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SPECIAL TOPICS (SPECIAL)

Section 6 Special Topics

1. Treating Customers Fairly

Treating customers fairly (TCF), is about placing responsibility on the firms' senior management to deliver fair outcomes for consumers whilst offering the firm flexibility to deliver these outcomes in a way which best suits their business.

Principle 6 of the FCA Handbook states, "that a firm must pay due regard to the interests of its customers and treat them fairly". There are also 4 other Principles which apply to how you deal with customers:

Principle 1: A firm must conduct its business with integrity.

Principle 7: A firm must pay due regard to the information needs of its clients and communicate information to them in a way that it is clear, fair and not misleading.

Principle 8: A firm must manage conflicts of interests fairly, both between itself and its customers and between a customer and another client.

Principle 9: A firm must take reasonable care to ensure that the suitability of its advice and discretionary decisions for any customer who is entitled to rely upon its judgement.

It is the responsibility of the Board, or the body who oversees the firm to ensure that they are adhering to these Principles. Where the firm has delegated this task to a compliance function, ultimate responsibility will still remain with them and they will account to the FCA.

Treating Customers Fairly needs to be embedded in the culture of the firm **including Appointed Representatives,** at all levels so that it becomes business as usual. One thing to remember: Treating Customers Fairly is not about being "nice" to the customer, creating satisfied customers or requiring all firms to offer the same service. The FCA does not want to inhibit innovation in new products or services or require firms to design products for specific individuals. It is more about ensuring that the firm has the interests of their customers and the integrity of the market at the heart of how they run their business. .

The FCA has identified the following broad themes for fair treatment:

a) Give the customer what they have paid for – ensure that the customer fully understands the product.
b) Do not take advantage of the customer:
   - avoid pushy sales tactics;
   - do not sell inappropriate products; and
   - do not allow the priorities of the provider to unduly influence the sale of a particular product.
c) Offer the customer a suitable product – both initially and during the ongoing relationship.
d) Do your best to resolve mistakes as quickly as possible
e) Show flexibility, empathy and consideration in dealing with customers:
   - use discretion where customers have made honest mistakes;
   - judge each case separately; and
   - err on the side of generosity.
f) Exhibit clarity in all customer dealings:
   - terms and conditions should be as clear and easy to understand as possible;
   - significant exclusions should be highlighted;
   - changes or new features should be explained;
   - messages should be consistent; and
   - avoid misleading language.

TCF is not just about customer satisfaction, but should cover all aspects of your business such as:

- providing training for your staff that ensures quality of advice;
- providing information for customers that is clear and easy to understand;
- ensuring the customer gets the right advice/product;
- meeting customers' expectations;
- putting things right if they go wrong and understanding why something went wrong to stop it happening to other customers; and
- not taking advantage of your customer.

Senior management of firms should have already carried out a gap analysis of the business to identify areas where they are not meeting these obligations and have put in place a programme to address any shortcomings. The FCA expects that firms continually review TCF and undertake the gap analysis on a regular basis.

The FCA has identified six outcomes for consumers that they would like firms to deliver. These outcomes are detailed below:

Outcome 1: Consumers can be confident that they are dealing with firms where the fair treatment of customers is central to the corporate culture.
Outcome 2: Products and services marketed and sold in the consumer market are designed to meet the needs of identified consumer groups and are targeted accordingly.
Outcome 3: Consumers are provided with clear information and are kept appropriately informed before, during and after the point of sale.
Outcome 4: Where consumers receive advice, the advice is suitable and takes account of their circumstances.
Outcome 5: Consumers are provided with products that perform as firms have led them to expect, and the associated service is both of an acceptable standard and as they have been led to expect.
Outcome 6: Consumers do not face unreasonable post-sale barriers imposed by firms to change product, switch provider, submit a claim or make a complaint.

TCF is a continuous process – it is not something that can be put in place and then forgotten about. It needs to be considered in all business decisions going forward and be regularly reviewed.

The FCA will be including TCF in any thematic or supervisory work that they undertake with firms.

1.1 Conduct for Treating Customers Fairly

Below are guidelines on appropriate conduct when dealing with customers which you should ensure that you follow:

- Acting with integrity and in good faith.
- Being open and honest with customers.
- Being transparent in your dealings with customers including use of plain and intelligible language, both verbally and in customer contracts, so that the meaning and purpose is clear and capable of being understood by the customer.
- Providing customers with clear and accurate information.
- Providing customers with help and assistance to understand relevant products and services.
- Acting with reasonable competence and diligence.
- Acting in accordance with the spirit as well as the letter of the relevant rule or clause in a code and standing by any implied meaning.
- Disclosing material information to the customer e.g. asking customers clear and relevant questions, ensuring customers are aware of their duty to answer questions accurately and honestly and the consequence of making

a misrepresentation and telling the customer important information such as exclusions in the insurance contracts.

- Honouring of representations, assurance and guarantees where this leads to a legitimate expectation in the mind of the customer.
- Treating like situations alike and differentiating as appropriate between different situations e.g. being consistent in your approach with customers.
- Acting impartially and reasonably, having regard only to relevant issues and not taking into account irrelevant issues.
- Refraining from exploiting customers, for example taking advantage of a customer's ignorance or acting capriciously e.g. changing your mind or going back on what you have agreed with a customer. Do not give your customers "nasty surprises".
- Putting things right for customers when you have made a mistake.
- Being accessible to customers, so that the customer knows where and how to contact you and, when they do contact you, ensure that they will receive a meaningful response.
- Maintaining clear and simple procedures – especially those relating to the complaints process.

1.2 What you need to do to implement TCF.

The FCA requires you to take an objective look at the way you do business. There is no requirement for small firms to have a documented strategy or detailed files showing how they deliver TCF. However you may wish to document the main decisions made in order to communicate what you have looked at and be clear about the areas that need addressing. Many firms do this by way of a 'living' TCF gap analysis document which is updated after each regular review.

You do however need:

- To have appropriate processes in place to enable you to be satisfied that you are treating customers fairly;
- Management information in place on areas such as advice given, products sold and complaints to ensure you are able to demonstrate that you are treating customers fairly;
- Be able to describe how TCF fits into the business and how behaviour within your firm takes account of the needs, acceptance of risk, level of understanding and needs/rights of your customers;
- Review where there might be gaps between how you should be treating your customers and what might be happening in practice and to have a programme of actions in place to meet these gaps. The templates (SPECIAL Template 1) may be used to help you. There is also a self-assessment tool available on the website; and
- To undertake a review of TCF at least annually or when there are significant changes in your business, such as selling new products or offering new services, if this is sooner.

1.2.1 TCF Culture

Having the right culture in place is crucial to being able to demonstrate that you are treating customers fairly. The FCA expects firms to:

- Demonstrate that you have a culture of treating customers fairly

  This means senior managers have a culture which shows they understand what the fair treatment of customers means. They expect their staff to always treat customers fairly. Where (a relatively small number of) errors are found, they are put right and learned from.

- Measure performance

  This means appropriately and accurately measuring performance against all customer fairness issues which are materially relevant to the business, and then acting on the results.

- Demonstrating you are delivering fair outcomes for consumers

  This means using the measures you have in place to show that you are treating customers fairly.

- To have no serious failings - whether seen through management information, including in areas of particular regulatory interest previously publicised by the FCA.

1.3 TCF Management Information

You need to collect management information to enable you:

- to monitor TCF on an ongoing basis and to take action to identify; and
- tackle any issues which may stop you delivering on your outcomes.

The FCA expects you to:

- have appropriate management information in place to test whether you are treating customers fairly;
- to be able to demonstrate that you are consistently treating customers fairly; and
- implement an annual review of TCF.

The FCA believes that it is not possible for a firm to demonstrate that it is actually delivering the TCF consumer outcomes without some evidence – management information.

MI is summarised as information that is collected during a period of business activity. It may be about customers, staff, calls, visits, meetings, sales, opinions, parts of a process, predictions etc. MI is not just numbers. Quantitative data is valuable to any business, but commentary or opinions are also MI and can help provide a comprehensive, balanced view.

Good MI should enable management to make good decisions. To do this, the MI should be:

1. **Accurate** – the correct numbers with any commentary contributed by the right people;
2. **Timely** – available a sufficiently short period after the date of business activity to enable managers to act;
3. **Relevant** – displaying what a manager can directly influence or something that they may need to escalate to someone who can take the necessary action.
4. **Consistent** – consistent on a period-to-period basis to allow managers to spot trends and make sound decisions.

There may also be MI that is produced for, or requested by, management on a particular issue or concern on an ad-hoc or infrequent basis. This approach is more cost effective if the investigation is a one-off event. In general, though, MI should be produced and monitored regularly to avoid problems rather than commissioned in response to problems.

The FCA has set out their principles of good TCF MI, which include:

- TCF MI should generally focus on how far a firm is delivering the TCF consumer outcomes rather than measuring processes.
- TCF MI is not MI that indicates the status of a firm's TCF initiative. TCF relates to the business activities that firms carry out now and MI on those processes can be regarded as TCF MI.
- Much TCF MI will exist already but some pieces of MI may be new. TCF should not generally require the creation of substantial amounts of new information – the relevant information may already be available in the form of current MI the firm collects and, in many cases, an expansion of existing MI to include extra analysis may enable firms to demonstrate delivery of TCF outcomes. The difference may be the viewpoint – what is the MI telling the firm about the consumer outcomes rather than the performance of the firm.
- MI on customer satisfaction may be indicative of fairness. However it does not demonstrate fairness – customers can be satisfied with unfair treatment and dissatisfied with fair treatment.
- MI is not just different parts of a firm telling each other things. It is for measuring performance and identifying potential risks. It can be a summary of what a firm already knows, but presented in a way that

helps management see a pattern and make a decision. Management information is for the role of managing, regardless of whether that role is performed by the same people who 'do' or by different people.

What information should I be collecting as part of my TCF MI?

Any management information produced by a firm needs to be proportionate to the size and complexity of that particular business. It is up to each firm to determine what management information is appropriate for its business, not the FCA.

Firms should review their current management information before creating a separate suite of reports for TCF. In many cases existing management information can be used to evidence and measure TCF outcomes.

Firms are already likely to report and take actions based on management information to enhance their commercial effectiveness and business efficiency. TCF may well be already built into this approach.

In some cases it may be a case of interpreting the results in a more qualitative way, for example analysing reasons for complaints to determine whether there are any TCF failings that need to be addressed.

It is therefore quite likely that most firms are already collecting management information that could be reconsidered from a TCF perspective.

Below are some of the examples of the types of management information that firms **might** consider collecting to evidence that they are delivering each of the six consumer outcomes.

Outcome one

Consumers can be confident that they are dealing with firms where the fair treatment of customers is central to corporate culture.

The FCA's paper on culture
http://www.fca.org.uk/your-fca/documents/-fsa-treating-customers-fairly--culture
provides some useful pointers.

It is the FCA's view that the leadership demonstrated by the firm's senior management will give a clear indication as to how far TCF has been embedded into the firm's corporate culture.

Firms might consider some of the following to help demonstrate that this outcome is being delivered:

- The firm's Mission Statement;
- Firm's regulatory business plan;
- Terms of engagement/TOBAs;
- TCF implementation plan and gap analysis;
- Test staff understanding of TCF and observe their behaviours with customers;
- Regular newsletters to keep staff up to date on developments;
- Training and competence – appraisals/objectives/job descriptions/recruitment;
- Whistle blowing - confidential helplines;
- Sales processes;
- Staff remuneration policy;
- Service standards;
- Breach log.

Outcome two

Products and services marketed and sold in the consumer market are designed to meet the needs of identified consumer groups and targeted accordingly.

This is less relevant for BIBA membership as few will be involved in product design. However, where firms are engaged in marketing products to potential customers, they could consider:

- Advertising/Mail shot sign off control by Director/Senior Manager and if separate, person with responsibility for marketing, to ensure words used about product/service are correctly directed at intended, customer profile.
- Monitoring results of any advertising;
- What questions are being raised about advertising?
- Is the business coming from expected sources – if not why not?

Outcome three

Consumers are provided with clear information and are kept appropriately informed before, during and after the point of sale.

A key tool to help measure this outcome might well be a programme of file auditing. Others might include:

- File review / checklists;
- Mystery shopping;
- Use of fact finds
- Demands & Needs confirmation
- Personal recommendation
- Customer Terms of Business
- Policy Summaries
- Policy document – contract certainty means prompt delivery
- Telephone call monitoring;
- Consumer research – emails/telephone surveys;
- Training and competence – appraisals results.

Outcome four

Where consumers receive advice, the advice is suitable and takes account of their circumstances.

This is another outcome where file audits are likely to be a key measurement tool. Others might include:

- File review / checklists;
- Use of scripts and/or cribs
- Use of fact finds
- Demands & Needs confirmation
- Personal recommendation
- Conflict management;
- Mystery shopping;
- Telephone call monitoring;
- Role plays for customer facing staff to check what is being said during sales process;
- Customer research – emails/telephone surveys;
- Training and competence – appraisals results.

Outcome five

Consumers are provided with products that perform as firms have led them to expect, and the associated service is both of an acceptable standard and as they have been led to expect.

Firms might wish to include:

- Complaints procedure.
- Complaints – outcomes and complaints log;
- Claims – details of repudiations;
- Lapses;
- Early cancellations;
- Mid term adjustments;
- Review of relevant reasons for PI claims against firm
- Review of insurer panels/markets used;
- Insurer ratings;
- Contract certainty figures;
- Conflicts of interest management policy, including any evidence of 'bias';
- Customer research – emails/telephone surveys;

Outcome six

Consumers do not face unreasonable post-sale barriers imposed by firms to change product, switch provider, submit a claim or make a complaint.

Firms could consider:

- How do you as a firm react to a cancellation?
- Premium refunds;
- Measure re-broke rates and lapses;
- Why has the customer gone elsewhere?
- Firms must not insist on customers putting complaints in writing.

What do I do with the TCF MI once collected?

The FCA states that once a firm has identified what measures to use, in order to demonstrate success, they would expect them to have two things:

1. A standard – the level of performance that the firm decides demonstrates that it is treating customers fairly and delivering the TCF outcomes; and
2. A result – how they performed against the standard.

The FCA expects firms to monitor how they are doing against the standards:

1. Consistently – so they can track their performance over time;
2. In some detail – so they can spot any outliers and demonstrate these are not being hidden in averages; and
3. Against expectations – they may be seeking to exceed their standards or they may be part way through a remedial plan to meet them.

The FCA states that it is important that they see evidence that the MI is used by the right people and in the right way.

Using TCF MI should involve five steps:

1. **Seen** – the TCF MI should be reported to and reviewed by the level of management for whom it is relevant;
2. **Challenged** – the FCA expect managers to challenge the content of TCF MI and to consider its substance and quality;
3. **Analysed** – the FCA expect managers to analyse the TCF MI critically. An example might be to look for root causes where problems are identified;
4. **Acted on** – the FCA deem this to be the most important area of TCF MI. Firms need to demonstrate how they act to remedy problems with the delivery of TCF outcomes that are indicated by the TCF MI; and
5. **Recorded** – the FCA expect firms to be able to produce evidence that actions have been taken to solve problems identified by TCF MI.

1.4 Tips for Sole Traders/Advisers

Treating customers fairly applies to all regulated firms including sole traders/advisers.

Look at the five basics behind treating customers fairly:

- Leadership

All firms, including sole traders/advisers, must have the fair treatment of customers at the heart of their business. You need to understand what treating customers fairly means, and be able to communicate this to customers and anyone you work with, such as an administrator.

- Business decisions

Sole traders/advisers are constantly making decisions about their business - whether it's a new type of product or a new area of business they want to move into. You should always think about how these decisions will affect the fair treatment of your customers.

- Controls

Every business needs to have controls in place to ensure it is being run properly. For example, you ask an accountant to look at the financial part of your business. You should also collect your own management information, so that you can easily identify the type and quantity of product you are selling, whether you are getting any complaints about a particular product, etc. Most importantly, if the information identifies a problem, you must take action to put this right.

- Recruitment, training and competence

New recruits can pose significant risks for firms until they are fully integrated into the business. A set recruitment procedure should be followed. This is particularly important in larger companies, but a sole trader/adviser also needs to ensure that they are up to date with their market, any new products available and whether there is a better or easier way of doing something. If you are moving into a new area of business, do you understand the risks involved? If not, can you get some training?

- Reward

If you are a sole trader/adviser you only have to deal with your own income. But if you are being fair to your customers you will need to ensure that you are not focusing on volume of sales at the expense of quality.

Sole traders/adviser should also consider the following:

- Undertaking a comprehensive review of your business annually.
- Keeping up to date with regulatory requirements and ensuring that your technical skills are adequate and relevant for the business you are undertaking.
- Consider having a confidentiality arrangement with your locum whereby you review each others files and/or complaints and give each other objective feedback.
- Consider joining a local networking group to help you benchmark yourself against your peers and get a fresh perspective on the way you work and the business decisions you make.

2. Conflicts of interest

It is the view of the FCA that managing potential conflicts of interest, which can arise from the relationship between brokers, their customers and the insurers they deal with, is the responsibility of senior management. The management of the issue can be demonstrated by evidencing effective policies and procedures.

Legal and regulatory obligations

You have to comply with a mix of common law and regulatory obligations, complicated by your special status as agent for your customer (the insured) and, on occasions, as agent for the insurer. In essence:

- You must conduct your business with integrity and treat your customers fairly. In particular, you must ensure that you do not conduct business under arrangements that give rise to a conflict with your duty to customers unless the conflict is managed.
- You must take ‘reasonable steps’ to ensure that you do not solicit, offer, accept or give an inducement if it is likely to conflict ‘to a material extent’ with your duty to your customers. Any inducement that is likely to do so, will be deemed an ‘unfair inducement’. An inducement is described as a remuneration arrangement or benefit (whether financial or non-financial) offered to you with a view to you adopting a particular course of action. This is a current focus for the FCA in the retail investment market: http://www.fca.org.uk/your-fca/documents/finalised-guidance/fg14-01 and firms would be well-advised to at least be aware of this.

- Under Law of Agency, any commission received by you should be disclosed to your principal (i.e. your customer) upon their request, unless it is clear that such payments constitute customary market practice. Firms should apply the industry guidance on transparency, disclosure and conflicts of interests and the Law of Agency. For further information on the industry guidance, please see section 7 below.
- You must not offer incentives to your staff that encourage them to sell products unsuited to customers' needs.
- Even where you disclose a potential conflict of interest to your customer and your customer gives you informed consent to continue acting, you must still decline to continue acting if this disclosure and consent does not enable you to reconcile the conflict.
- When handling a claim, you must not put yourself in a position where your own interest, or the duty you owe to any person for whom you act, conflicts with your duty to the customer, unless you have fully disclosed the details of the conflict to the customer and obtained their prior informed consent.
- You need to be able to demonstrate that you have in place rigorous internal policies and procedures for identifying and managing potential conflicts of interest and a mechanism for preventing them adversely affecting your customers. Once in place, the FCA will expect these policies and procedures to be regularly tested, reviewed and updated and to see evidence that staff have been properly trained to follow them.

You should also bear in mind the Principles 1, 3, 6 and 7 when reviewing your handling of potential conflicts.

What is a conflict of interest?

It is a conflict between:

1. your duty as a broker to act in the best interests of two or more of your customers such that neither are disadvantaged by your actions; and/or
2. your interests as the broker and those of your customer such that your customer is not disadvantaged.

A broker faces a conflict where:

1. the firm's own interests conflict with those of the customer; or
2. the firm is unable to act in the best interest of one customer without adversely affecting the interests of another customer.

Your customer

Your customer will expect you to have their interests as paramount in your mind in all of your dealings with them and this must dictate your conduct as their broker at all times.

Identifying and managing potential conflicts

There exist a number of different ways in which you, as a broker, can be remunerated for your services. If you structure your remuneration arrangements correctly, you can protect your revenue streams and your customer base. If you do not, you are likely to face regulatory sanctions (from the FCA), civil sanctions (from your customers) and corporate governance sanctions (from your shareholders and funders), with potentially serious consequences for your business and management.

Profit share agreements

Profit share agreements (which can apply in both the consumer and reinsurance context) are typically based on a formula which delivers a share of the profit to the broker. This is calculated by reference to a maximum loss ratio and a minimum volume of premium income in a given period of time. This is ostensibly designed to reward the broker for the good quality risks across the book of business placed by the broker with the insurer. Such agreements are an inducement and must be managed correctly to avoid a conflict of interest arising.

Questions to ask of yourself and your organisation:

- What percentage of your total revenue is made up of income from profit commission?
- Does the profit commission income form part of your annual budget (i.e. you are reliant upon it to meet your budget)?
- Who knows the details of these arrangements?
- What influence do those with the knowledge have over the placing broker function?
- What management systems are in place to separate out the placing broker function from the executive function?
- What systems do you have to monitor the performance of your panel of insurers (including those insurers from whom you receive profit commission)?
- What happens to insurers who are under performing?
- How robust and effective are your control systems and are they embedded in your organisational structure?

Volume and other over rider agreements

Volume over rider agreements are designed to pay a pre-agreed percentage to the broker, based purely on the volume of business placed by the broker with the insurer. This is regardless of the profitability of the business. Many of the larger broking houses have now moved away from this basic model. Such agreements are an inducement and must be managed correctly to avoid a conflict of interest arising.

In addition to the questions posed in relation to profit share agreements above, the following additional questions should be asked:

- What precise functions do you perform for the insurer (claims handling, issue of policy documentation, availability of your distribution network etc) in return for the remuneration you receive from the volume over rider?
- Is this remuneration a fair market value for these functions?
- What pre-agreed service levels are there in place and which form part of the agreement?
- Are these documented and monitored at regular intervals and by whom?
- Is the existence of these generic arrangements disclosed to your customers?

Corporate hospitality and gifts

On one level, a strong relationship with your panel insurers, developed through a combination of professional and personal interaction, delivers a real and direct benefit to your customers. Corporate hospitality and gifts are, nonetheless, inducements and must be managed correctly to avoid a conflict of interest arising.

Questions to ask of yourself and your organisation:

- Do you have a hospitality and/or gift register?
- Is there a minimum level of activity which is not logged (e.g. lunches and gifts below a certain monetary value)?
- What are the criteria for determining what is appropriate and what is not?
- Who makes the decision on whether to permit or disallow an invitation?
- Are these records reviewed by senior management at regular intervals?
- How robust and effective are your control systems and are they embedded in your organisational structure?

Claims handling and binding authorities

Some intermediaries have authority to settle claims for an insurer under an agreement. It is not uncommon for these claims settling authorities to be linked to a profit share agreement. By rejecting claims, or delaying payment of claims, you could enhance the value of your profit share, thus creating a conflict of interest between yourself and your customer.

Questions to ask of yourself and your organisation:

- What is the level of your settlement authority (is it so low that it is unlikely to affect the profit commission)?
- How frequently does the relevant insurer undertake an external audit of your claims handling and claims settlement function?
- Are the claims handlers aware of the existence of/details of the profit commission arrangement?
- Are your arrangements with the insurer disclosed to customers and have you obtained their informed consent?
- What are your own internal audit systems and how frequently are they monitored?
- What happens on a contested claim? Are you acting on behalf of your client or the insurer?
- How robust and effective are your control systems and are they embedded in your organisational structure?

Training support

The availability of good quality training is likely to be of real benefit to you as it:

- enables you to satisfy your CPD requirements;
- improves the level of your service quality to your customers; and
- improves the technical capabilities of your staff and may improve staff retention.

When this is provided or funded by an insurer, it could be an inducement and must be managed correctly to avoid a conflict of interest arising.

Questions to ask yourself and your organisation:

- Do you have a training register?
- What are the criteria for determining whether the training offered is appropriate or not?
- Is the training "product specific" (and, therefore, relevant to your customers' needs)?
- Does the training fit with the CPD requirements of your staff?
- What level of management approves the training?
- How frequently is the training register monitored?
- How robust and effective are your control systems and are they embedded in your organisational structure?

Soft loans

Loans are sometimes made available to broking houses from some insurers on terms which are more favorable than those which would be available to the broker from the commercial lending market. In certain circumstances these can translate into the lender taking an equity stake in the broking house. Such an arrangement is an inducement. Unless managed extremely carefully, it is inevitable that this will create a conflict of interest, particularly in circumstances where the broker runs into financial difficulties. Any such arrangements should be approached with extreme caution and the terms negotiated between the broking house and the lender must have the conflict of interest issue as paramount in those negotiations.

Questions to ask of yourself and your organisation:

- Who knows the details of these arrangements?
- What influence do they have over the placing broker function?
- What management systems are in place to separate out the placing broker function from the executive function?
- What systems do you have to monitor the performance of your panel of insurers (including insurers with whom you have a soft loan)?
- What happens to insurers who are underperforming?

Reinsurance conflicts

Sometimes placement of business with a particular insurer is used to encourage the insurer to then use the intermediary to arrange reinsurance contracts. This could mean that you are encouraged to place the business to ensure that you get the additional reinsurance business and that you are not putting the interests of the customer above your own.

Questions to ask yourself and your organisation:

- Who knows the details of these arrangements?
- What influence do those with the knowledge have over the placing broker function?
- What management systems are in place to separate out the placing broker function from the executive function?
- What percentage of your business will come from the reinsurance placement?
- What systems do you have to monitor the performance of your panel of insurers?
- What happens to insurers who are underperforming?

Work Transfer

Some intermediaries may be paid an additional commission for provision of specified services to the insurer such as issue of policy documentation.

- What precise functions do you perform for the insurer (claims handling, issue of policy documentation, availability of your distribution network etc) in return for the additional remuneration you receive?
- Is this remuneration a fair market value for these functions?
- What pre-agreed service levels are there in place and which form part of the agreement?
- Are these documented and monitored at regular intervals and by whom?
- Is the existence of these generic arrangements disclosed to your customers?

2.1 Conflicts of interest - management controls

Your conflict management controls need to:

- be carefully thought through and benchmarked against the sector;
- form an integral part of your overall risk management reviews and be regularly monitored by the executive;
- be based on robust, up-to-date advice and well documented; and
- be, not least, sufficiently comprehensive to allow scrutiny by the FCA.

You need to be able to demonstrate that you have in place rigorous internal controls for identifying and managing conflicts of interest and a mechanism to prevent them adversely affecting the firm's customers. These controls need to be regularly tested, reviewed and updated and there must be evidence that staff have been properly trained to follow them. One means of achieving this endorsed by the recent industry guidance on conflicts of interest is to introduce a conflicts management policy.

Intermediaries must be able to demonstrate that:

- the firm has undertaken adequate risk assessments and created/updated a conflict management policy for the business;
- the firm's senior management promotes the core values of treating customers fairly and a culture within the business that is focused on mitigating or removing potential conflicts of interest;
- the firm's conflict management policy has been properly promoted at all levels within the business;
- the firm has control systems in place to ensure that the conflict management policy is observed within the business;

- the firm collects management information and monitors key performance indicators to ensure that the control systems are effective; and
- the firm has invested in adequate staff and management training to promote change within the business.

What is the purpose of a "conflict management policy"?

There is a regulatory principle that firms must manage conflicts of interest fairly and the purpose of a conflict management policy is to demonstrate how the firm will do this. It should set out a clear statement of:

- the firm's strategy for identifying potential conflicts of interest that can arise as a result of the firm's business activities; and
- the management processes which are in place to minimise the risk of such potential conflicts of interest adversely affecting customers.

How should a conflict management policy be put together?

First, it is important to conduct a thorough risk assessment of the firm's business activities to identify those activities that have the potential to give rise to conflicts of interest and to assess the risk of such conflicts actually arising and adversely affecting customers. This assessment will lead into an analysis of the control systems that are in place to identify and manage the risks and to a determination of who within the management team is responsible for ensuring that the control systems operate effectively and are regularly reviewed and tested.

The data generated by the risk assessment can then be used to draft the conflict management policy or (where one already exists) to review and update it.

What should a conflict management policy contain?

A conflict management policy does not need to be in any particular format but should contain at least the following elements:

- A statement of the firm's (and, in particular, the senior management's) overall commitment to treating customers fairly and operating within the insurance industry's codes of practice and regulatory principles.
- A statement of each business activity which could give rise to a potential conflict of interest (as identified by the risk assessment) and the perceived severity of the risk of an actual conflict arising and adversely affecting a customer of the firm.
- A statement of the control systems (registers, information barriers etc) that the management have in place to guard against an actual conflict arising and adversely affecting a customer of the firm. This should detail the firm's conflict management approach to each of its business activities and any which are peculiar to the firm's business model. A typical conflict management policy is, therefore, likely to cover:
    - profit share agreements with insurers;
    - volume and other over-rider agreements with insurers;
    - corporate hospitality and gifts from insurers;
    - claims handling authorities with insurers;
    - binding authorities with insurers;
    - training support provided or funded by insurers;
    - soft (i.e. low interest) loans or cash gifts from insurers;
    - commission disclosure;
    - differential commission rates;
    - inter-group or associated company dealings;
    - premium finance arrangements with insurers;
    - individual personal links with insurers;
    - line-slip arrangements;
    - insurer "clubs";
    - office sharing with underwriters;
    - staff remuneration, bonus schemes and appraisal arrangements.
- A statement as to how often the policy will be reviewed and by whom.
- A statement as to which members of the management team are accountable for conflicts identification and management.
- A statement as to what training on conflict avoidance has been, or will be, provided to staff.
- A statement as to the procedures for staff to report potential conflicts of interest to senior management.
- A statement of the management information that will be collected and the key performance indicators that will be used within the business to monitor and appraise the control systems referred to above.

Special Topics template 2 at the end of this chapter is an example of a conflict management policy.

Creating the right management culture

Management control systems, reporting procedures and corporate governance practices need to demonstrate that the management of conflicts is a live and ongoing activity within the business and one that is championed by senior management and at Board level. For instance, one way of demonstrating this would be to have conflict management as a standing agenda item at Board meetings. A system of internal or external file auditing and spot checks would also be advantageous.

In essence, broking firms need to be able to demonstrate that they do not just pay lip-service to the FCA's concerns over the conflicts issue but that senior management live and breathe it as a key regulatory issue. It is not just about rule compliance but also about complying with the spirit of the rules and the principles that underpin them.

Timetable for management action

Firm Supervision Framework (FSF) visits will focus increasingly on the issue of conflicts of interest. Firms will need to be able to demonstrate that:

- the firm has undertaken adequate risk assessments and created/updated a conflict management policy for the business;
- the firm's senior management promotes the core values of treating customers fairly and a culture within the business that is focused on mitigating or removing potential conflicts of interest;
- the firm's conflict management policy has been properly promoted at all levels within the business;
- the firm has control systems in place to ensure that the conflict management policy is observed within the business;
- the firm collects management information and monitors key performance indicators to ensure that the control systems are effective; and
- the firm has invested in adequate staff and management training to promote change within the business.

3. FCA Conduct Risk

3.1 What is Conduct Risk?

The FCA's overall objective is to ensure that the financial markets function well. This means ensuring consumers get financial services and products that meet their needs from firms they can trust, that markets and financial systems are resilient with transparent pricing information and that firms compete effectively to meet the interests of their customers. Conduct Risk can be described as risks in a firm's behaviour that could negatively impact the FCA's achievement of its objectives.

Two types of risk have been identified:

i. Risks associated to what could go wrong
ii. Risks associated with firms not investing or innovating to meet changing needs of society

The FCA has identified that there are three key drivers of conduct risk:

- **inherent risk** features of financial market structures or the behaviours of market participants, a combination of supply-side market failures (e.g.information problems) and demand-side weaknesses such as inbuilt biases, which results in poor choices and outcomes;
- **structures and behaviours** - Structures, processes, culture and incentives designed and embedded into the financial structure which allows firms to profit from consumer shortcomings and market failures; and
- **environmental challenges, change and uncertainty** – current and historical environmental factors that have played and will continue to play a role in firm and consumer decisions and behaviours e.g. regulatory and technological changes.

They have also identified what some key conduct risks resulting from these drivers. These are:

- Firms do not design products and services that respond to real consumer needs or are in consumers' long-term interests;
- Distribution channels do not promote transparency for consumers on financial products and services;
- Over-reliance on, and inadequate oversight of, payment and product technologies;
- Shift towards more innovative, complex or risky funding strategies or structures that lack oversight, posing risks to market integrity and consumer protection.
- Poor understanding of risk and return, combined with the search for yield or income, leads consumers to take on more risk than is appropriate.

The risks can manifest themselves in a number of situations. Examples include, but are not limited to:

- Complex financial incentive schemes which promote pressurised selling and customer detriment;
- Auto renewals which are not transparent;
- Over selling costly products to existing customer base;
- Transparency of information to consumers specifically in the “add on” and Motor Legal Expenses Market;
- Poor management of client assets and controls in place for holding client money;
- Unclear and misleading financial promotions; and
- Barriers to exit from products including high cancellation fees.

3.2 Monitoring Conduct Risk

The FCA has a number of tools at their disposal to monitor conduct risk – all of which form part of the pillars of supervision framework. There are specific teams in place to monitor particular areas of the financial market such as the Competition Team and the Financial Promotions Team, they can analyse market intelligence data and complaints data to give an indication of where failings are occurring and they also perform thematic reviews of products and practices across the industry. In insurance they have completed reviews of Motor Legal Expenses and Mobile Phone Insurance as examples of this.

3.2.1 What Should Firms be doing to monitor and manage Conduct Risk?

Senior management and the board should adopt a suitable approach in terms of oversight and review of the firm’s practices. This could include:

- Taking proactive steps to assess customer processes and controls and delegated authorities;
- ensure the approach looks across the whole product life cycle; and
- Revisit and revise their assessment of conduct risk with higher emphasis on potential risks; and
- ascertain what the Conduct Risk Indicators are for your firm and report against these to the Board

Poor consumer outcomes recur where consumers have bought unsuitable, deceptive or overpriced products or services. Many mistaken consumer choices can be traced back to the role of information (its availability, quality and interpretation). The FCA takes the view that even where firms disclose information and consumers understand the products, poor communication can result in them focussing on the wrong information and failing to take into account the salient factors needed to make an appropriate decision. This could lock them into costly decisions for a long time.

FCA expects firms to:

- Evidence how their consumers receive appropriate outcomes, throughout the product lifecycle;
- Implement targets that are aligned with consumers actual cover requirements;
- Understand the difference between customers being satisfied and customers being treated fairly; and
- Identify, capture and mitigate the risks to their customers receiving inappropriate outcomes

In doing so firms need to take into consideration factors which may lead customers to make bad choices or decisions including:

- Products being inherently complex for most people;
- Many products involving trade-offs between the present and future;
- Decisions require assessing risk and uncertainty;
- Decisions can be emotional; and
- Some products allow for little learning from past mistakes.

One means to evidence this would be to review the lifecycle of the product, identify conduct risk indicators and then measure against these.

Examples of conduct risk indicators include:-

<u>Service Levels</u>

Ensure that your service levels with customers are fair throughout the product lifecycle. For example review the service levels that you have for sales of products against those you have for dealing with mid-term adjustments, cancellations and general customer queries. Although the service levels do not have to be the same for all areas of the business you need to ensure that you are able to deal fairly with all customer enquiries and not just focus on sale of the product.

<u>Cancellations/Not Taken Ups (including renewals)</u>

Monitor cancellations both within the cooling off period and outside of the cancellation period. You should be reviewing both numbers and also more importantly the reasons for the cancellations. Monitoring these may identify risks of pressurised sales, product deficiencies and sales of unsuitable products.

Where possible reviewing why a customer decides not to go ahead with a sale can also provide valuable insight into whether the product is suitable. This is an especially valuable indicator at renewal as it can identify weaknesses in whether the product has actually performed as the customer expected it to.

Declined Claims

Where possible obtain data on declined claims or partial claim payments as this again can be used as an indicator as to whether the product was suitable or whether there are deficiencies in the sales process.

Customer Satisfaction

Targeted customer satisfaction measures are useful to identify whether the customer understands the product they have been sold, is satisfied with your service, has been treated fairly and has been provided with sufficient information on the product.

It is important however that the feedback is targeted at a specific service provided rather than being generalised.

Complaints

As with customer satisfaction complaint reasons can be invaluable indicators of service provided, product suitability and whether you are targeting the right markets.

Sales Monitoring

This should be used to identify whether advisors are selling suitable products and where advice is provided that this is correct.

3.3 Key Messages for Firms

Firms need to ensure they are putting the consumer and the integrity of markets at the heart of their business models and strategies. This specifically requires making strategic cultural changes where necessary and establishing oversight and appropriate supervision around the design and innovation of products and services. They must be transparent in their dealings with consumers.

Most importantly, firms must take an active role in supporting and maintaining the integrity of the financial markets to ensure consumers can have confidence in the firms and products they engage with.

4. Business Risk Awareness

As part of their supervision of small (C3/C4 category) firms the FCA are undertaking business risk reviews. These encompass all firms and look at Governance, Systems and Controls and Culture in the firm. The main focus of the review is how the firm identify and take steps to prevent the potential risks within their business. It is a comprehensive check on how firms run their business on an ongoing basis. But it should be stressed that TCF is still very much a focus for FCA albeit with a renewed focus on the outcomes for the customer e.g. has the firm put the customer at the heart of its business.

It is a three stage approach:-

- Voluntary (but advisable) attendance at a FCA run workshop;
- Face to face interview, telephone interview or on-line assessment;
- Follow up work either supervisory if risks found or for verification purposes.

4.1 Stage 1 - FCA Workshop

The half-day workshops are run regionally and, at the time of writing, a number of regions have already been completed. Attendance is optional but you are recommended to take up the offer, even if it simply confirms you are on the right lines.

4.2 Stage 2 – The Review

The workshops are followed by reviews, either telephone, face-to-face or online, dependent on their size, their business model and the markets in which they operate (in other words looking at the impact and probability of customer detriment). This is how the FCA will try and differentiate firms and use its supervision resources to best effect. Reviews take around two hours but some have been known to last a while longer.

In all cases the reviews are an opportunity for firms to gain reassurance that they are meeting the regulator’s requirements; to get feedback on areas they should review; to discuss their firm specifically; and to demonstrate the good practices within their firms.

Regardless of the type of interview you will be given feedback at the end. In the case of the online review you will need to click on a link to obtain the specific feedback. This will centre on where the FCA feel improvements should be made in line with where they feel risks to consumers exist. Firms will be expected to act promptly on any highlighted points.

As the three ‘cornerstones’ of governance, culture and controls feature heavily it would be prudent to ensure you are up-to-speed in these areas before your review.

Examples of governance would be the oversight of the business, establishing who has accountability for what, the management processes, decision making.

Culture is all about the behaviours in the firm, what motivates the team and the communication in the business. It focuses on the tone set at the very top of the business and how this flows through to all levels.

Controls are perhaps a more familiar area – supervision, training and competence, management information – and whether these are effective in identifying and mitigating risks to consumers.

Given that two of the FCA's objectives cover consumer protection and protecting and enhancing the integrity of the UK financial system there will also be a focus on the control and quality of the regulatory returns submitted by firms and on their financial strength.

4.3 Stage 3 – Follow Up Work

A random selection of firms are likely to be selected for a half-day verification visit where two supervisors will visit the firm to ensure that what you have outlined at your review is actually happening in practice.

Where the FCA believe there are more significant risks the firm may receive a full day supervision visit which will be more in-depth, exploring the areas of concern and providing more feedback on actions the firm can take to address the risks.

5. Introducers

Many intermediaries have business introduced to them by a third party. The Insurance Mediation Directive (IMD) lists the activities for which registration is required in article 2.3, and these include 'introducing'.

The IMD was incorporated into UK legislation via the Regulated Activities Order (RAO). This sets out the regulated activities and available exclusions.

There is an exclusion within the RAO, at **article 72C**, which gives an exemption to introducers in certain circumstances.

For the article 72C exclusion to be available, an introducer must meet each of the following three 'tests':

1. The activities are restricted to passing information to the potential customer only. So the introducer can give the customer the broker or insurer's details, but cannot give the customer's details to anyone else.
2. The activities must be incidental to the introducer's main business. So the introducer cannot do solely insurance introducing. A vet introducing pet insurance could meet this test, but not if he introduces car insurance.
3. The introducer cannot engage in other regulated activity. This requirement prevents an IFA or mortgage broker from benefiting from the exclusion.

Examples of types of activity that may be able to use the exclusion are:

- Property manager providing a leaflet to customers on household insurance.
- Doctor's surgery providing leaflets on private medical insurance.
- Motor dealer providing a name and number of an insurer for a customer to ring to obtain motor insurance.

Remember that the need for authorisation stems from undertaking a regulated activity by way of business.

Where a firm can use the article 72C exclusion, they can still be remunerated and not need authorisation.

By the same token, a firm who cannot use the exemption may still not need authorisation provided they gain no direct or indirect financial benefit from undertaking the activity.

If the introducer cannot benefit from the exclusion and is doing the activity by way of business, he will either need to be directly authorised by the FCA, or the Introducer Appointed Representative of an authorised firm.

Where the introducer is undertaking the activity by way of business you must have an agreement in place which outlines the responsibilities of each party. If the introducer is using the article 72C exclusion an agreement is not required but would be recommended. Examples of introducer agreements can be found in the template section of this chapter.

6. Appointed representatives

6.1 What is an appointed representative?

An appointed representative (AR) is a firm or individual which you, as principal firm, appoint to carry on regulated activities on your behalf. The principal firm must be FCA authorised and must accept full responsibility, including any liabilities that might arise, for ensuring that the AR complies with the FCA's regulation.

The AR will not be authorised by the FCA but the principal firm must inform the FCA of any ARs that it has.

6.2 What is an introducer appointed representative?

An introducer appointed representative (IAR) is an AR who just introduces customers in relation to general insurance to the principal firm and/or distributes marketing material such as product flyers and non-real time financial promotions. The principal is still responsible for ensuring that the IAR complies with FCA regulation however the rules are considerably reduced as there is no selling of insurance involved.

An example of an IAR is a vet who gives out information on pet insurance to customers and passes on details of an interested customer to a general insurance intermediary (his principal).

IARs cannot enter into regulated activities such as arrange deals, make arrangements, assist in administration/performance, deal as an agent or advise on general insurance contracts. If they do any of these they need to be a full AR.

6.3 Responsibilities of the principal firm prior to appointment of an AR

Before appointing an AR the firm should undertake a number of checks to ensure that they are suitable to be appointed. This process of assessment should be documented and should cover the following:

- An assessment to ensure that their appointment will not stop the firm meeting their threshold conditions. This could happen if the AR's general insurance income meant that the principal firm could not meet their capital resources requirement.
- Checks to ensure that the AR is solvent. The principal should review the proposed AR's last financial statements and last 3 months' worth of management accounts.
- Checks to ensure that the proposed AR is suitable to act on behalf of the firm. The firm should look at the type of business the proposed AR undertakes, the objectives and vision of the company, future growth etc.
- Checks to ensure that the proposed AR does not have any close links which would prevent effective supervision. If there is a close link the firm should check that there would not be any conflicts of interest between what the close link may ask the proposed AR to do and what the principal will be asking the firm to do.
- Checks to ensure that the firm will have adequate controls in place to monitor the proposed AR's regulated activities, e.g. selling insurance products, introducing insurance products to the firm.
- Checks to ensure that the firm will have adequate resources in place to monitor the proposed AR's compliance with FCA and its processes and be able to enforce their compliance. The principal will be responsible for the compliance of the proposed AR and as such should ensure that they have a full compliance monitoring programme in place.

If the proposed AR is going to undertake a regulated activity on behalf of the firm, e.g. arranging and selling general insurance contracts then the AR must have an approved person, approved by the FCA responsible for insurance mediation activities.
The principal firm should ensure that the approved person is fit and proper to perform this role. The principal firm needs to put in place an assessment process to assess the AR's approved person. This process, together with the results of the assessment must be documented.

The vetting process should include an assessment of:

- honesty and integrity;
- financial standing;
- criminal records.

This can be achieved by obtaining references, checking qualifications, obtaining a credit check and by asking the approved person to complete a questionnaire and declaration covering any previous financial issues, criminal records and disciplinary action taken by other principals or by other regulatory bodies. This assessment needs to be performed on an annual basis. Further details on approved person assessments, including sample declarations can be found in this manual in Section 2, High Level Standards, Chapter 3, Approved Persons.

6.4 What contracts need to be in place?

When a firm appoints an AR or IAR it must enter in a contractual agreement with the AR or IAR. This agreement should cover:

- responsibilities of AR/IAR;
- responsibilities of the principal firm;
- monitoring that will be undertaken;
- other commercial arrangements.

Both parties need to sign the contract and retain copies. This contract should be review on an annual basis.

An example of an AR contract can be found at the end of this chapter in the template section.

6.5 AR training

The principal firm is responsible for ensuring that the AR or IAR has received adequate training on FCA rules and the processes with which the principal firm would like them to adhere. The training would need to be provided on an ongoing basis and documented evidence should be kept.

6.6 Principal firm's supervisory responsibilities

At all times the principal must have adequate controls and resources in place to ensure that its ARs and IARs are fully compliant. The principal must ensure on an ongoing basis that its ARs are:

- fit and proper to deal with clients;
- able to deliver the same level of protection to clients as if the clients had dealt with the principal itself and if the AR is not, the principal must provide this protection itself; and
- adhere to FCA rules and any other requirements agreed between the principal and the AR.

For IARs the principal must check that the IAR is adhering to FCA rules relating to introducing and must demonstrate that they have checked on a regular basis that the IAR is not doing more than they are allowed to do, e.g. that they are only introducing customers and are not providing advice on the products. This can be achieved by customer surveys, on site visits, customer complaints and mystery shopping.

For ARs the principal should set up a comprehensive compliance monitoring programme to evidence that they are supervising their ARs adequately. The compliance monitoring programme should include:

- policy documentation checks;
- file checks including records of a client's demands and needs, and documentary evidence that status disclosure and product disclosure have been issued;
- financial checks;
- checks on the sales process including telephone monitoring, mystery shopping or accompanied sales visits (if applicable);
- complaints received by the AR; and
- compliance with CASS rules if applicable.
- that the AR has adequately trained and competent staff in place and is assessing competence on an ongoing basis.

An on-site audit should take place at least once a year.

The firm must undertake a comprehensive check of the AR's financial standing at least once a year and more often if required. This check should be performed by an experienced person within the firm. The checks should look for indicators that the AR may be experiencing financial difficulties. These may include:

- failure to adhere to repayment schedules for debts;
- failure to meet other financial commitments; and
- requests for advances of commission.

Should the firm have any concerns these should be looked into and necessary action taken. This may include increased monitoring or termination of the contract.

The principal should also ensure that a comprehensive compliance monitoring and auditing process is set up within the AR. This should include file checks, policy documentation checks, sales process monitoring and financial checks.

Part of compliance monitoring and auditing should be compliance breach reporting. The AR should have a process in place to identify, record and deal with any compliance breaches. This should include an investigation into the root cause of the breach and to implement actions to ensure that the breaches do not reoccur. They should also notify the principal firm of any breaches they have found and the actions they are taking.

A compliance audit checklist is included in the template section of this chapter.

6.7 PI cover

If a firm has ARs they must be included in the firm's PI cover.

6.8 Client money

Client money held by ARs is the responsibility of the principal firm and they must be able to account for any client money held by the ARs. If a shortfall arises then the principal firm will be liable to make good that shortfall. If the principal firm does not have risk transfer agreements in place covering ARs then the easiest way of achieving this is to ensure that all client money received by an AR is paid immediately into the principal's client bank account.

If an AR is not able to pay client money into the principal's client account then they will need to have their own client bank account set up.

If the AR does hold client money then the principal firm must ensure that they have set up the correct client money account. The principal firm must have adequate and appropriate systems and controls in place to monitor the AR's compliance with client money rules. Appropriate records should be maintained to show what:

- procedures are in place to ensure client money is received, segregated and paid by ARs in line with the client money rules;
- training has been given to ARs for handling client money; and
- monitoring is done to ensure ARs handle client money according to the firm's own procedures.

This monitoring should include:

- set up of the account;
- client money calculations;
- reconciliation of the client bank account;
- dealing with excesses and deficits;
- removal of their own money within 25 business days;
- adherence to any procedures that you wish them to follow.

If the AR does handle client money in its own bank account then the principal firm needs to hold in their client account £1 for £1 that which is held in the AR's client bank account.

AR client money needs to be included in the principal firm's client money calculation.

If the principal firm has risk transfer agreements in place then these should be extended to cover their ARs.

Further details on client money rules can be found in this manual in Section 3, Business Standards, chapter 3 Client money.

6.9 Record Keeping

A firm must keep the following records in relation to its appointed representatives from the date the contract is terminated or amended:

- the AR's name;
- a copy of the original contract and subsequent amendments made to the contract, date and reason for termination of the contract; and
- arrangements under a multi principal agreement.

In addition the firm should also ensure that the AR is keeping the required records under FCA rules, such as ICOB records and T&C records.

6.10 Management Information

Principal firms should have rigorous management information in place to allow close and continuous supervision and monitoring of the activities of its ARs. This should meet the FCA good MI guidelines which are set out in Section 2, High Level Standards, Chapter 2, Senior Management Arrangements, Systems and Controls

6.11 Treating Customers Fairly

The Principal firm has responsibility for ensuring that the AR has implemented TCF and this is "embedded". The Principal firm should have ensured that a TCF gap analysis has been implemented. Further information on this can be found in Special Topics chapter 1 Treating Customers Fairly.

7. Non-Executive Directors (NEDs)

The NED role is seen as important by the FCA as it provides a continual independent check on the executive team. It is a controlled function (CF2) and therefore NEDs need to become approved persons, unless the firm is a secondary intermediary and only requires one approved person under FCA rules.

7.1 The role of the Non-Executive Director

NEDs should focus on board matters, providing an independent view of the company. They should offer a creative contribution to the board by providing objective/constructive comment and, if need be, criticism. Their function is to provide general counsel on matters of concern and to provide guidance on issues before they are raised at the board meetings.

The Board as a whole is collectively responsible for promoting the success of the company by directing the company's affairs. NEDs have an important contribution to make to the proper running of the firm and should bring an independent judgement to bear on issues of strategy, performance and resources including key appointments and standards of conduct.

They should focus on board matters rather than stray into the executive direction. They will provide an independent view that is removed from day to day running of the firm and will often bring:-

- Impartiality
- Wide experience
- Special knowledge
- Personal qualities/reputation

There is no legal distinction between an executive director and a NED and, as a consequence, NEDs have the same legal duties, responsibilities and potential liabilities as their executive counterparts. However, clearly they will not be able to provide the same continuous attention to the business of the firm (they may be a NED on more than one board). They do, however, need to be able to demonstrate the same commitment to its success as their executive colleagues.

Where a NED is an approved person his responsibility and liability under FCA rules will be limited by the role that he undertakes. Provided he has personally taken due care in his role, the NED is unlikely to be held liable either for the failings of the firm or for those of individuals within the firm.
FCA consider the role of a non-executive directors to be key to running of the business. Where they undertake supervisory reviews with the firm then they are able to request an interview with the NED. Previously the FSA used to only request interviews with the senior NEDs i.e. those who chaired the Board or sub committees. The FCA however are moving to interview a range of directors and NEDs during supervisory work.

7.2 Functions of the NED

NEDs are expected to focus on board matters and not to stray into “executive direction” thus providing an independent view of the company that is detached from the day to day running of the firm. They would be expected to focus on the following areas:

- Strategic direction

  To provide a creative and informed contribution and to act as a constructive critic in looking at objectives and plans devised by the Managing Director and the executive team.

- Monitoring

  NEDs are responsible for monitoring the performance of the executive management team especially in regard of achieving the company strategy and objectives. They should scrutinise and monitor the reporting of performance.

- Communication

  Helping to connect the business and board with networks of potentially useful people and organisations, and possibly represent the company externally.

- Audit

  Ensure the internal controls are in place and are monitored regularly and rigorously. Sit on the firm's audit committee (if the firm has one).

- Risk management

  Provide an independent and challenging view on the nature and impact of risks to the business. Play a role in ensuring that business risks are identified and monitored and that the company has effective controls in place to manage risk.

- People

  Some NEDs will have a role in setting the remuneration of the executive directors and may also be involved in the appointment of senior managers/directors. They should also ensure that the company has adequate and robust succession planning in place. This role may be performed by sitting on either a Nominations Committee or Remuneration Committee (and sometimes these committees are combined).

- Mediation

  Helping to mediate in conflict situations and helping the chairman to reach clear conclusions where discussions are lengthy or complex.

7.2.1 How should you fulfil your role?

In fulfilling the role of a NED you should:-

- Where there are more than one NED on the Board you should meet at least annually as a group without the CEO, MD or Chairman present;
- Be entitled to seek independent professional advice at the company's expense;
- Ensure that you are able to commitment adequate time to the role;
- Be able to commit to initial three year duration with a further three years as a maximum;
- Consider whether you are independent in character and judgement;
- Review the Board balance of executive roles versus non-executive roles; and
- Ensure that the effectiveness of the board is reviewed and evaluated at regular intervals.

7.3 Appointment of a NED

When choosing a NED the firm should consider:

- breadth of experience;
- understanding of the company and target market;
- specialist knowledge and skills;
- independence;
- impartiality;
- objectivity;
- ethical standards, integrity and probity;
- ability to support the executives in their leadership of the company;
- questioning, challenging and debating skills;
- understanding of corporate governance and compliance.

The appointment process for all directors to the board should be formal, rigorous and transparent.

There is no defined term that a NED should sit on a board however best practice would suggest that NEDs should be appointed for a specified time subject to re-election and Companies Act provisions relating to the removal of a director. Re-appointment should not be automatic. It would appear that good practice suggests two terms of three years and then they can be re-elected on an annual basis thereafter.

When appointing a NED a firm should produce a terms of reference document/ a contract. These should be signed by both parties and should include the following items:

- Appointment

  What criteria you intend to use to appoint a NED and who will appoint them.

- Term of appointment

  If you have a set length of time a NED can remain on the board and how often they would need to be re-elected.

- Remuneration

  How NEDs are remunerated, who agrees remuneration and when it is reviewed. The remuneration should reflect the likely workload, scale and complexity of the business and responsibility involved. A more attractive amount may be offered to secure the services of someone that will make a real difference.

- Termination of appointment

  How the contract can be terminated and what the consequences of early termination are.

- Training/induction

  What training and induction do you intend to provide the non-executives with. Is this just boardroom level or do you intend for them to visit the site operation to see how you sell, deliver and administer products. Will there be any ongoing training, etc.

- Functions of the Non-Executive Director

  These should be listed.

- Duties and responsibilities

  What the duties will be.

- Approved person status

  They are approved by the FCA as an approved person and that they adhere to the Statements of Principle and Code of Practice for Approved Persons as set out by FCA in the APER Sourcebook. They will need to complete a “Form A” and their appointment is conditional on them being approved by the FCA.

- Conduct

  What conduct you expect them to adhere to. This should include:

  - meeting the FCA Fit and Proper test (Form A);
  - honesty and integrity;
  - confidentiality;
  - minimum attendance at board meetings;
  - an undertaking that the NED would have sufficient time to meet what is expected of them taking into account other commitments;
  - NEDs will inform you of their other commitments to ensure there are no conflicts;
  - an undertaking to inform you of any changes to circumstance which may impact on their ability to remain an approved person or their commitment to their role.

- Mode of working

  How you expect your NED to work with you, likely time that will be required to perform their role, meetings you would expect them to attend, etc.   If there are specific functions you would like them to undertake or be involved with, state how these would happen, e.g. remuneration reviews, risk assessment reviews, appointment of new directors, etc.

  How you expect the NED to provide information to you, e.g. provide information to the board sufficiently in advance of meetings (you may want to have specific timescale) to enable thorough consideration of the issues before the meeting.

  Ensure that any information provided to them for board meetings is accurate, sufficient, timely and clear.

  If the NED is concerned about a matter of business: how this is raised.

- Meetings

  How often the board will meet and if there are other sub-committees, etc. in which you expect the NED to participate.

- Authority

  What the authority is of the NED - can they investigate anything they want and seek information from any employee?

- Assessment of performance

  How and who will assess the non-exec performance in their role.

8. Industry Guidance on Conflicts of Interest, Disclosure and Transparency in the Commercial Market

The FCA has reviewed the industry solution and has confirmed “industry guidance” status for it. This confirmation means that it will take into account this guidance when exercising its regulatory functions. The industry guidance is not mandatory and is not FCA guidance. This guidance came into force on 1 April 2009.

The practical effect of such guidance is that in the event of a breach of relevant requirements, the FCA would take into account the firm’s adherence to this guidance in any enforcement action. This guidance provides firms with one approach to meet the relevant FCA requirements – it does not represent the only means of achieving compliance. Firms that decide not to adopt this approach will not be presumed to be non-compliant by the FCA.

It is however important to stress that industry guidance can only be granted based upon existing FCA rules and requirements and so does not impose new requirements upon firms. It does seek to provide greater clarity to firms about what is required of them. The full industry guidance can be found on the BIBA website.

The industry guidance has been designed to address the outcomes for commercial customers that the FCA are seeking:

Outcome 1

Commercial customers should have clearer and more comparable information about the commission intermediaries receive.

Outcome 2

Commercial customers should have clearer and more comparable information about the services intermediaries are providing.

Outcome 3

Commercial customers should have clearer information about the capacity in which the intermediary is acting

Outcome 4

Commercial customers should be alerted to their right to request commission information

Outcome 5

Commercial customers should be made aware when there is a chain of intermediaries.

These outcomes are addressed in a series of sections within the industry guidance. Where applicable the relevant sections of the manual have been updated to include this guidance.

8.1 Conflicts of Interest

The FCA rules and Principles require firms to take all reasonable steps to identify conflicts of interest between themselves and their client. The industry guidance explains that insurance intermediaries will face a conflict of interest where the firm's own interests conflict with those of a commercial customer; or the firm is unable to act in the best interests of one commercial customer without adversely affecting the interests of another commercial customer.

The industry guidance also states that it is the duty of an insurance intermediary to manage conflicts of interest so that the intermediary's interest does not conflict with the interests of a commercial customer and of any of the insurers on whose behalf they may act.

The industry guidance suggests that firms establish their own internal conflicts of interest management policy. It reminds firms that the FCA's Rules require that they must:

- take reasonable care to establish and maintain such systems and controls appropriate to the business; and
- must maintain and operate effective organisational and administrative arrangements with a view to taking all reasonable steps to prevent conflicts of interest from constituting or giving rise to a material risk of damage to the interests of clients.

The guidance also suggests:

- how to build suitable conflict management controls;
- the circumstances in which conflicts of interest may arise; and
- points out that brokers need to be able to demonstrate that they have in place rigorous internal controls for identifying and managing potential conflicts of interest and a mechanism for preventing them adversely affecting the firm's commercial customers.

Chapter 2 above provides further details on identifying and managing conflicts of interest taking into account the industry guidance.

8.2 Capacity

One area that the industry guidance suggests would help manage conflicts of interest that arise from commercial relationships, is to give the commercial customer clear information regarding the capacity in which the insurance intermediary is acting – i.e. whether it is acting for them or on behalf of the insurer or in some cases, for both.

Relationships that the firm may have with customers and insurers may give rise to conflicts of interest and one way of mitigating any conflict is to clearly describe the capacity in which they are working to the commercial customer. Simply relying however on a generic statement in a TOBA is not sufficient and it needs to be done contract by contract and can vary.

Further information on this including a template which firms can use can be found in the ICOBs section of this manual.

8.3 Status/Breadth of Search

During its Forensic Review in 2007, FCA's researchers found that commercial customers generally overestimated how much searching of the market the broker had undertaken. Often generic statements in the TOBAs do not match the actual circumstances.

The FCA rules require firms to take reasonable steps to communicate information in a way that is clear, fair and not misleading.

Status and product disclosure requirement apply separately in respect of each contract and so the commercial customer must be informed of the breadth of choice on a contract by contract basis. FCA's rules require the breadth of choice to be described as:

- provides advice on the basis of a fair analysis of the market; or
- it is under contractual obligation to conduct insurance mediation business exclusively with one or more insurers; or
- it is not under a contractual obligation to conduct insurance mediation business with one or more insurers, however, it does not give advice on the basis of a "fair analysis" of the market.

Further information on how to assess whether a broker's breadth of choice can be described as a fair analysis of the market is provided in the ICOBs section of this manual.

8.4 Commercial customer's right to information and disclosure

The industry guidance maintains the current "upon request" disclosure regime, but gives direction on how brokers can give greater prominence to the commercial customer's right to ask for commission information. FCA research shows that a significant number of commercial customers are unaware of their right to know how much commission their broker receives.

Simply including a statement in the TOBA would not be sufficient and industry guidance suggests that it should either be made:

- in a covering letter which may accompany a written quotation;
- in a document of no more than one page in length; or
- orally.

Where the customer exercises the right to request commission disclosure, the industry guidance points out firms should have in place processes to ensure that the commercial customer receives full, accurate and timely disclosure of the total commission payment. The guidance states that it is not sufficient to have no process in place because no-one has requested the information.

The industry guidance provides assistance on how to disclose any contingent arrangements the firm may have such as profit share and volume over-rides.

Further information on this including a template that could be used to disclose commission can be found in the ICOBs section of this manual.

8.5 Distribution Chains

Industry guidance reminds firms of their obligation to provide clear, fair and not misleading information and suggests that brokers inform commercial customers where they have used the services of another broker in placing the insurance.

8.6 Top 10 Tips on Implementing Industry Guidance

1. Check your current processes, procedures and documents to ensure the accuracy of the disclosures concerning the breadth of search and the capacity in which you are working. Remember – these disclosures must be contract-specific.

2. Look again at the terms of business agreements (TOBAs) you have with your commercial customers. Do they contain generic descriptions of searching and your capacity?

3. If you decide to change your current methods, consider using the annex template from the Industry Guidance, or use a TOBA that can easily be adjusted to suit the contract-specific searching and capacity.

4. Do you already inform commercial customers that they have the right to ask you about the commissions you receive? If you do, how prominent do you make this? Remember, Industry Guidance states that it is not sufficient simply to rely on inserting a statement into your commercial customer TOBA.

5. When you use the services of a wholesale broker or MGA for the placing of a commercial insurance contract, do you notify the commercial customer that you have done this? Industry Guidance reminds firms that commercial customers should be made aware of the presence of others in the distribution chain.

6. How well developed are your internal policies and processes for identifying and managing potential conflicts of interest that might arise in your business? BIBA have produced two very helpful guidance papers on how to identify and mange conflicts and how to design and implement your own internal conflict management policy. Now might be a good time to fundamentally review your whole approach to conflicts management.

7. Do you have a formal process to disclose commission upon request to commercial customers? It is not sufficient to simply say that we have had no requests and therefore do not need a process! BIBA issued a guidance note in 2007 assisting firms in creating and implementing a disclosure process. If you already have a process, are you sure your staff know what it is?

8. The FCA has found that commercial customers are often unaware of the services provided by their broker. Do you clearly set out for your commercial customers' details of the nature of the services you provide for them? If not, it would be a very prudent thing to do. Clearly the nature of these services will vary depending on the customer and the complexity of the risks involved. When designing a schedule of services, you could include the specific activities you undertake at the new business stage, mid-term and at renewal. You could also include details of your claims service, the day-to-day support you can make available and, most importantly, the expertise that you can make available and the quality of your advice.

9. What plans do you have to train your staff and increase their awareness of any changes you make to processes, procedures or documentation as a result of implementing the Industry Guidance?

10. Lastly, where you do make a change to the ways you are currently doing commercial business, it would be prudent to keep a formal record of the changes.