

Lloyd's Coverholder Auditor Conference

Delegated Authority and Conduct

10 February 2016

Introductions



David Sansom

Direct Tel: + 44 20 7951 3008
Mobile: + 44 7760 201 692
Email: dsansom@uk.ey.com

- ▶ Director in EY's Financial Services Risk practice.
- ▶ He joined EY in 2010 and is based in the London office. Prior to that David worked at the Financial Services Authority and the UK Treasury in a range of insurance policy and supervision roles.
- ▶ Experienced regulatory advisory insurance professional with experience across conduct and prudential risks
- ▶ Has led numerous independent reviews and s.166's for insurers and brokers covering governance frameworks and risk management systems including controlled functions of Risk, Compliance and Internal Audit



Anthony Clapton

Direct Tel: + 44 20 7951 0198
Mobile: + 44 7467 441 624
Email: aclapton@uk.ey.com

- ▶ Manager in EY's Financial Services Risk practice.
- ▶ Joined EY in 2014. Prior to that Anthony worked for a large national retail insurer in Governance, Risk and Compliance.
- ▶ Experienced regulatory advisory insurance professional focussed largely on conduct risk in the London Market.
- ▶ Seconded to Lloyd's Conduct Standards Assurance Team until January 2016. Responsible for performing reviews of managing agents against the Conduct Minimum Standards (MS11) and the day to day supervision of managing agent conduct.
- ▶ Regular author of articles for EY's insurance publications across EMEA.

EY's market experience

EY is supporting the market on conduct and has worked with Lloyd's and managing agents across a broad range of initiatives:

- ▶ Review, design and implementation of conduct risk frameworks.
- ▶ Development and delivery of market wide training on conduct to managing agents and other key stakeholders.
- ▶ Assessment and enhancement of DA frameworks in areas including due diligence, audit, product and coverholder risk assessments.
- ▶ Helping firms develop conduct MI in respect of coverholders and TPAs.
- ▶ Supporting the work of the Lloyd's Conduct Standards Assurance Team (CSAT) in relation to the Conduct Minimum Standards.

Agenda

Comprehensive and effective oversight and management of Delegated Authorities has been an area of focus across the market for several years. In this time, insurers have been working to address commercial needs and regulatory concerns but there is still a great deal more to be done.

This presentation covers:

1. **Recap of ‘Auditor Conduct Training Workshop’:** a summary of the key messages from yesterday’s training workshop.
2. **Conduct lessons learned:** sharing insights on good practice and areas for improvement for audits and other Delegated Authority controls.

Recap of the 'Auditor Conduct Training Workshop'



Market overview of conduct risk

Conduct risk is the risk that good customer outcomes are not delivered

Basic principle of Conduct is universal

Customer can be applied to those covered or entitled to benefit under an insurance policy

Millions of individuals and SME's are Lloyd's policyholders

Different types of Customer can have different needs and reasonable expectations

Outcome based approach to regulation

The insurer may be held to account for poor customer outcomes across the distribution chain

Forward looking attributes

Professional audit practices have evolved in recent years

Scope and approach to DA auditing is undergoing change

Lloyd's Minimum Standards (CR15 and CR16)

'Involvement', 'Influence' and 'Impact'

F irmly linking the 'case for change' to **business objectives** helping to make the business better, and steer clear of trouble

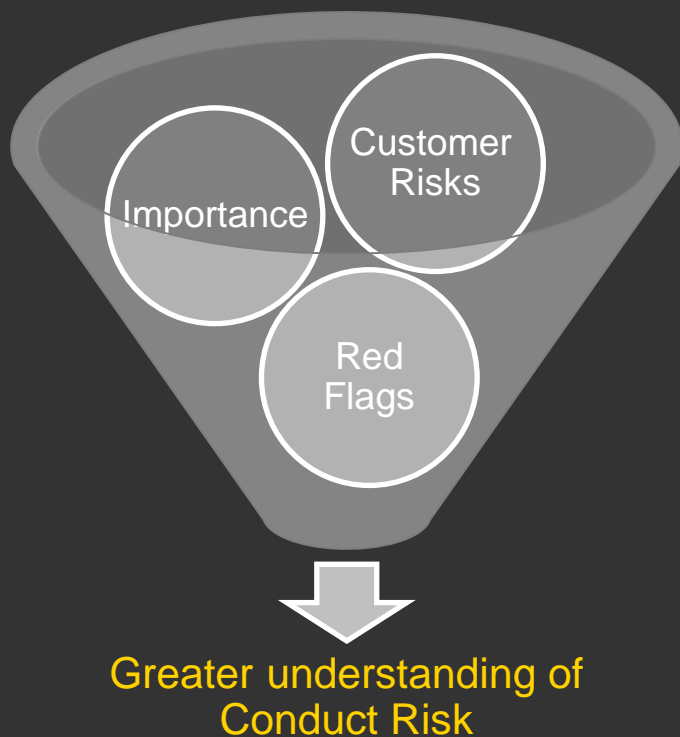
A sking 'why?', 'why?', and 'why?' again to source the **underlying root cause**

T hinking more closely about risk/control **behaviours and mind-sets** exhibited by people

J oining the dots to draw together information into **impactful broad themes** for key stakeholders

Breakouts

Customer risks



Audit approach



Key messages from the discussion

What managing agents want from auditors

The following points were raised by participants:

- ▶ Audits should comment and focus on culture regardless of the scope.
- ▶ Objective and evidence based assessment.
- ▶ Context and root causes to aid in the resolution of issues.
- ▶ More time testing on site, less time on information gathering.
- ▶ Achieving good outcomes for customers is a principle that applies globally; auditors should look to identify where this is not the case
- ▶ Audits should go beyond process design and consider the outcomes driven by the process.

Key messages from the discussion

What auditors need from managing agents

The following points were raised by participants:

- ▶ More information in advance of fieldwork, from other areas of the DA framework.
- ▶ Managing agents should better educate their coverholders and TPAs on conduct.
- ▶ More involvement from managing agents at planning stages.

Concerns

- ▶ Some disparity experienced in the level of support from brokers.
- ▶ Audience of audit reports not always clear.
- ▶ Report actions not always followed up.
- ▶ Varying expectations of managing agents on joint audits.

Summary

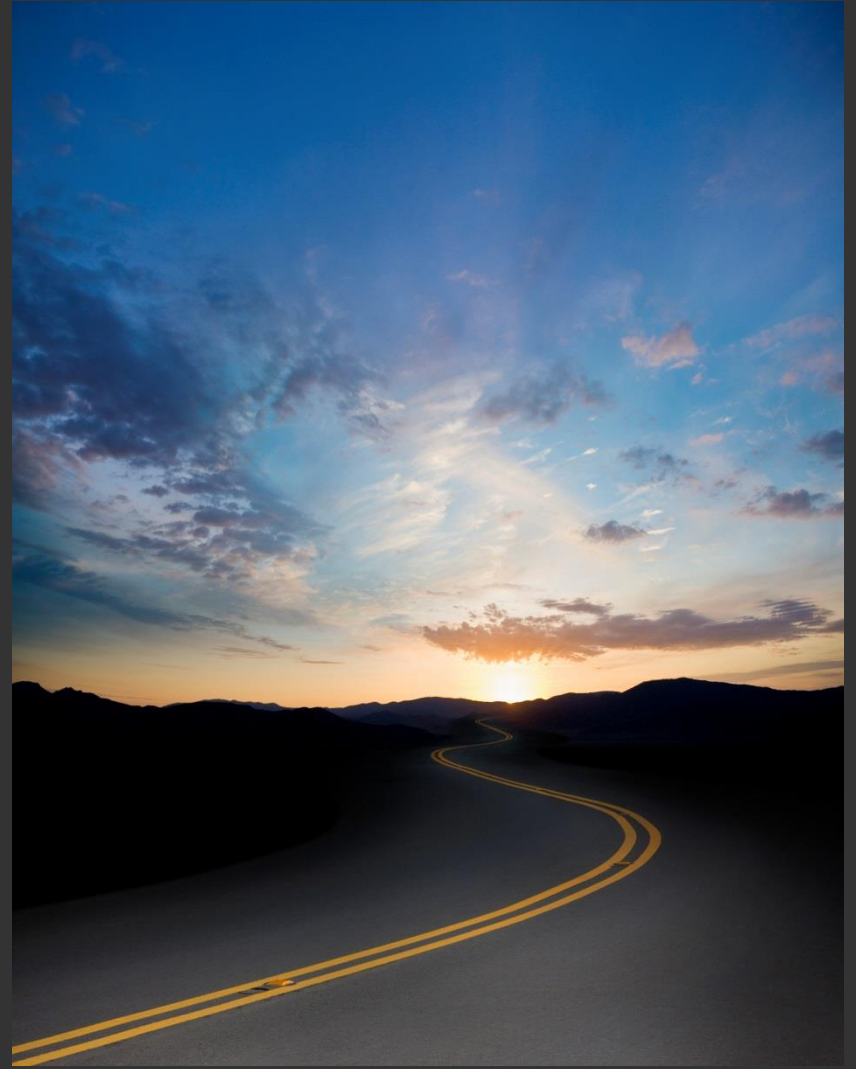
- ▶ Expectations of audits are changing.
- ▶ More is required to assess whether there is a culture which puts the customer at the heart of the business.
- ▶ Enhancing the audit scope will help, but ultimately auditors will need to make an objective assessment of this culture.
- ▶ It is the quality and depth of testing and reporting that delivers value.
- ▶ Managing Agents need to set clearer requirements and provide better information to their DA auditors...
- ▶ ... and auditors need to respond by asking the right questions to identify the key conduct risks in the businesses they are auditing.

Conduct Lessons learned



Conduct Lessons learned

The following slides set out common issues and areas of challenge in relation to conduct in delegated authority frameworks.



Lessons learned – Risk assessment



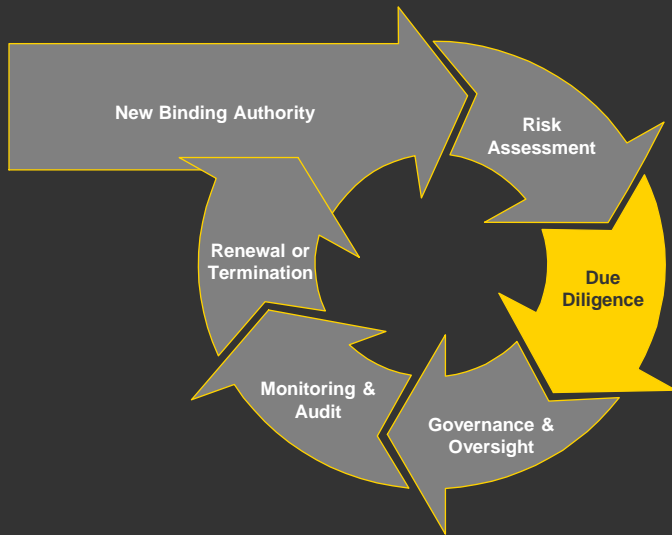
Good practice

- ▶ Objective assessment of inherent risk that determines whether delegation is within the firms risk appetite and what level of due diligence and monitoring is required.
- ▶ Comprehensive training.
- ▶ Quality control mechanisms in place.
- ▶ Clear and detailed output, including assessor commentary.

Areas to improve

- ▶ Risk assessment fails to adequately consider Conduct Risk.
- ▶ The results of the risk assessment do not influence decisions or trigger any action.
- ▶ The output of risk assessments are not recorded or records are inadequate.
- ▶ The weighting of risk factors is imbalanced or incorrect.
- ▶ Lack of consistency in application due to the use of subjective questions.
- ▶ Too simple (such as automatically rating high or low based on customer type)
- ▶ Too complex (such as use of complicated formula without rational)

Lessons learned – Due diligence



Good practice

- ▶ Report produced including commentary from assessor to help inform decisions.
- ▶ Depth and breadth of due diligence determined by the risk rating.
- ▶ Comprehensive assessment of conduct risk in addition to commercial and prudential factors.
- ▶ Assessor has sufficient knowledge and experience to assess evidence.

Areas to improve

- ▶ ‘Check box’ approach to due diligence - no assessment or analysis.
- ▶ Due diligence completed after inception without a clear rationale for exception.
- ▶ Potential issues identified do not inform decision making process and are not followed up.
- ▶ Undue influence from underwriters.
- ▶ Conduct assessment is too general and fails to cover all risks posed across the value chain.

Lessons learned – Governance and oversight



Good practice

- ▶ Ownership and accountability over the performance of each relationship is clearly understood (including conduct).
- ▶ Governance body in place to provide oversight has sufficient authority and receives sufficient MI to inform decisions.
- ▶ 2nd and 3rd Line of Defence oversight and assurance over DA framework.

Areas to improve

- ▶ Relationship owners lack the necessary skills and experience to monitor performance, provide training and coaching, and identify and resolve issues.
- ▶ Governance body focusses on commercial performance without considering conduct.
- ▶ Underwriters do not recognise coverholders as outsource partners but as clients or customers.
- ▶ Conduct expectations, MI requirements and SLA's not documented or included in binder.

Lessons learned – Monitoring and audit



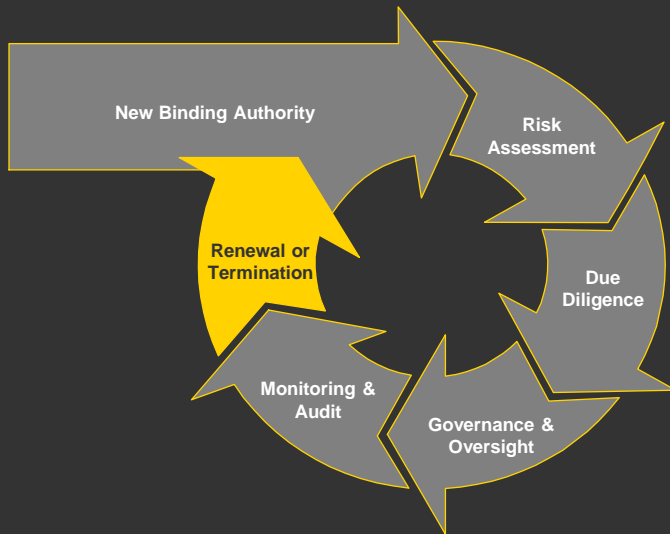
Good Practice

- ▶ Audit depth and frequency influenced by risk rating and also triggered by certain events (such as material changes).
- ▶ Regular and comprehensive program of monitoring activities by underwriters, claims adjusters, complaints handlers.
- ▶ Review of audit reports and prompt follow up and closure of actions.

Areas to improve

- ▶ Scope and depth of audit not linked to conduct risks.
- ▶ Use of audit as a means of gathering basic information rather than testing.
- ▶ Lack of communication between managing agent and auditors on key risk areas.
- ▶ Audit results not shared with all interested stakeholders.
- ▶ No follow-up on issues risen out of monitoring or audit.

Lessons learned – Renewal or termination



Good Practice

- ▶ All open monitoring and audit actions resolved prior to renewal.
- ▶ Repetition of risk assessment and due diligence processes.
- ▶ Formal processes in place for managing lapsed or terminated arrangements.

Areas to improve

- ▶ Termination of arrangements do not involve the assessment of impact on the customer.
- ▶ Renewal approved on purely commercial grounds despite conduct issues being identified and outstanding.
- ▶ Renewal process fails to identify and assess material changes.

So what does this all mean?

- ▶ Cultural shift on DA is ongoing.
- ▶ Unprecedented regulatory scrutiny on oversight of DA frameworks is not going away.
- ▶ Audit is a key control mechanism – but there needs to be a step change in approach. This requires effort from all participants.
- ▶ A lot of work has been done on framework design and implementation. However, it is now time to embed and enhance the maturity of the DA control framework.

EY | Assurance | Tax | Transactions | Advisory

Ernst & Young LLP

© 2016 Ernst & Young LLP. Published in the UK.
All Rights Reserved.

The UK firm Ernst & Young LLP is a limited liability partnership registered in England and Wales with registered number OC300001 and is a member firm of Ernst & Young Global Limited.

Ernst & Young LLP, 1 More London Place, London, SE1 2AF.

ey.com