


# Principals and their Appointed Representatives

Compliance  
update

# Introduction



The principal's regulatory obligations to control their AR's activities

**As members know, General Insurance Mediation activities are Regulated Activities in the UK so firms undertaking these activities must be authorised or exempt. For those wishing to carry out regulated activities but not wanting to be directly authorised they can become an Appointed Representative (AR) and undertake regulated activities under the supervision of an authorised firm who acts as their principal.**

The Financial Conduct Authority (FCA) has found significant shortcomings in the control and oversight of ARs by their principal firms. Their findings suggest that some principals do not fully understand their regulatory obligations in respect of AR's.

The principal's regulatory obligations to control their AR's activities are the same as the principal's obligations for his own activities.

Anything that the appointed representative has done or omitted to do is treated as having been done or omitted to be done by the principal firm itself.

Principals need to be able to demonstrate that they are meeting their regulatory requirements so that customers who receive products and services delivered by the AR's are receiving the same outcomes as if they were dealing with the authorised firm itself.

There are 20,000 ARs linked to insurance intermediaries in the UK and within these ARs, there are individual representatives. Without proper supervision it is probable that customers may suffer detriment arising from the AR's activities.

COBRA has produced a guide on the FCA Rules relating to the Appointed Representatives Regime and this can be found on Cobra Connect.

This article highlights the areas that the FCA has found to be lacking in the oversight of ARs.

The FCA has looked at all the phases of the Principal AR relationship:

- Initial Selection
- Appointment of ARs
- Set up
- Contracting
- Oversight
- Termination



## Initial Selection and Appointment of an AR

The decision to take on an AR should always be strategic rather than opportunistic. The AR's activities should clearly align with the principal's business model, core activities and skill sets.

Firms should not be using ARs to diversify from their core activities. Principal firms need to demonstrate that they have considered and understood the nature, scale and complexity of the risks arising from the AR's activities and the risks the activities present to customers.

Although taking on an AR will hopefully grow revenues, there are also cost implications including putting in place systems and controls and appointing the right staff with the skills to oversee and monitor the ARs. Therefore, firms should conduct a cost-benefit analysis prior to appointment.

### Appointment

Firms must have appropriate and effective policies and procedures, supported by adequate resources, for the selection and appointment of ARs.

There are three core elements to assess when appointing an AR:

- 1 Impact on the principal** – This requires the principal to carry out due diligence to fully understand the AR's activities and the risk these present to the principal firm and customers.

The following areas should form part of the due diligence:

- The fit with business model and activities
- Type of products sold, sales process and method of sales and the needs of and risks to customers
- The remuneration of the sales agents and any risks this creates
- Additional costs of appointing an AR
- Experience and capabilities of the AR and its management
- Conflicts of Interest that could arise
- Availability of staff with the right skills to monitor and oversee the AR.
- Any relationship with parties in the value chain that could prevent the principal from properly overseeing the AR.

## Initial Selection and Appointment of an AR continued...

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**Solvency and Suitability** – Firms must consider the solvency and suitability of the AR and the impact on their own compliance with the FCA Threshold Conditions.

Basic checking tends to be carried out at appointments but is rarely revisited. A tick box exercise with narrow financial measures will provide little understanding of the suitability of the AR. It should be noted that solvency checks and suitability should not only focus on the legal entity but on its senior management both at appointment and on an ongoing basis.

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**Adequacy of controls and resources – assessment at appointment** - Before taking on an AR the principal should assess its own controls and resources to ensure that these are adequate to monitor the AR and enforce compliance once appointed.

The Principal needs to ensure that their Professional Indemnity Insurers have been advised of the AR and that the policy will cover its activities.



## Set Up

Appointed Representatives are added via the Connect System. Where an AR is appointed solely to distribute GI products as an ancillary to its primary non-regulated activity e.g. Motor dealership selling GAP then the AR is only required to have one director as an approved person.

Where the AR's primary or only activity is selling insurance then all persons carrying out a controlled function must be approved. Principals need to check that they have the required approval for all persons carrying out a controlled function.

This is often missed as once the AR has been appointed and added via the connect system firms need to go back and add the person holding the controlled functions for the AR. It is not a requirement for sole traders acting as an AR to have an approved person.

## Contracting

Firms must ensure that the contracts are fully compliant. An AR may operate under more than one principal but if it does, all principals must enter into a written agreement.

This should set out which regulatory activities each principal has accepted responsibility for as well as identifying the lead principal. Failure to put in place multiple principal agreements generates risks for both principals and customers. There is a lack of clarity over who is responsible for each of the activities of the AR leading to possible gaps in oversight and control and lack of clear ownership for any issues arising.

Contracts should not be generic, they need to accurately capture the nature and extent of the relationship between the principal and the AR.

They provide clarity on the responsibilities of each party and the regulated activities that the AR is allowed to undertake. They also contribute to an open and cooperative relationship between a regulated firm and the FCA as required by PRIN.

- The contract should set out clearly the activities that the AR is permitted to carry out and include appropriate parameters and limitations around these activities
- The terms should be designed to enable the principal to comply properly with any requirements or the limitations of its permission
- The contract must ensure that the AR will co-operate with the FCA and allow access to the firm's auditors
- The contract should allow the principal to terminate the contract in certain circumstances.

## Governance and oversight

A principal firm must be able to demonstrate effective risk management oversight and control frameworks to identify monitor and mitigate the risks arising from their ARs activities.

ARs must not be conducting activities that are outside the principal's core areas of expertise as this will mean they cannot be effectively supervised.

Effective supervision starts with the principal firm having adequate resources to oversee the AR and enforce compliance with the contract and regulatory requirements.

Sometimes principal firms are reluctant to challenge their ARs, especially where the AR is a larger entity that owns the customer relationship.

In some cases, the AR may even be allowed to dictate the relationship. However, this is not appropriate.

The principal firm must remember they hold the authorisation /permissions for performing the regulated activities and therefore they are responsible for ensuring the AR is compliant. This is especially important where the AR is dealing with Retail Clients.

The level of supervision/monitoring should be commensurate with the level of risk each AR presents. It should consider the contract terms of the AR and ongoing suitability and solvency of the AR, product type, sales method, volumes, target market, and number of sites and representatives involved in the ARs activities.

Those with responsibility for the appointment and monitoring of ARs need to have the appropriate skills and knowledge to perform their oversight role effectively.

It is recommended that firms separate the ongoing monitoring from the management of the commercial relationship with their ARs who are often regarded primarily as a client rather than an AR performing regulated activities.

Different individuals should deal with the different relationships. So that the same person is not trying to ensure that the AR is complying with their regulatory obligations whilst also managing and developing the commercial relationship.



## Governance and oversight continued...

Firms can rely heavily on IT systems with clearly defined processes and procedures as the primary means to control certain activities of their staff and ARs.

These systems do provide a clear sales process and an audit trail but firms must not place undue reliance on the system. Material risks remain that are not addressed by the IT system such as mis-selling by deviating from the appropriate script or process. Sufficient supporting monitoring work must be in place.

Monitoring needs to include:-

- Whether the AR and its senior management continue to be Fit and Proper
- The financial position of the AR (on an annual basis at least)
- The quality of the sales processes through file audits or observed sales
- KPIs
- A review of reward and incentives policies and any conflict of interest
- Compliance with the terms and restrictions in the contract.

Where ARs operate from various sites it is important to conduct compliance visits. Any monitoring by insurers does not replace the need for firms to monitor their ARs. The principal firm must ensure any audit recommendations are followed up / implemented.



## Training and Competence (T&C)

Firms always acknowledge the importance of T&C for sales agents but the quality of T&C regimes varies greatly. One of the primary failings is that the majority do not seem to assess competence at the outset and do not assess whether the training, that has been undertaken, has been implemented in practice and is delivering fair outcomes.

Training needs to cover all areas, not just product knowledge and the sales process with a view to maximizing sales.

Other important training needs include understanding and recognising vulnerable customers, complaints, treating customers fairly and the risk of mis-selling.

Appropriate Management Information (MI) plays a key role in enabling principals to identify trends and issues and to manage risks. For example, if ARs are using sales targets and incentives the principal must have MI in relation to these arrangements and their impact on sales. MI should also be requested on Complaints and Claims.

## Termination

Contracts should allow principals to terminate the agreement including where the principal has reasonable grounds to be concerned over the suitability of its AR but is unable to rectify the issue.

Termination should not be automatic as principals need to take appropriate steps to mitigate any risks to customers.

The principal is responsible for ensuring that outstanding regulated activities and obligations to customers are properly completed and fulfilled and that customers are informed of any relevant changes.

To achieve this it is very important that principals have access to the ARs customer records / ARs complete records. Firms must tell the FCA when the relationship has ended within a specified period.



## What the FCA expects - a quick checklist

Principals are expected to be able to demonstrate that they consistently comply with their regulatory obligations to:

- Consider the impact of ARs on their own business model and ability to meet threshold conditions
- Assess the solvency and suitability of their ARs
- Take reasonable steps to put in place an appropriate risk management framework to identify and manage the risks ARs present to their business
- Put in place compliant contractual arrangements with the ARs
- Have adequate controls over their ARs regulated activities for which the principal has responsibility and;
- Have adequate resources, policies, and processes for the selection, appointment, monitoring, and termination of ARs.
- Have adequate resources in place to monitor and enforce compliance with the relevant requirements that apply to the regulated activities for which the principal is responsible.

**Remember, a Principal is fully responsible for the activities of their Appointed Representatives and their Authorisation is at risk if anything goes wrong.**

**If you would like any assistance with reviewing your arrangements for your Appointed Representatives or, if you have any questions regarding any aspect of FCA Compliance, please do not hesitate to contact a member of the Cobra Network Compliance team.**