholder may be looking to broaden out their sources of capacity and will ask a broker that it knows whether it has any ideas or suggestions as to where it might look for this capacity. As we will see later in this chapter, brokers are a central part of the process of introducing new coverholders into the Lloyd's market and have to actively support the application for approval from Lloyd's.

Facilitation of the agreement process

Once insurers and coverholders have found each other, a broker can remain involved to assist with the creation of the binding authority agreement. The London market uses standard binder agreements as the basis for the contracting process, but other markets/insurers will use their own standard documents, all of which can be amended as required to satisfy the needs of the actual contract.

Placing risks

The broker obviously has a role, as with all insurance, in considering the appropriate market for a client's risk that it has been asked to place. A broker should consider when placing business with a coverholder-managing general agent (MGA) the quality and nature of the security backing that coverholder-MGA and give due weight to the needs of its clients.

If the broker also holds a binding authority, it will need to be very careful to capture clearly its decision process. This is so that there can be no allegation in the future, either by the insured client or by the insurer, that they were prejudiced either in the use or the non-use of a binder when placing the business.

Movement of funds and data

If a broker has been involved between the insurer and the coverholder-MGA in setting up the delegated underwriting contract, it can also remain involved as the conduit through which regular information and funds flow. It is, however, also possible that the parties decide that they would prefer to communicate directly, particularly in respect of the regular reporting of risks written and claims handled etc. As mentioned in previous chapters, the use of formatted bordereaux makes the provision of information between coverholder-MGAs and insurers for both premiums and claims straightforward.

In the London market centralised data capture and money movement systems have been in use for many years. The broker plays a large part in submitting data into the central resource, which then sends data out to each insurer involved in any particular risk using overnight messaging.

Money can also be moved centrally by the same organisation, on the basis of data provided by the broker. The funds are moved for premium from the brokers' bank accounts into the insurers', and vice versa for claims. If there is no central system to use, then the coverholder-MGA has to account to the insurers individually. They need to pay funds/receive funds either directly or via any broker involved within that arrangement.



**Model answer for Question 11**

- (a) In many contracts of delegation there will also be some delegating of claims handling, at least within set financial or factual limits. This makes perfect sense as good customer service to the client is achieved by speedy and effective claims handling. For those smaller risks that often make up a typical binder portfolio, the ability of the coverholder-managing general agent (MGA) to handle the claims on the spot is a key differentiator for the customer.

It is a very rare contract that has a complete delegation of the claims handling. Where a number of insurers are involved in a contract of delegation, usually claims involving certain facts, the claim will be handled by a pre-agreed group of the insurers, known as the agreement parties. However, it would only be those situations which merited the consideration of an ex gratia settlement that might end up being agreed by all insurers.

For binders, the claims authority might be given to the coverholder-MGA or it might be given to a completely separate entity, known as a third party administrator (TPA). Whoever the authority is given to, it will have to be clear as to the extent of its authority and more particularly where claims might start out within its authority but, because of an increase in the quantum or a change in the facts, have later to be referred to the underwriters. These claims are known as over authority claims.

Within the binding authority agreement, the claims handling arrangements for over authority claims should already have been set up. This will typically involve a subset of the insurers concerned, making decisions on behalf of them all but might, in some cases, also involve each insurer making a decision for its own share.

- (b)
- A situation where the claim is being denied – this is because the client may challenge the decision or other complications may arise.
  - Serious personal injury claims – due to the potential size of any resulting award.
  - Matters where the insurers are being sued by the insured – insurers will need to know as soon as possible to inform their own legal team.

**Model answer for Question 12**

- (a) When discussing a potential new binder or the renewal of an existing binder with an insurer, a coverholder-managing general agent (MGA) will have used potential profitability as one of the positive characteristics of the arrangement. A coverholder-MGA with a proven track record in certain classes of business will obviously have something concrete to demonstrate.

When monitoring the operation of a binder, the insurer will be interested to see whether any projections that had been made are being realised. However, its ability to do so, just as with open market business, will be affected by the type of business being written. Any risks written which are of a long tail nature, such as liability risks, will take longer to develop. Whatever class is being written, an insurer needs to be mindful that if a binder starts to show signs of not being profitable early, then consideration should be given to the appropriateness of allowing the coverholder-MGA to continue to write business without some changes being made. This could either be to the products being written or the nature of the binder itself.

The coverholder-MGA will be equally interested in the data as it will want to measure its own profitability against the targets it set itself. If the product is not selling as well as anticipated, this data can form the basis of discussions with the insurer concerning, for example, joint marketing activities. If the coverholder is really on top of its data, this conversation should be triggered by it as it should be in a position to realise the need for action before the insurer. This is because the insurer always gets the data in arrears when provided via the monthly bordereau system.

- (b) Within the coverholder-MGA's business plan there should have been some commentary about the potential for business growth within perhaps a geographical region, a new potential customer base or niche product. It would be appropriate to set performance targets for business growth and, where possible, reward the coverholder-MGA using commissions or similar for reaching those targets.

These aspirations should be measured as part of the ongoing consideration of the performance to ascertain whether they are being achieved and, if not, why not. If the insurer did not validate those aspirations well enough at the time the discussions were being held, then it may find itself disappointed to discover that they were not realistic and there was not the new market there that had been promised.

As with the profitability point, the data collected should form the basis of a conversation between coverholder-MGA and insurer concerning options – in this case for business growth. The coverholder-MGA will be reviewing its own data and figures to establish whether the original perspective remains valid and whether other contributing factors have appeared, such as competition, that were not foreseen during the original analysis.

**Model answer for Question 13**

- (a)
- No need to consider coverholder-managing general agent's (MGA) claims handling ability, the third party administrator (TPA) will be a specialist. This saves considerable management time.
  - No drain on the insurer's claims resource. By using a quality third party resource, this can be done at a potentially cheaper location.
  - Some TPAs have live claims systems that can be accessed by their principals, ensuring the insurer still has an element of oversight and control, without having to complete all the work.
- (b) *Any four of the following:*
- The insurer loses an element of control and real-time awareness of claims in the same way as they do if a coverholder-MGA is handling claims. This can impact the insurer's reputation.
  - Need to ensure that the insurer contracts properly with the TPA in relation to their services, pricing etc. Minimum service standards must be agreed, and this may take time to embed.
  - Need to ensure that the TPA has catastrophe loss capabilities and they are tested. This takes time and any costs may be passed back to the insurer by the TPA.
  - Need to factor in costs of external audit of TPAs or internal cost of doing audit, both financial and in terms of management time.
  - Claims funds improperly managed. This can have an impact on the insurer's reputation and financials.

**Model answer for Question 14**

- (a)** Contract certainty is achieved by the complete and final agreement of all terms (including signed lines) between the insured and insurers before inception.

In addition:

- i. The full wording must be agreed before any insurer formally commits to the contract.
- ii. An appropriate evidence of cover is to be issued within 30 days of inception.

The full wording of the submission to insurers will be a combination of:

- i. wordings and/or clauses;
- ii. either referenced and/or full text;
- iii. bespoke and/or model material.

Brokers may choose which combination is submitted to insurers; insurers may choose whether to accept this or require a different approach.

- (b)**
- Complete and final agreement of all terms of the binding authority between the coverholder-managing general agent and insurers before the inception of the binding authority.
  - Complete and final agreement before the inception of the binding authority of the format and scope of the terms to be used on the insurance documents which will be issued under the binding authority.

There are two contracts in operation with delegated authority. There will be problems for one or more of the parties involved if either of them is poorly constructed.

**Model answer for Question 15****(a) Analysing the market**

One of the key appeals of a good coverholder-managing general agent (MGA) will be the particular knowledge that it provides of its own market, location or specialism. A coverholder-MGA must make a convincing case as to where it expects business to come from when presenting a proposal for the provision of capacity. The business can come from a number of different areas as follows:

**Targeting a niche**

The identification of an untapped market area is a good starting point when considering whether there is any value in developing a new product or altering an existing product to better serve a particular market. The insurer's own underwriters will always look for innovative ways to find new sources of customers and it will look to its coverholders-MGA to do the same. The presentation of this 'new idea' may be an early contact between potential coverholder-MGA and potential capacity provider. The coverholder-MGA may have done its own analysis and identified a new niche market. Alternatively, it may have existing relationships with key business or affinity groups, which it has identified would be interested in a specialist insurance product that no other insurer or broker is currently offering.

**Affinity relationships**

The coverholder-MGA may be in a privileged position of holding an existing relationship or position of trust with groups of potential clients who may be inclined to buy their insurance products through it. It may have a relationship with a business federation of organisations which may have access to groups of members with a similar business profile.

**Existing clients**

Coverholders-MGA may also have a volume of existing clients to which an insurer would like to gain access. Setting up a delegated authority scheme that is specifically designed to cater for their needs means the coverholder-MGA is able to offer a better product or service to its clients and the insurer will gain access to its desired market.

**Distribution analysis**

Just as an insurer has already considered distribution as part of its decision to utilise binding authorities, the coverholder-MGA can do the same thing to identify whether there are smarter ways of attracting business. One of the key ways will be the use of e-business formats by which enquiries, quotes and even binding can be done in an entirely e-enabled way. This format also allows the customer access to a secure certificate format whereby they can print off documentation. They can then provide this to their own clients as part of the sale contract for goods.

**Marketing the business**

Even if a coverholder-MGA develops the most innovative product in the market, if customers are not aware that it is available there will be few sales, if any at all. Part of the marketing and distribution analysis will focus on the optimal way to reach the maximum number of the target audience.

The types of risks being placed, and the use or otherwise of intermediaries, will have an impact on the appropriate methods of marketing. Methods can vary from advertising in various media through to sponsorship of events or education seminars.

A prior analysis of the distribution network and target audience should improve the coverholder-MGA's business plan and make its presentation to the insurer more meaningful. It will also provide a more thorough understanding between insurer and coverholder-MGA of each other's marketing philosophy. An insurer that works hard on its brand image does not want it damaged by unfortunate marketing activity carried out by a coverholder-MGA using its name. In the same way, a coverholder-MGA might seek financial support for marketing activity from the insurer to promote the product.

For a very niche product, that might be offered through a membership organisation, the organisation can send a mailshot to its membership to attract new customers. Alternatively, the membership organisation could, in fact, be the holder of the insurance. It then offers it as a benefit to its members as an integral part of their membership fee.

#### Affinity schemes

This type of business offers highly specialist cover that is targeted at a very focused market, for example the insurance of classic cars or in a particular sporting sector. By developing and targeting a product particularly for one group of customers, the coverholder-MGA has the opportunity to create a very niche product to try to dominate the market and charge a competitive price for it. The competitiveness of the price will also reflect the fact that the buyer is obtaining something that fits their needs exactly, removing the need to buy extraneous cover.

An affinity or group scheme that provides cover automatically to members as part of their membership has a key advantage for insurers. Offering cover this way gives the insurer a reasonably guaranteed income stream, based on the membership level, without having to go out and sell individual products.

Whatever the method of marketing chosen, the insurer and the coverholder-MGA should always be mindful of the exact distribution chain and identify/consider the risks it poses, particularly where the products are aimed at consumers and might be sold via a network that includes non-regulated entities.

All insurers should be able to explain, if challenged, the precise distribution network being used for any product sold on their behalf. The Financial Conduct Authority (FCA) thematic review highlighted that insurers did not even know via which networks their product was being sold and had lost control of the extent of sub-delegation of authority. In these types of cases, it is almost impossible for the insurer to prove that it is treating customers fairly, or that the way the product is being distributed accords with its expectations.

Leveraging the insurer’s brand

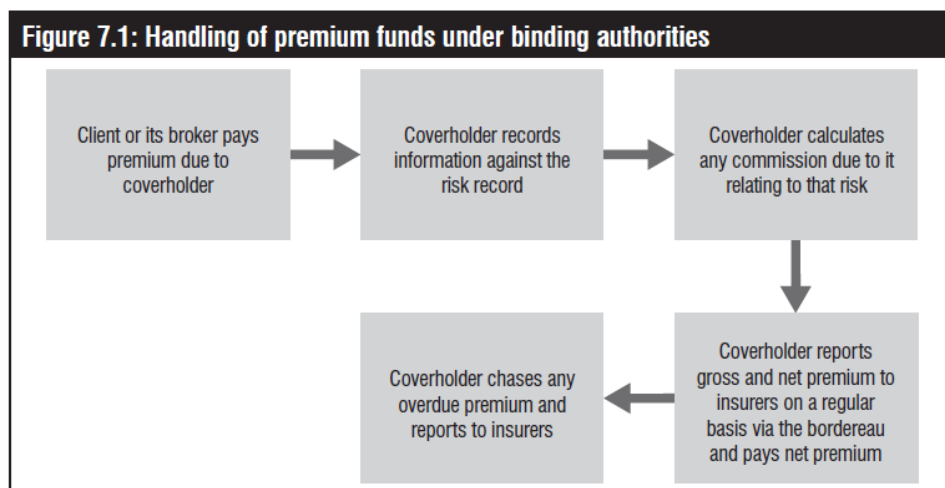
While the coverholder-MGA may have standing and reputation within its own market or environment, an important benefit to it will usually be the opportunity to promote its relationship with a certain insurer. In addition, the coverholder-MGA can refer to the security rating of the backing insurer. This will give anyone wanting to do business with it a quick and easy measure of how good its backers are. To the customer, being able to engage with a local resource is a key benefit, and one which both the coverholder-MGA and insurer should use to their advantage.

**(b)** Importance of contractual transparency

Some coverholder-MGAs may be positively keen to identify exactly who is taking on the risk and the fact that they are merely their representatives, while others may not make it so explicit. It is, however, important to all parties that everyone knows who the parties to the contract of insurance actually are. The coverholder-MGA may have a substantial presence in a particular market and the customer would not think to challenge whether it is actually the risk taker, because why would it not be? Transparency is very important as part of treating customers fairly and conduct risk behaviour, and insurers should take steps to ensure that customers are provided with full information about whom they are buying their insurance from. Insurers should not hide behind coverholders-MGAs’ branding, thinking that it somehow presents them with less risk because, as the FCA pointed out in its recent thematic review, it does not.

If the contracts all run smoothly, with risks being accepted properly by the coverholder-MGA and all the claims being non-controversial, then the detail is unlikely ever to become an issue. However, if there are problems, particularly when the coverholder-MGA acts outside its authority and accepts risks which the insurer is not prepared to ratify, then who the parties to the insurance are becomes an issue. Legally the insurer could decline to ratify the contract which has been entered into on its behalf. However, the customer is holding a piece of paper with the insurer’s details on it and there is a substantial reputation and brand issue at stake. If the problem is more widespread, then the challenge may involve dealing with both the customer issue and a regulatory issue, as there might be a suggestion that the insurer has not maintained close enough scrutiny of its coverholder-MGA.

**(c)**

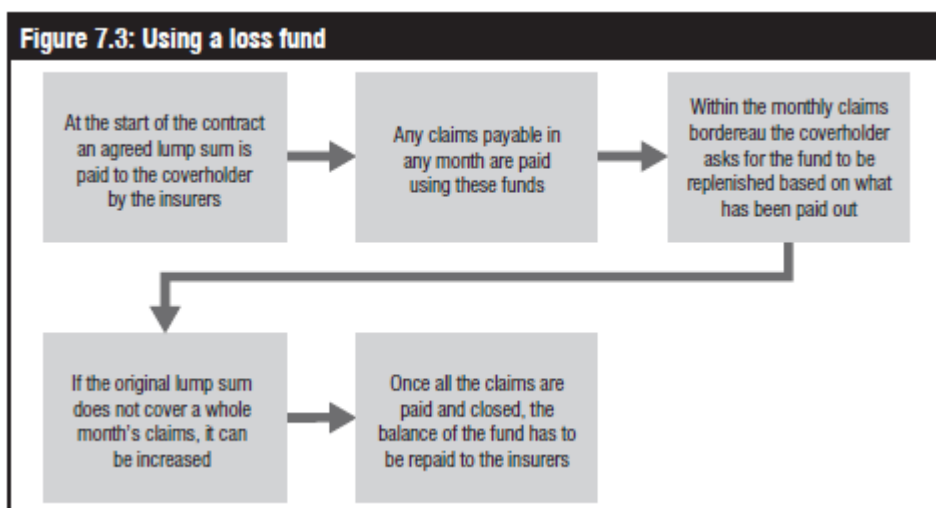
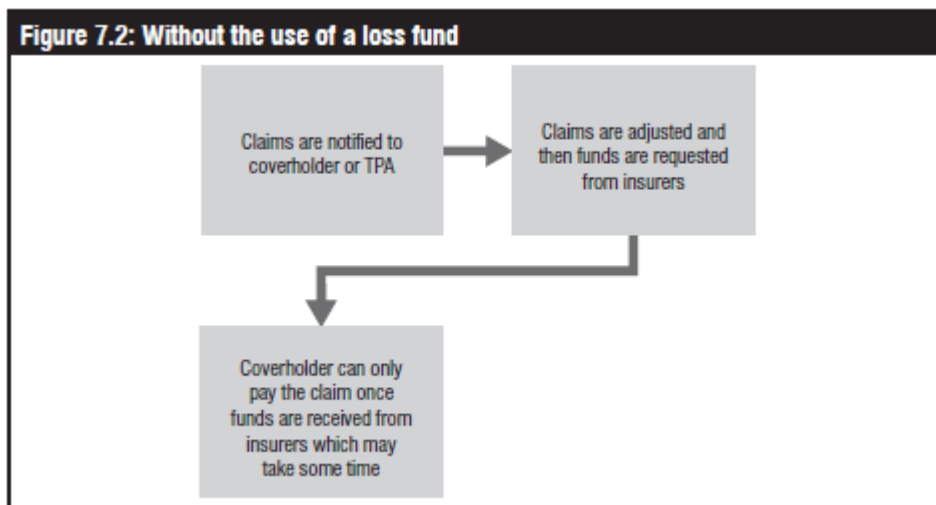


Points to note about the movement of premium funds include the following:

- In common with open market business, it is entirely possible for clients to be given some terms of credit or terms of trade, which permit them an agreed period of time within which to pay their premium. In this case, the coverholder-MGA will also take responsibility for the credit control element of premium payment. It should identify those payments that are not made in a timely fashion, chase them appropriately and report to insurers any amounts that remain unpaid.
- Part of the amount payable by the client to the coverholder-MGA may be retained by the coverholder-MGA as its commission. There may also be commissions payable to retail brokers locally. Both of these must be accounted for and reported to the insurers.
- The reporting criteria will have been set up within the delegated underwriting contract and will normally provide for monthly reporting.
- In some jurisdictions, the coverholder-MGA will also take responsibility for the identification and payment of certain taxation obligations.

Claims handling and payment can be done in two contrasting ways, both of which are completely normal. However, one of these ways gives the coverholder-MGA a fund of insurer's money with which to pay the claims. This fund is called a loss fund.

The diagrams below describe how claims are paid, and funds transferred:





The local handling of claims and the provision of good claims service is one of the key reasons that the delegated underwriting model is used. The existence of the loss fund means that not only can the coverholder-MGA or third party administrator (TPA) make decisions quickly, it can complete the process by making the payment as well, which will be very good for the customer.

There are a number of variations on the loss fund, but the underlying concept is the same: it means the coverholder-MGA does not have to use its own funds to pay claims and then seek reimbursement, nor does it have to wait for insurer funds to pay the claim, even though the coverholder-MGA has already made the claims decision.

Two variations on the loss fund are revolving loss fund and premium funded loss fund:

- Revolving loss fund – in this case, the insurers give the coverholder-MGA an agreed sum of money at the start of the contract. The coverholder-MGA/TPA uses that fund to pay agreed claims and then, as part of the monthly reporting, advises how much of the fund has been used. It then requests reimbursement to replenish the fund back up to the starting amount. If the original amount proves inadequate to cover the monthly claims outgoings, it can be increased with the agreement of the insurers.
- Premium funded loss fund – in this case, instead of the insurer paying a lump sum at the start of the contract, the coverholder-MGA/TPA retains a proportion of each month's premium to build a claims fund. This type of fund is becoming less popular as the premium data and flow of funds is more difficult to manage. Similarly, the data transparency is less acceptable from a regulatory perspective in today's marketplace.

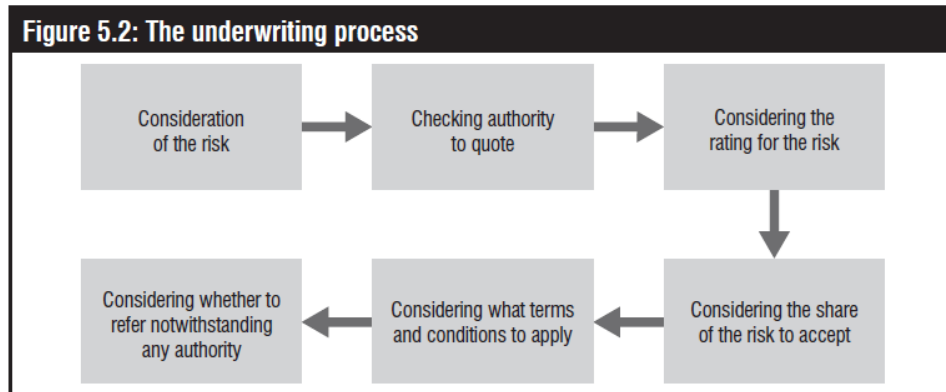
In both cases, if there is a broker involved between the coverholder-MGA/TPA and the insurers, the coverholder -MGA/TPA will report via that broker.

#### Dedicated accounts

Any funds that coverholder-MGAs hold on behalf of insurers should be held in dedicated accounts. They should not be used for any matters other than premium or claims. As with any insurer funds held by an intermediary, there is always the risk that they will be trapped by insolvency proceedings if the party holding the funds suffers financial problems. Therefore, these special accounts, known as trust accounts, are a standard requirement of any intermediary holding what are known as client funds.

## Model answer for Question 16

(a)

Consideration of the risk

When considering a risk, a key question for the coverholder-managing general agent (MGA) is the scope of the binders it holds. Therefore, on being presented with a risk the first thing that the coverholder-MGA has to do is to decide whether the risk itself actually fits within a binder that the coverholder-MGA holds. If it does not, then the coverholder-MGA has the following options:

- To decline to consider the risk through lack of appropriate capacity.
- If they are both a coverholder and a broker, to ask their client if they would like them to pass the business through to the brokers themselves to see if they can get an open market quote for the risk.
- To contact the insurers to see if they might be interested in extending the authority to permit consideration of the risk.

This latter option might not be as practically possible as it sounds depending on the permissions that might be required to extend the coverholder-MGA's authority even on a temporary basis. The insurer could also consider writing the risk itself as an open market risk, rather than via the coverholder-MGA if it is appealing enough.

Authority to quote

As we have already seen, there are various types of binder ranging from the prior submit through to the full underwriting authority. When presented with a risk, having considered whether the class of business fits, the coverholder-MGA then has to decide whether it can offer terms or whether it must be referred to its principals to consider.

Assessment of the rating

A coverholder-MGA might be able to offer a quote but may have to rely on the pre-agreed rates that the insurers have provided them with. Even with these rates there may be some actual assessment by the coverholder-MGA as there may be add-ons and discounts to be factored in, depending on certain details of the risk. The coverholder-MGA will usually be empowered to make those decisions, albeit using matrices supplied by its principals.

What proportion to accept?

Here, the coverholder-MGA has a number of matters to consider:

- What is the maximum any one risk that it can accept on any binder?
- What aggregate issues have to be considered – what risks are already on the books from this same area?
- Does it want to spread the risk across a number of binders?
- Does it need to take account of any premium income limits that are close to being breached?

What terms and conditions to apply?

Here the coverholder-MGA may have no say in the matter, as the binding authority agreement may dictate the terms and conditions that have to be applied to any risk. If the coverholder-MGA is given any flexibility to decide then it not only has to decide on the main terms and conditions, but also ensure that any specific jurisdictional or class of business wordings are included, such as several liability clauses or war exclusion provisions. The terms and conditions do not only include the policy wording applicable, but also include financial matters, such as the brokerage to be paid. Again, the insurers may have given instructions about this within the binder or may have given the coverholder-MGA free scope. Whichever is the case, the coverholder-MGA must make sure that such information is clearly captured and capable of being reported to insurers.

Referrals

Notwithstanding the authority within the binder, the coverholder-MGA can always refer anything to its principal and this is a key part of the relationship at the heart of a delegated underwriting contract. Anything presented to the coverholder-MGA which is outside of its authority under the binder should be referred to insurers, which may be prepared to do a special acceptance or similar. This is an area of exposure for insurers if, as the Financial Conduct Authority (FCA) found in its 2015 thematic review, many contracts were not as detailed as they should be and did not include some practical operational service standards, which could include the need for referrals.

**(b)** *Any five of the following:*Underwriting process

Service standards can be set up for the quotation process to ensure that quotes: are always given a lifespan of an agreed number of days only; are captured in the system both quickly and accurately; and that there is a process for tying up quotes and any firm orders that are subsequently received.

There should also be a service level around responding to customer and potential customer enquiries. If this response time is part of the promotion of a product, then this will be a key measure for the insurer as it needs to ensure that its customers' expectations are being well managed, even via a delegated authority. The insurer should also consider its service to the coverholder-MGA in relation to any referrals made to it. The benefits of delegated authority can easily be lost if the insurer requires all risks to be submitted but does not then provide an efficient turnaround of those risks.

### Regularity of reporting

Normally reporting will be required on a regular basis, often monthly or quarterly. The frequency of reporting is very important to permit the insurer to remain fully up-to-date with its exposures, both through delegated business and direct written risks. Of particular importance will be the aggregation or accumulation of risks, such as those exposed to catastrophe perils. Examples of this would be homeowner's business located in known storm risk areas in the US or known flood risk areas in the UK.

### Quality of reporting

The quality of the data being reported is as important to insurers as how often it is received. Insurers will focus on the quality of data capture about the original risks, as well as whether certain key pieces of data, such as tax or regulatory information, are being captured at all.

The move of coverholder-MGAs to common reporting standards, including the use of technology for the submission of data to insurers, will hopefully result in an increase in quality. However, as with any data collection system the output is only as good as the input.

### Movement of funds

Along with the regular reporting of risk and claim data to insurers, the coverholder-MGA is expected to account on the same cycle for the premium associated with new risks written as well as any current risks that are being amended. As has been discussed previously, coverholder-MGAs are required to hold funds in dedicated accounts and the insurers will want to see a clear link between the risks on the bordereau and the individual movements of money. As part of this, there will usually be a service level around the effective handling of any local tax and regulatory obligations on behalf of the insurers.

### Cash flow management

A coverholder-MGA may or may not have been given a loss fund out of which to pay claims. Whether it is using the insurer's funds to pay claims or its own, the insurer will have expectations concerning the cash flow management in the business. It will be concerned if it finds, for example: insurer funds being diverted for office expenses; different insurer funds being intermingled; and one insurer's fund being used to pay the claims for another insurer's contract.

In relation to the management of loss funds, the insurer will expect to see a clear reconciliation of the fund each time a bordereau is submitted. As already mentioned, the insurer also has to consider its service to the coverholder-MGA and the speed with which claims funds will be provided after presentation of data. Slow reimbursement will have potential customer service and perception issues both for the coverholder and the insurer, as well as exposing the insurer to a potential breach of Insurance Conduct of Business Sourcebook for not settling funds in a timely way following agreement of the claim.

### Complaints

The potential for complaints is higher in the personal lines classes because individual policyholders will have expectations of their insurance coverage which are sometimes unreasonable. Coupled with this is the wide FCA definition of a complaint. That does not, however, mean that an insurer writing commercial risks via a binder should not put a service level in concerning complaints. Some complaints where expectations as to coverage are unfulfilled are unavoidable. However, the insurer does not want to find complaints that are grounded in the quality of service provided, or where the documentation does not in fact reflect the risk that was accepted.

Complaints are an issue for an insurer for a number of reasons: it will normally incur a charge each time a complaint is filed with a regulator, even if the complaint is not upheld; there will be a cost in the insurer staff time taken to consider and deal with the complaint; and there will be a reputational risk if there are a number of complaints arising out of the same underlying theme.

The overall management of complaints should include the coverholder-MGA's own internal complaints process. This will only be triggered if the coverholder-MGA is capable of identifying things which can be defined as a complaint even though the word complaint is not being used. Therefore, it should be considered part of any monitoring of this area. If complaints are being received, but they are being well managed and resolved in an appropriate way, then this is a positive sign.

From the coverholder-MGA's perspective, the ultimate indication of a client's unhappiness is their taking their business elsewhere. The coverholder-MGA then runs the risk that the binder will be cancelled or not renewed because it has not been able to achieve the originally agreed volumes of business or profit levels.

Within the conduct risk standards, there is also a requirement to measure the number of complaints and the work done to improve the situation.

### Referrals

Within any binder, there will be fixed referral points both for underwriting and claims. There will also be an expectation of the common sense referral of matters that, while ostensibly within authority, could do with a second opinion. When reviewing a coverholder-MGA's files, careful attention will be paid to the formal referral criteria. Questions will be asked as to whether they have been followed at all, followed in a timely manner, and even whether the input back from the insurer following the referral was followed. There could also be different levels of authority internally within the coverholder-MGA's office. Compliance with those internal operational controls should also be checked.

### Authority breaches

If something is not referred and is outside the authority, either on financial or factual terms, then this is an authority breach. If not spotted and reported by the coverholder-MGA itself as a result of its internal quality controls, the earliest opportunity that insurers have to spot this is when the next bordereau is presented.

Document issuance

Issuing documentation in a way that is both timely, accurate and contract certain is central to the coverholder-MGA role, even if it has no other authority delegated to it. Insurers should set service standards concerning the time between acceptance of the risk and documentation going to the client that as closely matches their contract certainty obligations as they can. Secondly, the insurer must always check that the documentation going out is accurate. In other words that it exactly matches the terms of the risk accepted and, where appropriate, that it contains market required wording, for example several liability, or any particular exclusions, for example for nuclear risks.

Financial crime prevention

Just as financial crime prevention is important within the insurer's own office, it needs to check that the coverholder-MGA satisfies the requirements of its own regulator in relation to training and procedures. Examples of this might be seeing whether large movements of funds require double signatures.

**Model answer for Question 17**

- (a)
- Accessing business held by regional brokers who would not want to share the risk or commission with a London Market broker to access the market directly.
  - Underwriting process is more cost effective for those risks too small to be placed individually.
  - Lower operating costs per risk, notwithstanding the need to pay commission to the coverholder-managing general agent (MGA).
  - Accessing the knowledge, experience and reputation of the coverholder-MGA.
  - A more cost-effective way of trying out a new area of business rather than employing a new set of underwriters.
  - Localised speedy claims handling provides superior customer service.
- (b)
- Mismanagement of funds leading to intermingling of funds belonging to different insurers.
  - Loss of control.
  - Premiums not being accounted for and paid regularly and accurately.
  - Regulatory issues because local tax or other requirements are not being complied with.
  - Impact of poor claims service from both a brand and regulatory standpoint.
  - Anti-selection where the coverholder-MGA has a number of binders onto which to place risks.
  - Failure to report adequately.
  - Unauthorised sub-delegation of authority.

**(c) Identifying a suitable partner**

The first step is for the property insurer to identify a suitable coverholder. It is likely to be one who already has access to a number of small property risks and who understands the property market. It could be in the UK or wider a field.

It might be that an insurer has already identified a successful coverholder with whom it wishes to do business: it is aware of the coverholder because it is already enjoying delegated underwriting relationships with some of the insurer's competitors.

**Obtaining approvals**

If the property insurer does decide to write risks in overseas territories it must ensure that it has the required approval from any regulator to write business via delegated authority routes.

Once a suitable coverholder has been identified, the insurer should take time to consider the coverholder's own business plan and whether what it is proposing fits in with the insurer's wider business plan. This due diligence is a key requirement to being able to obtain the necessary approvals either internally or externally.

**Deal direct or via a broker?**

The coverholder may not be a broker, they could be a property company with a number of property risks. The insurer might prefer to use a broker to set up the delegated contract, but then continue without it.

Constructing the formal agreement

This is a key practical step in the process and all parties need to be aware of their responsibilities and any restrictions placed on them. The insurer can use its own in-house wordings or use standard market wordings, which will assist in achieving contract certainty.

Processing and onward activity

There are now a range of steps that should be taken to ensure the agreement operates efficiently. Capturing risk details of the binder onto its systems at the start of the contract and then onwards as risks are attached is a key activity for the insurer.

- Receive risk reports and premium submissions on a regular basis.
- Receive claims reports and provide claims funds as required.
- On an ongoing basis consider any need for contractual changes such as increasing authority.
- The whole agreement should be monitored, and any corrective action should be taken.

Within this framework of activity, insurers should pause and consider the conduct risk elements that will have an impact when they are considering the use of delegated authority. Some of the areas of concern were transparency, the distribution chain and ensuring that the end customer gets the product that they want and is suitable for them. The responsibility for satisfying conduct risk standards remains with the insurer, even if they delegate activities to a third party such as a coverholder-MGA. Therefore, the insurer must ensure that the coverholder-MGA understands the regulatory requirements and complies with them.