



FSA Themes in General Insurance And Pure Protection Regulation

As we have now passed the first anniversary of FSA regulation of general insurance and pure protection, it is worth looking at some of the key themes the FSA has raised over the last twelve months and how this might affect firms in the future.

Introduction

The areas that I would like to look at are

- Client money
- Non Advised Sales
- Product suitability
- Customer understanding
- Conflicts of interest
- Claims.
- Treating customers fairly



With the exception of client money, it is perhaps no surprise that the majority of FSA comment has been in those areas where the rules are principle based rather than prescriptive.

The difficulty with this is that we must interpret the FSAs requirements with a degree of uncertainty as to whether our interpretation is correct and our implementation is sufficient. On the other hand the FSA seems to prefer to work with firms (at least in the first place) around these areas rather than immediately resort to enforcement action.

Client Money

Let's start where there can be a reasonable degree of certainty, client money. Whilst the rules requirements are a little complex they are reasonably certain. In a short article it is not possible to cover all of the requirements in detail so I will merely list the areas where I have seen FSA comment in the last year.

These are

- Using a statutory trust correctly.
- Client money audit requirements
- Reconciliation
- Control of appointed representatives

Given that this is a black and white (well dark grey and cream!) area of the rule book, there is little defence if a firm gets these requirements wrong.

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Non-advised sales

It may be useful to look at the recent review of Payment Protection Insurance (PPI) to gauge the FSA's expectations in this area. In that review the FSA found the following with regard to non advised sales:

- some sales staff were unclear whether they were making sales on an advised on non advised basis.
- a number of instances where staff overstepped the line and provided advice.
- Customer's were not always provided with sufficient information to make a decision about the suitability of product.

I am convinced the FSA will look closely at the same issues across the board in the near future to ensure that a non-advised sale is genuinely just that and not an attempt to circumvent their rules. Therefore if you have a non advised sales process, especially if it is accompanied by a 90% penetration rate you need to start collecting the evidence that you are meeting the FSA requirements.

Product suitability

Ensuring a product is suitable for the customer is a basic FSA requirement for advised sales. However the retail market is highly price driven and there is little appreciation amongst consumers that there may be a reason why one policy is cheaper than another.

The consequence of this is that price often becomes the overriding factor when recommending a product, but under the FSA rules it is essential that any product is suitable for the customer's need in all respects, price is only one factor. The following example may illustrate this point further.

A friend of mine recently received a renewal for their annual travel policy. The broker had reviewed the existing cover and suggested an alternative based on price. However on checking the policy details, off piste skiing was excluded. My friend does ski off piste. Thus the most likely cause of a claim would have been excluded making the product totally inappropriate for the clients needs. Apart from failing the FSA suitability rules, I suspect my friend, (who also happens to be a judge!) would be less than pleased to find that he would be paying his own medical bills whilst lying in a Colorado hospital.

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Customer understanding

The above point brings us on to the issue of the customer understanding what they are buying, which in turn is connected to disclosure documentation and the process surrounding its issue.

Once again if we turn to the PPI review for guidance, the key findings in this regard were:

- many statements of demands and needs were not customer specific.
- there was an over reliance on the customer reading the documentation for themselves.
- the presentation of documents often lacked clarity

With regard to demands and needs statements, the FSA found that many listed product features rather than explaining why the particular product was suitable for the particular customer.

Balancing the needs for specifics and clarity is a tricky balance and even the FSA could only quote generalised examples about what they expect to see. The content will vary greatly according to the product. For example my personal view is that if I have a central heating system I know there is an inherent risk of it breaking down. Therefore cover against eventuality is self evident. However in most cases there is a need to justify the recommendation beyond the inherent need and statements such as “you are going on holiday therefore need travel insurance” or “you have a car therefore need car insurance” would seem to fall short of FSA expectations.

The solution lies not with the issue of the demands and needs statement but at the beginning of the process with the fact finding. The adviser must assume the customer doesn't know what information is needed and ask targeted questions to establish the need. Going back to my skier friend, establishing that he skied off piste without a guide was an essential factor in establishing the correct cover.

Once the precise need has been established, constructing the demands and needs becomes much easier “ I have recommended xyz cover because it specifically covers you for off piste skiing” is the sort of specifics the FSA is looking for.

This approach can also bring business benefits by helping to convince customers that not all cover is the same and perhaps achieve a higher premium and fewer complaints. For example my friend was quite happy to pay 50% more for travel insurance that actually covered him!

With regard to the issue of the customer reading the documentation, the FSA acknowledge that they do not have a rule specifically requiring a verbal explanation. However they found that verbal emphasis was being placed on the benefits with little attention drawn to the limitations and as such could breach the clear, fair and not misleading requirement.



On a similar note with regard to the presentation of disclosure documentation, the FSA stated “Although the content requirements of our rules may have been met, the information was often presented as small print and the layout would not encourage the customer to read it. In many cases, this could breach our ‘clear, fair and not misleading’ rule, which relates to the presentation of information as well as to the content.

The difficulty for regulated firms in this regard is *knowing* what is required in the absence of a detailed rule to follow. I generally advise firms that when they design their documents and process to record their rationale and the results of any testing of the document/process and explain how they believe the document or process meets the FSA's requirements.

How far you go with this will in part depend on the size of your firm. If you are a large national company then obtaining the views from a consumer panel may be a good way of a) receiving feedback and b) proving to the regulator that you take these issues seriously.

If you are a sole trader this is not so easy to do, but asking a sample of clients if they understand the documents you provide them with will achieve the same end.

Either way this exercise will help prove to the regulator in the event of any inspection, that you are concerned to do the right thing and could form part of a Treating Customers Fairly review.

Conflicts of Interests

As with so many other issues raised by the FSA the issue with conflicts of interest is not so much whether they exist or not, or even if they are managed or not, the issue is whether firms can prove they have the appropriate systems in place to identify and manage conflicts.

In late November a dear CEO letter was issued requiring the board to review the issue and put in place a formal policy by January 20. Very rarely has such an urgent response been required from such a senior level been required by the FSA, indicating the importance they place on the matter.

The problem for the GI sector is that so many of the existing market practices could be seen to be conflicts of interest. The very nature of the agency relationship where an intermediary is paid by one party but acts for another could be seen to be a conflict.

The subject is too wide to be covered in this article but if you contact me I can provide more information.



Claims

In the run up to regulation there was a major debate around the extent claims should be regulated and in the end a relatively light touch was decided upon.

The FSA will now be looking at whether or not this was the right decision and two key points will be high on their agenda. Firstly are insurers paying legitimate claims?, and secondly are they doing so without undue delay?. If the FSA find the industry wanting in either of these areas we could see further action.

Treating Customers Fairly

I can't leave any review of FSA themes without making reference to Treating Customers Fairly. This initiative reflects the FSAs intent to move away from strict rules to a more principle based approach to regulation. This in itself has a number of advantages and disadvantages, on the plus side firms are free to operate their business without reference to fussy tick boxes. On the down side it is much harder to define what good looks like.

Ultimately it probably involves more thought by the firm, but at the same time customer satisfaction and repeat business are goals that most businesses are constantly striving for.

Some of the key points the FSA have raised are:

- The need for senior management to take a lead and set the "tone" for the whole business.
- Firms need to look at the markets and sectors they operate in and act accordingly. For example dealing with individual private buyer requires a very different approach to dealing with large corporates.
- Successfully implementing TCF is as much about culture as systems.
- Having the right level of MI is essential. The expectation is a large company will need more detailed than a small one simply because of the remoteness of senior management to day to day customer interaction.
- A firm can't assume the way it does things now is the best way of dealing with the issue.

The key factor for any business is that it is absolutely essential for senior management to be committed to the principles, and secondly to actively start reviewing whether or not customers of your firm would consider they had been treated fairly in all aspects of your dealings with them. If not, what will you do about it. The bottom line is that by actively doing this you will be going a long way to meeting the requirements.

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