



January 2004

BRIEFING

Regulation of general insurance

Executive summary

The FSA's new conduct of business rules for general insurance are to be published in final form this month, with the new regime to take effect on 14 January 2005. The application process for firms to apply for FSA authorisation or for variations of existing permissions has already begun, and the FSA has sent a series of strong messages to senior management to make sure they are prepared for the new regime in good time. This briefing outlines the scope of the new regime and highlights its likely effect on insurers and insurance intermediaries.

The countdown to the regulation of general insurance by the Financial Services Authority (FSA) has now begun in earnest. Two years have passed since the government announced that the FSA's remit was to be further expanded to cover general insurance, and the new conduct of business rules are to be published in final form this month. The new regime will take effect on 14 January 2005 and the application process for firms to apply for FSA authorisation or for variations of existing permissions has already begun.

Purpose of the new regime

The concerns that the FSA wished to address through regulation of non-investment insurance policies (referred to as 'general insurance') were outlined in its consultation paper 160. These included: unsuitable cover being provided to policyholders; poor value policies; consumers failing to buy products that they in fact need; slow and unfair handling of policy claims; poor standards in dealing with customer complaints; and lack of appropriate redress where problems occur.

In accordance with its statutory objectives, the FSA's primary desire is to protect consumers and small businesses, although it considers that certain minimum standards should apply to all general insurance policies.

What types of business will the new rules apply to?

The draft rules, to be finalised later this month, provide that policyholders are to be classified under the new

regime either as 'retail customers' or 'commercial customers'. Retail customers will be individuals who are acting for purposes outside their trade, business or profession – and all other policyholders will be treated as commercial customers. Many of the more detailed rules will apply only to the sale and administration of policies to retail customers, to provide these policyholders with a greater degree of protection. Less detailed rules will apply to commercial customers, some of which are not applicable where certain types of specialist business are written (for example marine and aviation lines) or where the financial position of the policyholder exceeds certain thresholds – known as 'contracts of large risks'. The FSA hopes that this will give smaller businesses an adequate level of protection without unduly hampering the sale and administration of insurance to larger entities that have reasonable access to specialist advice.

The FSA considers that the sale and administration of reinsurance is not appropriate for regulation and so will not be covered by the new regime.

What duties do the new rules impose?

The new conduct of business rules will impose a range of duties on insurers and/or insurance intermediaries, including requirements to:

- ensure the suitability of policies sold, encompassing a duty to collect and take into account all relevant information held about the policyholder, and then to provide the policyholder with a 'statement of demands and needs' summarising why the product is

- considered to be suitable for that particular policyholder;
- provide detailed disclosure about the policy, including a summary of the key aspects of the policy prior to the contract being concluded;
 - provide policyholders with cancellation rights following the sale of a policy;
 - ensure that when the firm communicates information to policyholders it does so in a way that is clear, fair and not misleading;
 - maintain adequate records of the sales process;
 - deal with claims fairly and promptly, and keep policyholders reasonably informed about the progress of the claim and the reasons for any refusal to pay the claim;
 - obtain informed consent from all parties before an insurance intermediary can act for an insurer in investigating a claim; and
 - observe strict procedures for handling and determining complaints against the firm.

When the final rules are published by the FSA, close attention will need to be paid in particular to the precise application of each rule in the context of sales to commercial customers.

Further consequences of regulation

These new conduct of business rules are intended to implement in detail the high level obligations enshrined in the FSA's Principles for Businesses. In conducting general insurance business, insurers and intermediaries will have to comply with the Principles for Businesses and the detailed conduct of business rules. As well as imposing general obligations, for example, to observe proper standards of market conduct (principle 5) and pay due regard to the interests of customers and treat them fairly (principle 6), principle 11 requires firms to deal with its regulators in an open and co-operative way, and to 'disclose to the FSA appropriately anything relating to the firm of which the FSA would reasonably expect notice'. This duty to notify the FSA proactively of any serious issues within the firm is an important regulatory tool for the FSA – and, as with all of the new rules and principles, failure to comply with principle 11 can lead to disciplinary action being taken. Action can result in public censure, restitution orders, unlimited fines or even withdrawal of authorisation against the firm and/or its

senior management. As well as the risk of regulatory action by the FSA, firms will also need to be ready to defend complaints by consumers to the Financial Ombudsman Service (FOS). The FOS has the power to adjudicate complaints on the basis of what is 'fair and reasonable' rather than on a strict application of the rules. While FOS awards are binding on the regulated firm, the complainant can elect whether to accept the award or choose, for example, to pursue legal proceedings instead. FOS awards are subject to a cap of £100,000 per case.

Preparation for the new regime

The introduction of the new regime in January 2005 will mark a significant change in emphasis for those selling and administering general insurance policies. Firms, particularly senior management, will be responsible for ensuring that all policyholders are treated fairly. While this has always been commercially desirable, it will now be transformed into a clear regulatory duty backed by powerful sanctions.

The FSA will be monitoring firms over the coming months to check that the necessary systems and controls are being put in place for compliance with the new rules and ensuring that policyholders' interests will be put ahead of the interests of those selling and administering their policies. In line with its approach to other regulated activities, the FSA can be expected to pursue high-profile cases against senior management of firms that have not ensured the necessary measures have been put in place when the new regime comes into force. As FSA chief executive John Tiner explained in a speech to the Insurance Institute of London late last year:

'The responsibility of firms' own management is one of our principles of good regulation and a matter that we at the FSA take very seriously. So my message this afternoon to any senior manager here who has not already engaged in their firm's preparation for the new regime is that I urge you to do so without further delay.'

For further information please contact
Alastair Crawford
T + 44 20 7832 7535
F + 44 20 7716 4398
E alastair.crawford@freshfields.com