



# **Specimen coursework assignment**

## **M66 – Delegated authority**

The following is a specimen coursework assignment including questions and indicative answers.

It provides guidance to the style and format of coursework questions that will be asked and indicates the length and breadth of answers sought by markers. The answers given are not intended to be the definitive answers; well-reasoned alternative answers will also gain marks.

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## Coursework submission rules and important notes

Before you start your assignment, it is essential that you familiarise yourself with the information in the *Coursework Support Centre* available on RevisionMate.

This includes the following information:

- These questions must not be provided to, or discussed with, any other person regardless of whether they are another candidate or not. If you are found to have breached this rule, disciplinary action may be taken against you.
- Important rules relating to referencing all sources including the study text, regulations and citing statute and case law.
- Penalties for contravention of the rules relating to plagiarism and collaboration.
- Coursework marking criteria applied by markers to submitted answers.
- Deadlines for submission of coursework answers.
- You must not include your name or CII PIN anywhere in your answer.
- The total marks available are 200. You need to obtain 120 marks to pass this assignment.
- Your answer must be submitted on the correct answer template in Arial font, size 11.
- Answers to a coursework assignment should be a maximum of 10,000 words. The word count does not include diagrams however, it does include text contained within any tables you choose to use. The word count does not include referencing or supplementary material in appendices. **Please be aware that at the point an assignment exceeds the word count by more than 10% the examiner will stop marking.**

## Top tips for answering coursework questions

- Read the Learning Outcome(s) and related study text for each question before answering it.
- Ensure your answer reflects the context of the question. Your answer must be based on the figures and/or information used in the question.
- Ensure you answer all questions.
- Address all the issues raised in each question.
- Do not group question parts together in your answer. If there are parts (a) and (b), answer them separately.
- Where a question requires you to address several items, the marks available for each item are equally weighted. For example, if 4 items are required and the question is worth 12 marks, each item is worth 3 marks.
- Ensure that the length and breadth of each answer matches the maximum marks available. For example, a 30 mark question requires more breadth than a 10 or 20 mark question.

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The coursework questions link to the Learning Outcomes shown on the *M66 syllabus* as follows:

Questions	Learning Outcomes	Chapter(s) in the Study Text	Maximum marks per answer
1	Learning Outcome 1	Chapter 1	10 marks
2	Learning Outcome 2	Chapter 2	10 marks
3	Learning Outcome 3	Chapter 3	30 marks
4	Learning Outcome 4	Chapter 4	20 marks
5	Learning Outcome 5	Chapter 5	20 marks
6	Learning Outcome 6	Chapter 6	10 marks
7	Learning Outcome 7	Chapter 7	20 marks
8	Learning Outcome 8	Chapter 8	20 marks
9	Across more than one Learning Outcome	Across more than one chapter	30 marks
10	Across more than one Learning Outcome	Across more than one chapter	30 marks

## M66 specimen coursework questions and answers

### Question 1 - Learning Outcome 1 (10 marks)

You are a coverholder with a number of delegated underwriting and claims authorities for UK household business. You receive a different mix of remuneration methods for each binder, including standard commission as well as profit commission, fees and overrides. The level of underwriting authority varies between the different household delegated authority schemes.

The claims for the household binders are managed in various ways including:

- No authority.
  - Limited authority.
  - One with a third party arrangement.
- (a) Identify **five** potential conflicts of interest for the coverholder. (5)
- (b) Explain, with justification, the most significant conflict of interest the coverholder may face. (5)

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## Answer to question 1 (Learning Outcome 1)

- a) Five potential conflicts of interest:
- Having both underwriting and claims authority.
  - Potential for the same risk to be acceptable under each binder.
  - Having more than one client claiming for losses that have occurred from the same incident.
  - Having various levels of remuneration presents a conflict as there may be a desire to place more business on the binder that provides the best financial return for the coverholder.
  - A conflict may also exist between the third party administrator (TPA) arrangement and the delegated claims handling authority. There may be a certain obligation for the TPA to handle certain types of claim that could also be handled under the delegated binder. (CII Study Text, M66 Delegated authority, 2018)
- b) The most significant conflict of interest occurring here will arise when the coverholder has delegated authority for both underwriting and claims. The coverholder will presumably use brokers as part of their distribution channels to get products to market. Where there is a broker involved the broker will act as an agent of the insured under English law, but will also have obligations to the coverholder under the binding authority agreement. The coverholder will also in turn have obligations to the insurer under each agreement, which could be very different. The interests of each principal will need to be identified and managed very carefully.

As firms have a regulatory requirement to identify and manage conflicts of interest whenever they occur it is important to have adequate controls in place which must be clear.

There must be a clear audit trail to prove any decision made regarding the sale of a product or claims decision made has been on the merit of the product or service and the needs of the customer. When placing business, customer's needs must come first before considering any remuneration arrangements.

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## Question 2 - Learning Outcome 2 (10 marks)

You are an operations manager for a UK-based insurer. You have been approached by one of your underwriters who has been asked by an insurance broker for a coverholder agreement. This proposed agreement would incorporate property risks from many overseas territories. This proposed agreement raises considerations regarding territories, distribution channels and regulatory issues.

- (a) Identify **five** issues which would form part of your strategic planning when considering this proposed agreement. (5)
- (b) Explain, with justification, the most important issue you have identified in (a) above. (5)

## Answer to question 2 (Learning Outcome 2)

- a) Five issues that would form part of my strategic planning will include:
- i) **The authority in the territory being proposed.** The obligations upon a coverholder or insurer could be very different to those in the UK. The insurer will need to be able to confirm that they are authorised to write business in these territories and to comply with any class specific or compulsory classes of insurance.
  - ii) **Tax.** There may be a different tax regime operating in the overseas territories. The insurer will need to be clear about what rates apply to each class of business, how the tax is calculated and how it is to be paid – for example, by the insurer or the insured, and does the tax need to be paid locally (maybe by the coverholder).
  - iii) **Route(s) to market.** The insurer will need to be clear about any licences that the coverholder may need to ensure are in place. There may have to be a local broker involved to place business on behalf of the coverholder, if the coverholder is not based in the same jurisdiction or is in a different binding authority set up.
  - iv) **Financial issues.** There may be issues with the currency of the location under consideration – premium may only be able to be accepted in local currency, which will then have to go through an exchange control process where the premiums are converted into sterling.
  - v) **Documentation.** There may be a requirement for documents to be issued in the local language, in a certain format or including certain clauses or endorsements. There may also be an issue in agreeing where the choice of law and jurisdiction lies and whether the insurer can operate an agreement written under, for example, French law. Any wording may also need to be agreed by any local regulators before it can be used. (CII Study Text, M66 Delegated authority, 2018)

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- b) The most important issue here will be compliance with local rules and requirements and any sanctions that operate in the territories under consideration.

The insurer will need to ensure that due diligence is carried out to ensure clear understanding of the environment in which they will be operating and how to comply with any requirements. The consequences of not complying with regulatory requirements could mean that customers are issued with non-compliant documentation which doesn't meet local requirements or that compulsory classes of insurance are not placed correctly. The worst case scenario would be that the client could find they are uninsured.

It is not yet understood how the UK's exit from the EU will affect the placing of business overseas, however, it is felt by some that this will make it more difficult to place risks within the EU, if the UK is no longer part of it, as existing passport arrangements may no longer exist.

Appropriate due diligence and research is key to ensuring all these issues are covered in any proposal under consideration.

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## Question 3 - Learning Outcome 3 (30 marks)

You are a Lloyd's wholesale insurance broker who specialises in European business. You have just been approached by an insurance broker domiciled in Spain. This Spanish insurance broker, which is part of a larger group of companies, has an established reputation.

The Spanish insurance broker has an existing coverholder agreement in place with a Spanish insurer. However, the Spanish insurance broker is interested in applying for a new coverholder agreement in the Lloyd's market, to replace the existing agreement with the Spanish insurer.

The Spanish insurance broker has other existing delegated authority agreements at Lloyd's.

During a recent underwriting and claims audit of the Spanish insurance broker the following issues were raised:

- The systems of control and governance were lacking.
  - There are various employment problems, including high staff turn-over and a lack of experienced employees.
  - A high number of complaints due to delays in payments for claims and other services, and another company in the group has been declared insolvent.
- (a) Explain **three** advantages and **three** disadvantages for the Spanish insurance broker in placing the coverholder agreement in the Lloyd's market. (18)
- (b) Explain, with justification, **two** significant issues that may arise during the Lloyd's application process. (8)
- (c) Identify, with justification, the most likely type of coverholder arrangement Lloyd's would authorise. (4)

## Answer to question 3 (Learning Outcome 3)

- a) Three advantages to the regional broker would be:
- i) **Access to Lloyd's.** Using Lloyd's extensive licence network will enable the Spanish broker to write worldwide business and access the wide range of diverse talent which exists within the Lloyd's market to assist in placing risks. Given the strength of the Lloyd's name this can only help strengthen the Spanish broker's reputation and assist them with future growth and development.



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- ii) **Greater flexibility.** Having access to Lloyd's will also provide additional capacity and the flexibility to develop new areas of business, possibly in new territories, and the capability to provide bespoke solutions. Outsourced systems such as Xchanging will help with the centralisation of data capture and money movement if required.
- iii) **Increased authority.** In terms of both underwriting and claims handling, increased authority is also possible given the market which is available. There will also be access to Lloyd's standard market wordings, which are accepted and understood across the world.

Three disadvantages are:

- i) **Lloyd's expectation of coverholders.** There are existing problems with governance, staffing and complaints together with insolvency within the group. This will all be highlighted within the application process and the broker will need to meet Lloyd's high expectations. Lloyd's will need to be satisfied that all previous issues have been addressed and that adequate controls are now in place to prevent them happening again, as will any MGA approached to support the application. The Spanish broker must also be willing and able to accept the terms of any undertaking given by Lloyd's.

The overall person managing or controlling a Lloyd's coverholder must also have the necessary reputation and standing, so the Spanish broker must be able to demonstrate that this is the case. It may be that a completely new team is now in place at the broker following previous problems, but Lloyd's will need to see evidence of this, if this is the case.

- ii) **Compliance.** The Spanish broker must be able to comply with any additional terms imposed by Lloyd's – which may not already in place and that may be difficult to do given its previous history. It will also need to prove that it can demonstrate good governance, the quality and adequacy of its staff and HR function, management controls and procedures in place, and that it possesses all the relevant licences, and approvals that may be required to write business in the territories it is operating in.
- iii) **Solvency requirements.** Lloyd's has stringent capital and financial resourcing requirements. Given the previous history with this broker, this may be difficult to achieve. This will include having adequate capital and financial resources and details will be required of accounts and other financial information including evidence that professional indemnity insurance is in place.

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- b) The two most significant issues likely to arise are:
- i) To be able to bind risks within the Lloyd's market, as well as having support from the wholesale broker, the Spanish broker will need a letter of support from a managing agent to complete the application. Whereas the application would be approved with just the wholesale broker's support, a managing agent will also need to be identified and approached before any risks can be bound. Any MGA approached will want to satisfy themselves that any previous issues have been overcome. This may involve a lengthy review and possibly a re-audit to see whether any actions put in place from the last audit have taken effect and if any further remedial action is necessary.
  - ii) The coverholder undertaking. This is a key part of the application process which sets out Lloyd's expectations of its coverholders and the way they operate within the market. This includes the conduct and writing of business, dealing with customers, governance, compliance with local requirements, fund holding and the coverholder's administrative arrangements. Given the previous issues the Spanish broker has faced, again it may be difficult to convince Lloyd's that things have changed and past problems are behind them and that they are now able to meet all the requirements of the undertaking.
- c) If the Spanish broker is successful in their application to Lloyd's with the support of both a managing agent and the wholesale broker, bearing in mind their previous history, it seems likely that Lloyd's would authorise some kind of arrangement via a service company, which would still need to be set up via a MGA.

This type of arrangement would still require approval from Lloyd's and an initial part of the process would be a meeting with Lloyd's delegated authority team to discuss (amongst other things) staffing, processing of data and funds, compliance, local requirements and the best operational solution.

The managing agent will need to confirm that all reporting requirements are met. The option of a service company should help formalise the whole application process for the Spanish broker and will ensure adequate controls are in place to ensure any agreement runs smoothly without any repeat of past problems. Again, there will be a service company coverholder undertaking, focusing on the ongoing management and approval of the service company that must be agreed and signed off.

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## Question 4 - Learning Outcome 4 (20 marks)

You are an insurer who writes many delegated authorities with an insurance broker, acting as a coverholder, in a highly competitive market. Your relationship with the insurance broker is good. Most of these delegated authorities are very profitable and generate a substantial amount of premium income. However, you are very concerned about one delegated authority which includes claims handling and limited underwriting authority.

After a mid-term review of the delegated authority which is causing you concern you have decided to cancel it for the following reasons:

- You are losing a substantial amount of money.
- Some of the risks attaching to the delegated authority are of very poor quality.
- Delegated authority levels are regularly exceeded.
- The validity of many claims that have been authorised by the coverholder are disputed by you.

In cancelling the delegated authority, it is essential that you protect the needs and interests of the coverholder and the insureds whilst also ensuring that your needs are also fully protected.

Explain, with justification, **four** appropriate actions you would need to take when implementing the cancellation. (20)

## Answer to question 4 (Learning Outcome 4)

Early cancellation of a binder will generally only be considered once all other options have failed, so it is assumed in this example that remedial action has already been taken to improve the performance of the binder, but this has not been successful.

Four appropriate actions when implementing the cancellation include:

- i) When cancelling the delegated authority, the insurer will need to consider any notice period which is laid down in the binding authority agreement. Notice will need to be correctly served, and full details of any in force policies or ongoing claims obtained. The insurer will still have an obligation to see any claims through to settlement and to continue with cover for any live policies during the notice period and possibly beyond, depending upon the provisions of the cancellation notice. Post cancellation, any other obligations to the coverholder, such as profit commission will still need to be honoured.

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The insurer will also need to closely monitor the handling of the delegated authority throughout the notice period, including the maintenance of adequate staffing levels at the coverholder, to ensure insureds still receive the service they are entitled to. If there are any concerns about customer service levels, service may need to be taken back in house by the insurer.

- ii) Once notice has been service, the insurer will need to make sure the coverholder can no longer issue any documentation in its name – if manual wordings are still used these can be withdrawn quite easily, however, as electronic documentation is more commonly in use now this may be more difficult to achieve. Authority for mid-term amendments should be amended to prior submit. The broker can retain authority to issue documents however all risks should be referred to the insurer for terms prior to cover being bound. This will ensure any issues with authority levels being exceeded are avoided and the insurer will have confidence that risks being bound are acceptable
- iii) Whilst the agreement is in run-off considerations should be given to removing any delegated claims authority, particularly given the concerns over claims disputes. One option would be to outsource this activity to a third party provider or alternatively redirect all claims directly to the insurer if the broker holds any kind of claims fund relating to the limited delegated claims authority, this will need to be repaid to the insurer. If claims handling is an issue with this arrangement with the coverholder, the insurer may wish to take the claims handling function back in-house, in which case the insured parties will need to be made aware.
- iv) The insurer needs to identify any risks that are due to automatically renew and ensure that all customers are contacted in advance of their expiry date. This is a key consideration to ensure there is no detrimental impact on customers – the insurer may choose to automatically renew directly. In all cases the insureds must be the most important consideration as they will still have an insurance contract in force with the insurance company (to which the coverholder is not a party) and the insurer will still have a duty to the insureds, at least until the policies expire. (*P66 Study Text 2018*).

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## Question 5 - Learning Outcome 5 (20 marks)

You are the Underwriting Manager of a managing general agent (MGA) which operates a household underwriting delegated authority on a prior submit basis. The delegated authority, which has been operating profitably for three years, has exceeded the expected growth targets.

However, you are concerned about the increasing number of customer complaints and a deteriorating conversion rate in the last few months. This could have an adverse effect on the MGA's reputation and the growth and profitability of the business unless action is taken.

- (a) Describe, with justification, **two** options that you could take to resolve your concerns. (10)
- (b) Recommend, with reasons, **two** appropriate actions, other than the two options you have described in (a) above, that you would take to maintain profitable growth. (10)

## Answer to question 5 (Learning Outcome 5)

- a) A good binder manager will require the Underwriting Manager to be able to analyse and assess the performance of the binder. The insurer will require good quality data to be provided, and to do this the MGA should have internal management procedures in place to see how the binder is performing at any point. Ideally, the issues around declining conversions and increasing complaints need to be highlighted and addressed prior to the insurer becoming aware of them at audit time.

Any review should include any growth above estimated premium income – the insurer will need to be made aware of this as it may mean that there is a breach of authority on the part of the MGA.

Two options to resolve the current issues are:

- i) It seems sensible to expect that an audit needs to be carried out concentrating on the performance of the binder and reviewing the complaints received to see whether there are any underlying issues. A re-audit could then be carried out within, say, three months to see if these issues have been addressed. Alternatively, the MGA could consider changing authority or reviewing how cases are submitted to the insurer and whether there is a delay in obtaining a decision or quotation.

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- ii) A full review of the arrangement will identify key problems. If the issue lies with the rating structure, the insurer should review its premium pricing policy to improve conversion whilst ensuring a sustainable margin is maintained. If the issue lies with the coverholder, minimum service levels can be reviewed and implemented to ensure customers have an improved service experience at the new business stage. For example, call back times and telephone answering commitments can be added to the coverholder agreement.
  
- b) The current arrangement is exceeding growth expectation, so if the arrangement can be managed more effectively, the binder should be profitable. It may be sensible to review the coverholder agreement to ensure that better control can be maintained by the insurer over the coverholder. An audit followed by a re-audit is the most likely and appropriate action following a review of information prepared for the insurer on the monthly bordereau.

The audit will focus on underwriting and complaint handling, together with any compliance and regulatory issues. Recommendations can be made with dates put in place when improvements will be expected to be made. A re-audit to follow up plus a review of information submitted on the bordereau will illustrate if there have been improvements or if further work needs to be done.

Secondly, as this is a prior submit arrangement, the MGA has no authority to make underwriting decisions itself, so any risk it wants to bind has to be referred to the insurer for terms. As there is a declining conversion rate here, it may be that this the wrong sort of arrangement. It may be that potential growth identified when the binder was set up has not transpired or the insurer may not have done sufficient due diligence to ensure expectations were reasonable. The binder is still making money so both MGA and insurer will want this to continue, but complaints could be a concern as they will take time to resolve and there could be regulatory penalties and a reputational risk.

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## Question 6 - Learning Outcome 6 (10 marks)

You are a motor claims manager of a managing general agent (MGA). The MGA has a delegated claims authority which involves a high volume of low value motor claims. Recently there has been an issue, with some of the MGA's customers querying the time taken between the approval of the claim by the MGA and the final settlement payment made by the insurer.

When solving the above issue, it is essential that you protect the interests of the MGA's customers, the insurer and the MGA's business.

- (a) Explain, with justification, the most appropriate method of solving the above issue. (6)
- (b) Explain **two** disadvantages for the MGA of the method you have explained in (a) above. (4)

## Answer to question 6 (Learning Outcome 6)

- a) The issue here appears to be around the claims payment process. The MGA has the authority to handle the first notification of loss and check whether cover operates, but they do not appear to have any authority themselves to pay the claim and no claims fund is in place.

Provided the insurer is satisfied as to the ability of the MGA to handle these claims, the best course of action would probably be for the MGA to request limited claim handling authority from the insurer.

This could be limited by either size or type of claim to be handled. In this case, as low value claims are the issue, a financial cap could be placed on the value of the claims, say £500, beyond which claims would need to be referred to the insurer for settlement.

This would mean that smaller claims could be handled more efficiently, thus creating less delay for the customer as no authorisation process will be required for these smaller claims. This will also reduce the amount of likely complaints arising from the time to handle claims.

- b) Two disadvantages for the MGA would be:
  - i) They may have to use their own funds to pay claims (and seek later reimbursement from the insurer) which would not be an attractive option for most MGAs. This could be managed by asking the insurer for a loss fund, where the insurer provides a loss fund at the start of the binding authority contract.

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- ii) The MGA will need to provide a regular claims bordereau to the insurer with details of claims paid – either to seek reimbursement if paid from own funds or to seek replenishment of their loss fund, depending upon how this is funded.

The MGA will need staff in place that can handle the limited claims authority and to submit the monthly documentation that will be required.

## Question 7 - Learning Outcome 7 (20 marks)

You are a compliance officer for a UK-based insurer. The insurer's Underwriting Manager has been approached by a potential coverholder for a new delegated underwriting and claims authority.

The potential coverholder has a number of customers throughout several overseas territories. You have concerns that some of the territories where the customers are domiciled have high levels of financial crime. You are aware of many fines levied by the UK regulator on insurance organisations in relation to inadequate and inappropriate compliance procedures. The Underwriting Manager has asked you to conduct a due diligence exercise.

- (a) Identify, with justification, **two** significant compliance risks, arising from the above territories, you must consider when conducting the due diligence exercise. (8)
- (b) Explain, how the insurer could mitigate **each** of the two compliance risks you have identified in (a) above. (12)

## Answer to question 7 (Learning Outcome 7)

- a) The biggest threats from a compliance perspective are likely to be bribery and money laundering.

**Bribery** is of concern where claims authority is delegated abroad as there may be a long chain between insurer and the end customer. Individuals may be more susceptible to bribery due to the nature of their work, for instance, local businessmen or politicians, and it may just be an accepted way of 'getting things done' in the territory concerned. Inappropriate payments to third parties could be bribes and as such the insurer and intermediary needs to be able to justify such payments such as remuneration to third parties. Appropriate due diligence should always be carried out on third parties, to ensure that there are no sanctions or trade restrictions in place to prevent trade with them. The same applies to claim payments. In some parts of the world to obtain information or obtain specialist equipment for a marine claim for example, payment of funds is sometimes required.



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- i) This would be a bribe in many parts of the world, the UK, although the US seems to allow such activity to take place. (CII Study Text, M66 Delegated authority, 2018)

**Money laundering** is the process of exchanging 'dirty' money – which is generally acquired through criminal activities – into 'clean' money. Insurance is often a target for money laundering as a premium can be paid using dirty money then the policy cancelled shortly after inception and a refund of money obtained. There will then be no connection to the previous dirty money. Staff will need to be fully trained on how to recognise potential instances of money laundering. This could be instances where the client seems to be over insuring to increase the premium (and pay over a higher amount of dirty funds to the insurer), interest in the process to cancel the policy with no apparent reason and with little or no concern over the rebate scale, no real insurable interest and involvement of third parties who seem to have no connection to the insurance contract.

- b) The various methods and procedures I would use to mitigate the risk of financial crime are as follows:

Staff training – ensure all staff are fully trained to understand what money laundering, bribery, anti-corruption and suspicious activity is. Then ensure that we have documented procedures in place for staff to report any suspicions of financial crime to the Money Laundering Reporting Officer (MLRO). Staff should be aware of the risks associated with financial crime, and ensure they do not 'tip off' anyone they suspect as being involved with financial crime.

Processes and procedures – ensure fully documented procedures are in place for taking payments, processing refunds, processing claims payments and payments to third parties. Checks should be done to ensure no payments are made to or received from individuals who are subject to sanctions and asset controls (Her Majesty's Treasury sanctions and The Office of Foreign Assets Control (OFAC)). Sign off procedures should be implemented to process claims payments and third party payments, i.e. claim payments over a certain level require approval from a higher authority level within the business.

Sanctions checks – as a minimum, we need to capture basic information about policyholders to enable sanctions and OFAC checks to be carried out. For individuals, the usual information captured is name, date of birth, gender and address. For entities, the usual information to capture is the full business name of the entity, the registered office in incorporation, the registered number and the business address if different. Checks should then be carried out to ensure there are no restrictions to dealing with the individual or entity.

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Customer due diligence (CDD) – where the customer presents a higher financial crime risk and for business based overseas, I would put customer due diligence procedures in place to mitigate the potential risks the business may face. It is key that a business knows who they are dealing with and so a process should be put in place to verify the identity of any customers or third parties being dealt with. This would involve obtaining the basic information as noted above (for sanction checks) and then obtaining identification (ID) documents to verify the identity of the customer/third party. This may be in the form of a passport, driving licence or other national ID card. Where photographic ID cannot be provided, documentation that supports the client's name, address and date of birth should be provided. For registered entities, sources such as Companies House, Charities Commission etc., can be used as a means of verification.

Where the customer presents further risk, enhanced due diligence should be carried out in addition to verifying the identity of the client. This is of importance where the client is a politically exposed person (PEP). Enhanced due diligence involve additional checks above CDD and may involve internet searches for any adverse press for example, visiting the client, verifying the source of their funds etc. and in the case of entities, carrying out due diligence on the company directors.

Monitoring – two types of monitoring can take place. Firstly, monitoring the territories that are being dealt with to identify whether there are any new concerns being raised. Indicators may include adverse press associated with the territory, or a change to the country's rating on the corruptions perception index which indicates that the level of financial crime associated with that territory has increased.

The other type of monitoring would be internal audits against procedures in place to ensure they are still adequate and are being followed by staff.



## Question 8 - Learning Outcome 8 (20 marks)

You are the Underwriting Manager for an insurer which has many delegated underwriting and claims authorities with a range of coverholders. You have agreed to provide a binding authority to a coverholder who has experience of operating delegated authorities but has not traded with you previously. You are in the process of drafting the delegated authority document. You are keen to avoid poor adherence to this delegated authority and you wish to monitor performance closely during the first year.

- (a) Explain, with justification, **four** key categories of information you would require the coverholder to provide on an on-going basis. (12)
- (b) Explain, with justification, the most appropriate method for monitoring performance of the delegated authority during its first year. (8)

## Answer to question 8 (Learning Outcome 8)

- a) Four key categories of information would be:
- i) **Referrals to the insurer.** Reviewing these will ensure that the coverholder is using the authority delegated to them correctly and not allowing any breaches to occur. The insurer will also need to check that referrals are carried out in timely fashion. Any breaches will need to be investigated to ensure authority is fully understood and that they do not occur again in the future.
  - ii) **Prevention of financial crime.** Insurers will need to check adherence to internal financial crime prevention measures by the coverholder and that their staff are adequately trained and understand how to recognise and report suspected financial crime.
  - iii) **Complaint handling.** The coverholder should have their own internal complaint handling process and the coverholder must understand how to recognise a complaint from the start to be able to deal with it. Complaints will mean that the coverholder will lose business and as well as incurring a charge for complaints to be investigated by the regulator, may also be at risk of reputational harm, as will the insurer.
  - iv) **Issue of documents.** This should be done in a timely fashion after the acceptance of risk, whether documents are issued in a printed form or as an email attachment. Documents must be contract certain, clear for the customer to understand and be accurate and complete, including full endorsement wordings if applicable.

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- ii) The most appropriate method of monitoring would be to review the monthly bordereaux regularly and conduct an audit quarterly (CII Study Text, M66 Delegated authority, 2018).
- b) The delegated authority documentation should itself set out the terms of the agreement with clear expectations as to what the insurer expects from the coverholder. There will be key service standards set out in respect of underwriting and referral processes, together with complaint handling, cash flow management and reporting standards/regularity. It is important that the coverholder complies with these. Probably the easiest way of ensuring this happens will be by reviewing the monthly bordereau submitted to the insurer by the coverholder, which will present a record of all risks written in the previous month. If there have been any mistakes or breaches of authority made, even innocent ones, then the monthly bordereau should highlight this. It will also be possible to tell from the bordereau; the quality and amount of business being written to ensure business growth and profitability targets agreed at the commencement of the binder are being met.

Given that the coverholder already has experience operating delegated authority agreements and underwriting authority is limited, there would not be a particularly high-risk associated with the agreement, therefore regular auditing would be an appropriate method to monitor performance. This can be formal or informal and may be done by the insurer or they could outsource to a third party. Audits should be carried out at least annually on an ongoing basis, however in the first year a more regular audit should take place, recommended as quarterly. This will enable any issues to be spotted at an early stage and remedial actions put in place. Audits undertaken on site will also enable better relationships to be established and key insight into the operation itself, rather than auditing from afar and not seeing the true picture. The insurer should have a framework in place for auditing with key topics identified for discussion and reporting. If the coverholder outsources any activity then the third parties undertaking such activities should also be included in the audit process.

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## Question 9 - Across more than one Learning Outcome (30 marks)

You are the Compliance Manager for a managing general agent (MGA) and you are preparing for a visit from the Financial Conduct Authority (FCA).

As part of your review for the visit, you have noticed a high volume of complaints on one of the UK household binders under which the MGA has a full underwriting authority. Upon investigation, you discover that one of the MGA's teams is placing business on a binder which has the most advantageous remuneration for the MGA, regardless of the demands and needs of the customers.

- (a) Explain, with justification, **three** significant actions you would take to address the actions of the MGA team with immediate effect. (15)
- (b) Explain **three** important procedures you would put into place to prevent any reoccurrence of the actions of the MGA team in the future. (15)

## Answer to question 9 (Across more than one Learning Outcome)

a) It will be important to understand why the practice of attaching more business to a binder with more advantageous remuneration than others are happening and whether the whole team at the MGA engage in this or just a few individuals. As well as the increased remuneration, this could be indicative of a conflict of interest, where business is placed in accordance with the MGA's own financial interests without bearing in mind the interests of the customer.

It is also important to understand why the complaints are coming in. This is probably also to do with cover being placed without understanding the demands and needs of the customer.

Three significant actions could include:

- i) **A regular bordereau reviews.** The Financial Conduct Authority will want to see sufficient data is being analysed on a regular basis to make sure service standards are met and any conduct risks managed. Looking at the risks placed will enable the MGA to understand if any risks are placed outside the authority granted under the binder. This will also help identify where business is coming from and help highlight where the business is spread across the binders held.
- ii) **Review binding authority.** With different options available under the various binding authorities, there is always the temptation to place business under binders which have the most financial reward for the MGA. Business should be placed under whichever binder provides the best cover for the customer's needs and there should be a good mixture of business spread across all binders, according to the different needs of each customer.

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By reviewing the various authorities in place it might become apparent that perhaps the MGA should not have ultimate control over how business is placed and maybe a limited or prior submit binder would be more suitable. It would also be interesting to understand how profitable the problem binder is.

iii) **Review complaint handling process.** By doing a root cause analysis of the complaints received, the MGA will be able to understand the reason why so many complaints are being received. If this is because cover is being placed incorrectly and not in line with customers' demands and needs, the MGA may need to re-train staff to ensure they fully understand the authority granted under the binder and which risks it is suitable for. It may be that the MGA can handle complaints themselves or they must be referred to the insurer for resolution. The MGA will need to be clear about who is responsible for handling complaints under this binder and across the other ones too, and that complaints are recognised, resolved and recorded appropriately.

b) Three essential procedures to ensure this problem does not occur again in the future are:

i) Continuing to review monthly bordereaux on receipt to make sure that there is a good split of business across all binders and that the advantageous binder is not used as the preferred option purely for financial reasons. Staff need to be trained as to how each binder works and what type of customer it is most suitable for.

Internal reference document could assist with this. There should be a robust quality control audit in place to ensure that the sales practices in place are based on the fair treatment of customers and that these practices are being followed. There should not be any sales incentives in place that encourage mis-selling of policies to generate higher commission, and staff sales should be closely monitored. In practice, firms should have robust procedures in place to regularly monitor sales activity and non-adherence to sales procedures should have appropriate consequences in place for staff.

ii) The MGA will be subject to audit from time to time by the insurer providing the binder authority. This will focus on many key areas such as details of everyone involved in the management of the binder, systems used, any accounting issues and of interest, compliance issues including complaint handling and treating customers fairly. The MGA will need to satisfy the insurer that adequate controls are in place. If they are not, it may be necessary for detailed feedback to be given and a plan for improvements to be put in place. A re-audit may also be necessary to check the effectiveness of any action taken.

iii) It may be that the insurer may want to review the authority held by the MGA under the problem binder and possibly all the other ones too. If there any concerns that authority is being mismanaged, it may be time to review how business is placed and whether the remuneration currently being received also needs to be reviewed. The insurer will not want to risk any damage to its reputation because of poor service and a high number of complaints. Complaints and errors and omissions (E&O's) also need to be monitored for

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trends. Any complaints suggesting that policies are being mis-sold need to be investigated as do any E&O's suggesting issues with cover. Any issues identified need to have remedial action taken, where there is evidence of client detriment. If necessary, clients may need to be contacted to address any issues identified. Claims repudiations should also be reviewed to establish if there a higher number of repudiations than expected, and for what reasons. A high frequency of claims repudiations would suggest that the products being sold are not performing as expected and therefore could be an indication of mis- selling.

## **Question 10 - Across more than one Learning Outcome (30 marks)**

You are an external auditor appointed by an insurer to introduce an audit process for motor fleet delegated underwriting agreements. The insurer has many different coverholders. The audit process is required to regularly monitor compliance with the agreements and the underwriting of each individual fleet policy.

Upon initial investigation, you have found the following issues:

- A wide variation in the extent of delegation between agreements.
  - A wide variation in the delegated authority document wordings.
  - Inconsistent underwriting rules between agreements.
  - Different bordereau requirements between coverholders.
  - A considerable variation in the experience and training of coverholders' staff operating the delegated authorities.
- (a) Recommend, with reasons, **one** action for **each** issue above that you would present to the insurer. (15)
- (b) Explain, with justification, an appropriate process, together with associated activities, you would present to the insurer, to improve compliance with the agreements. (15)

## **Answer to question 10 (Across more than one Learning Outcome)**

- a) A recommendation for each point is as follows:
- i. **Wide variation in the extent of delegation.** There could be many reasons why this is the case. Prior submit, limited authority binders or even pre-agreed rates still give the insurer an element of control in the acceptance of risks, whereas full binding authority means that the insurer has effectively delegated all authority to the coverholder. It is important to understand why there are so many different arrangements in place for what is on the surface the same class of business. This may be because of the experience of different coverholders and the length of time their relationship with the insurer has been in place.

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This will need to be included in the review to ensure this is still correct for each arrangement and the right level of authority is being delegated or retained.

- ii. **Wide variation in the delegated authority document wordings.** This could be linked to the level of authority above which is in place for each coverholder. Each binding authority agreement will set out details of the document wordings to be used. Some may differ according to the territory in which business is written, or where different regulatory requirements may be in place. Documents may also be specifically branded for each coverholder.

In any case, the auditor will need to build in a review of all documentation as part of the audit and review process to ensure this is all in the correct format with correct terms and conditions shown together with being contract certain.

- iii. **Inconsistent underwriting rules between agreements.** It is important that underwriting rules are consistent between contracts, particularly for the same class of business. Inconsistency between different agreements will lead to confusion for coverholders and may affect the profitability of business written due to lack of understanding or for coverholders to select an agreement which is more advantageous to them. This could also mean good and not so good business is not evenly spread when being placed under different arrangements. The audit needs to include a review of why this is the case. The binding authority agreement should include information on where business can be written, where insureds should be domiciled, the maximum limit of liability which can be accepted, any excess or deductibles applying, gross premium income limit and the method of premium calculation. If this is not clear from the binding authority agreement the agreement may need to be redrafted. Further clarification can be provided by issuing an underwriting guide for each binder and implementing this with the coverholders.
- iv. **Different bordereau arrangements.** These can vary but will rarely vary much for one insurer for the same class of business. A standard template often used is the Lloyd's non-marine contract which provides a template to satisfy most market requirements. It may be a good idea to review the existing contracts in place and try to understand why there is such wide variation. It may also be time to consider bringing these in line with the standard template.
- v. **Experience and training of staff.** Different coverholders will again employ different staff who may have differing levels of expertise and experience, but in any case, anyone dealing with a delegate authority contract should have received sufficient training and understand how the delegated authority works to be able to perform their role satisfactorily. It may be difficult for certain coverholders to retain key staff or there may be a higher than planned level of staff attrition. In either case, the insurer needs to understand the issues faced by its coverholders and the auditor will need to investigate. The auditor need to suggest ways in which the



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insurer can work with the coverholder to develop and deliver a training plan to help achieve an agreed level of competency for all staff handling risks being placed on the relevant binders or to insist on more formal accreditation for key staff.

b) An appropriate process to improve compliance with the agreements would be to develop a standard audit template. This would consist of obtaining the following data:

- Company information, such as details regarding the staff involved with the contract, staff attrition, training, outsourcing and any controls in place to monitor external suppliers, have staff are incentivised i.e. bonuses etc., whether the company has been subject to any external or regulator review, and whether there have been any errors and omissions (E&Os). This will all help the auditor understand the level of expertise managing the binder and any issues they may be facing.
- Accounts – the auditor will want to review how accounts are being managed, how transactions are being settled and reconciled, what credit control processes are in place and to ensure tax is being accounted for correctly.
- Information technology – a review of IT systems, controls anti-virus protection and Data Protection Act 1998 controls should be undertaken to understand the coverholders approach to protecting client and business data, and what contingencies are in place should IT systems fail for any reason.
- Likewise, the auditor will want to understand what business contingency procedures are in place and what testing has been carried out.
- Compliance with regulations. The audit will conduct a review of internal compliance, treating customers fairly (TCF), complaint handling procedures to ensure adherence with regulation.
- Financial crime – the auditor will want to review procedure and ensure training is in place to mitigate risks of the coverholder being used for financial crime.
- Contract specific reviews against any specific requirements agreed with the coverholder, and adherence to the level of underwriting and claims authority that has been granted to the coverholder.

The binding authority agreements in place with each coverholder need to be reviewed to see whether there is any provision made in terms of audit type frequency. If not, it would be wise to work with the insurer to establish what the expectations are in terms of how often the audit needs to be carried out by an external auditor and whether there are any records of previous audits that can be reviewed. There are various standard audit templates available which will cover the following areas:

- Staff** – who the key people are at each coverholder, what levels of staff attrition are like and what succession plans are in place.
- Finance and credit control** – how payments are authorised and reconciled and reported to the insurer, and how funds are held.

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- iii. **Systems** – do these fully support the requirements of the business and what disaster recovery and back up procedures are in place.
- iv. **Underwriting** – how the underwriting authority which has been granted to each coverholder is complied with, what the referral process to the insurer is and whether there have been any breaches.
- v. **Documentation** – whether the documentation issued to clients is correct and meets TCF requirements.
- vi. **Compliance** – are all regulatory requirements being met and is all reporting done correctly.
- vii. **Training** – this will need to include a review of the training programme in place at each coverholder to ensure staff training is carried out to the correct level including any mandatory training such as awareness of financial crime and money laundering.

The expectations from the audit then need to be agreed with the insurer and communicated to each coverholder so the audits can be agreed and arranged.

Following the audit, detailed feedback will be provided to the coverholder – it is a pointless exercise if the coverholder does not get affirmation that they are in adherence with the binder or alternatively, if any issues get identified, they need to be addressed with the coverholder and agreement sought on actions to remedy the issues found. The coverholder may also wish to have the opportunity to challenge any issues found if they feel they are incorrect.

If the audit is poor, there are many options:

- Re-audit: agree a suitable time frame to carry out a re-audit, ensuring there is sufficient time for any remedial actions agreed to have been completed.
- Changing authority: a possibility would be to reduce authority if necessarily, such as removing delegated claims authority. This could be on a temporary basis until remedial actions have been carried out.
- Cancellation: if the findings of the audit are significantly poor, the insurer may have no option but to cancel the delegated authority. There are many considerations to consider if this is the case, as there will still be many live risks that need to be managed through the run-off period.

## Reference list

Charlotte Warr LLB (hons) FCII – CII Study Text, M66 Delegated authority, (2018).

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## Question deconstruction and answer planning

The following three plans are based on 10, 20 and 30 mark questions respectively.

### Question 1 - Learning Outcome 1 (10 marks)

You are a coverholder with many delegated underwriting and claims authorities for UK household business. You receive a different mix of remuneration methods for each binder, including standard commission as well as profit commission, fees and overrides. The level of underwriting authority varies between the different household delegated authority schemes.

The claims for the household binders are managed in various ways including:

- No authority.
- Limited authority.
- One with a third party arrangement.

(a) Identify **five** potential conflicts of interest for the coverholder. (5)

(b) Explain, with justification, the most significant conflict of interest the coverholder may face. (5)

### **Question deconstruction**

- Review learning outcome 1 in the course material and the relevant information in the study text.
- Highlight the instructions within the question (which are circled in red above).
- What is the context? UK-based coverholder, holding several delegated underwriting and claims authorities, each with varying characteristics.
- The question in part (a) asks an identification of five conflicts – with only five marks available a very short answer is required.
- In part (b) an explanation of the most significant conflict is required and a justification of why it is the most significant in this scenario.

### **Answer plan**

- In part (a) you need to identify five conflicts arising from this scenario. The question is quite specific and only five marks are available, one for each conflict.
- In part (b) a longer explanation is required for how the conflict arises, why it is a conflict and why it is the most significant in this scenario.
- As this is a 10 mark question, your answer should be shorter than the answers to either a 20 or 30 mark question.

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## Question 5 - Learning Outcome 5 (20 marks)

You are the Underwriting Manager of a managing general agent (MGA) which operates a household underwriting delegated authority on a prior submit basis. The delegated authority, which has been operating profitably for three years, has exceeded the expected growth targets.

However, you are concerned about the increasing number of customer complaints and a deteriorating conversion rate in the last few months. This could have an adverse effect on the MGA's reputation and the growth and profitability of the business unless action is taken.

- (a) Describe, with justification, **two** options that you could take to resolve your concerns. (10)
- (b) Recommend, with reasons, **two** appropriate actions, other than the two options you have described in (a) above, that you would take to maintain profitable growth. (10)

### Question deconstruction

- Review learning outcome 5 in the course material and the relevant information in the study text.
- Highlight the instructions within the question (which are circled in red above).
- Consider the context which includes the fact that you are an Underwriting Manager of a managing general agent and are concerned by customer complaints and a deteriorating conversion rate.
- The marks in part (a) and (b) are equally weighted so spend an equal amount of time and effort in describing two options and then recommending the two most appropriate actions and justify why they are the most appropriate in this scenario.

### Answer plan

Part (a): You need only describe two options, with 10 marks, five for each option, Note that you must justify why these two options are the most important in this scenario.

Part (b): Requires a recommendation of two appropriate actions **other** than the two options you described in part (a). Note that you must give reasons as to why your recommendations are the most important in this scenario.

As this is a 20 mark question, your answer should be longer than the answer to a 10 mark question but shorter than the answer to a 30 mark question.

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## Question 10 - Across more than one Learning Outcome (30 marks)

You are an external auditor appointed by an insurer to introduce an audit process for motor fleet delegated underwriting agreements. The insurer has many different coverholders. The audit process is required to regularly monitor compliance with the agreements and the underwriting of each individual fleet policy.

Upon initial investigation, you have found the following issues:

- A wide variation in the extent of delegation between agreements.
- A wide variation in the delegated authority document wordings.
- Inconsistent underwriting rules between agreements.
- Different bordereau requirements between coverholders.
- A considerable variation in the experience and training of coverholders' staff operating the delegated authorities.

(a) **Recommend**, with **reasons**, **one** action for **each** issue above that you would present to the insurer. (15)

(b) **Explain**, with **justification**, an appropriate process, together with associated activities, you would present to the insurer, to improve compliance with the agreements. (15)

### Question deconstruction

- Review learning outcomes 4, 5 and 8 in the course material and the relevant information in the study text.
- Highlight the instructions within the question (which are circled in red above).
- Consideration of the context, you are an external auditor with the task of auditing an insurer with a range of motor fleet delegated authorities.

### Answer plan

Part (a) and part (b) are both worth 15 marks so your answer should be equal in depth between parts.

In part (a) you are asked to recommend one action for each of the five bullet points in the scenario. Therefore, there are 3 marks for each recommendation, including a reason for that recommendation.

In part (b) you are asked to explain with justification a process, together with associated activities to improve compliance with the agreements.

As this is a 30 mark question, your answer should be longer than the answers to 10 and 20 mark questions.

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## Glossary of key words

### Analyse

Find the relevant facts and examine these in depth; examine the relationship between various facts and make conclusions or recommendations.

### Construct

To build or make something; construct a table.

### Describe

Give an account in words of (someone or something) including all relevant, characteristics, qualities or events.

### Devise

To plan or create a method, procedure or system.

### Discuss

To consider something in detail; examining the different ideas and opinions about something, for example to weigh up alternative views.

### Explain

To make something clear and easy to understand with reasoning and/or justification.

### Identify

Recognise and name.

### Justify

Support an argument or conclusion. Provide or show reasons for a decision.

### Outline

Give a general description showing briefly the essential features.

### Recommend with reasons

Provide reasons in favour.

### State

Express main points in brief, clear form.