Leaving its mark

The Financial Services Authority has taken a firm hand with the insurance industry since the publication of the Strachan report. **Ali Sallaway** and **Christopher Robinson** look at some of its recent decisions.

THE UK'S FINANCIAL SERVICES Authority (FSA) assumed full responsibility for the regulation of general insurance business and insurance intermediaries on 14 January 2005, indicating that it would allow the insurance industry a "bedding in" period to adjust to the new regulatory environment. A few days later, the Financial Services and Markets Tribunal criticised the fairness of the FSA's enforcement procedures in the Legal & General case. This resulted in the FSA (led by David Strachan) conducting a major review of its enforcement procedures. The promised bedding in period (and possibly the FSA's wariness in taking enforcement action while Strachan's review was underway) meant the FSA issued no final notices against firms or individuals in the insurance sector during its first ten months as regulator.

However, the publication of the Strachan report in July 2005 and the changes made to the FSA's enforcement procedures have subsequently given renewed confidence to the enforcement division. Furthermore, a series of enforcement decisions taken since October 2005 suggests the industry's bedding in period has ended and that the FSA is now prepared to use the full range of its enforcement powers against insurance firms and individuals employed within the sector (see box on page 45 for a summary of recent decisions).

A number of aspects of these decisions are of general interest to firms and individuals engaged in the insurance business. First, the decisions provide guidance on the types of activity likely to attract the attention of the FSA's enforcement division in the future. Second, they indicate that it will rely on breaches of its general principles when taking enforcement action (in addition to breaches of detailed rules). Third, they demonstrate the FSA's commitment to taking action against individuals as well as firms. Finally, they confirm that it is also likely to cooperate with other regulators when taking enforcement action.

WITHIN ITS RADAR

In its 2006-2007 business plan, the FSA made it clear that its enforcement priorities are the same as its general priorities in the markets that it regulates. It is therefore unsurprising that its enforcement action in the insurance sector has involved practices and products identified as potentially problematic in its communications with the insurance industry. For example:

- Both the actions against Byrne and the former employees of Benfield involved the misuse of financial (finite) reinsurance, which has been the focus of regulatory concern on both sides of the Atlantic since New York attorney general Eliot Spitzer launched his high profile investigation into it at the beginning of 2005;
- The GoshawK decision involved systems and controls failures that led to a failure to manage the risk of inappropriate underwriting. In its 2005 annual report published in July 2006, the FSA warned that it "[expects] firms to manage their underwriting appropriately at all times through the cycle, to act prudently in their underwriting decisions and to write business only at levels which they can support"; and
- The FSA's Xsavi Limited, Anthony Rogers, AS General Insurance Brokers, Walsall Bridge Insurance and Carphone Warehouse decisions indicate the seriousness with which the FSA treats practices that prejudice the interests of consumers and in particular those that flout the FSA's "treating customers fairly" initiative.

> "A series of enforcement decisions taken since October 2005 suggests the industry's bedding in period has ended"

Given that the FSA uses enforcement actions to send messages to the insurance industry as a whole about practices and products it is particularly concerned about, it is important for firms (and employees in the sector) to be aware of its enforcement decisions. They should consider their implications for their own businesses and working practices and take any necessary action as a result.

In all but one of its enforcement decisions in the insurance sector, the FSA has relied on breaches of the general principles applying to firms and individuals, as well as on breaches of the more detailed rules, when taking enforcement action. This approach reflects its commitment not just to principles-based regulation, but also to principles-based enforcement. In June 2006 John Tiner, the FSA's chief executive, warned that "[the FSA] can and do take enforcement action on the basis of principles alone and it is our intention to go down >

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this route”. Insurance firms should therefore ensure that they comply not just with the detailed FSA rules applying to their business, but also with its general principles.

Three of the ten FSA enforcement actions in the insurance sector so far have been against individuals, rather than firms. In a speech in January 2006 Margaret Cole, the FSA’s director of enforcement, emphasised that “where individuals are themselves responsible for misconduct, whether their own or that of others, [the FSA] will bring cases against individuals as well as firms”.

It is significant that each of the FSA’s actions against individuals in the insurance sector has involved some element of dishonesty or lack of integrity. In the Anthony Rogers decision, the subject of the investigation had himself been found to be dishonest. By contrast, in the Byrne and Benfield decisions, counterparties to the firms, at which the subjects of the investigation worked, had sought to mislead others and the subjects of the investigation had been found to have assisted the counterparties in doing so. Individuals should be aware that enforcement action may be taken against them as well as against firms, particularly if they are involved in activities that may call into question their personal honesty or integrity.

TEAM EFFORT ENFORCEMENT

The FSA increasingly cooperates with other regulatory authorities. In the Byrne investigation it worked with the Irish Financial Services Regulatory Authority and the Australian Prudential Regulation Authority (APRA). Indeed, APRA obtained undertakings from Byrne not to perform regulated activities at the same time that the FSA issued its final notice to him. Given the international character of UK insurance and reinsurance, cooperation between regulators in different jurisdictions is likely to occur and firms should assume that findings made by other regulators might be made available to the FSA.

The FSA maintains that it does not regard itself as an enforcement-led regulator. But its enforcement decisions to date in the insurance sector show it is willing to use its powers to take action against both firms and individuals where their conduct breaches FSA rules and/or general principles. Firms and individuals who heed its enforcement messages will reduce the likelihood that they will attract the unwelcome attention of the enforcement division.

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Timeline: Recent FSA enforcement decisions

GoshawK Syndicate Management (10 October 2005)
The FSA fined GoshawK £220,000 for a series of systems and controls failures. It had failed to ensure it had effective controls over binding authorities. There was also a breakdown in the firm’s independent review system for a period of almost a year. Finally, it failed to ensure that its underwriters complied with its underwriting and reinsurance limits.

Robert Phillips and Isabel Rawlence (2 December 2005)
Robert Phillips and Isabel Rawlence, formerly Benfield reinsurance brokers, were banned from undertaking any function in relation to regulated activity for two years. They had been involved in designing and placing a loss portfolio transfer contract used by their client to deceive its auditors and distort its financial position.

Anthony Rogers (23 January 2006)
The FSA prohibited Anthony Rogers, a former director of a general insurance firm specialising in advising on private medical insurance, from performing any function in relation to any regulated activity. He had misappropriated at least £70,000 of client money.

Xsavi (21 February 2006)
The FSA cancelled the regulatory permissions of Xsavi. It had represented to various consumers that it had authority to bind an insurer, when in fact it had no such authority. As a result, a number of consumers were misled into thinking they had travel insurance cover.

Besso (26 April 2006)
The FSA fined insurance intermediary Besso £20,000 for failing to apply for approval for an employee who held a significant management role at the firm. It regarded this failing as particularly serious because the employee had previous convictions for fraud and was also alleged to have perpetrated various frauds while he was employed within Besso.

AS General Insurance Brokers (10 July 2006)
AS General Insurance was banned from carrying on regulated activities on the basis that it had failed to pay due regard to the interests of two customers. In particular, it had failed to comply with two awards made by the Financial Ombudsman on 8 June and 20 July in favour of the complainants.

John Byrne (20 July 2006)
The FSA prohibited John Byrne, the former CEO of General Re’s alternative solutions business unit, from performing any controlled function in relation to any regulated activity for five years because of his involvement in finite reinsurance transactions.

Walsall Bridge Insurance (4 September 2006)
The FSA cancelled the regulatory permission of insurance intermediary Walsall Bridge Insurance Consultants for failing to pass client premiums over to insurers or intermediaries, or to arrange associated insurance policies, which resulted in clients being uninsured. Walsall also provided clients with inaccurate and misleading information about their insurance policies.

The FSA also prohibited Walsall’s sole director, Robbins, from carrying on any further regulated business for failing to act with the honesty, integrity and competence required of an approved person and breaching the fit and proper criteria.

Regency Mortgage Corporation (5 September 2006)
The FSA fined Regency Mortgage Corporation £56,000 for various failures relating to the sale of mortgage-related payment protection insurance (PPI) in the sub-prime market.

Carphone Warehouse (7 September 2006)
The FSA fined Carphone Warehouse £245,000 for not treating telesales insurance customers fairly, as well as for breaches of other general principles and detailed rules in relation to mobile phone insurance sold through telephone sales channels.