

INSURANCE INSIGHTS

News for Insurance Internal Auditors

Welcome to the April 2017 edition of Insurance Insights, a regular round-up from PKF Littlejohn's Financial Services team of the main developments affecting the insurance market.

In this edition, we look at the challenges for insurers and their Internal Auditors of embedding conduct risk, drawing on the recent Lloyd's thematic review of conduct management information.

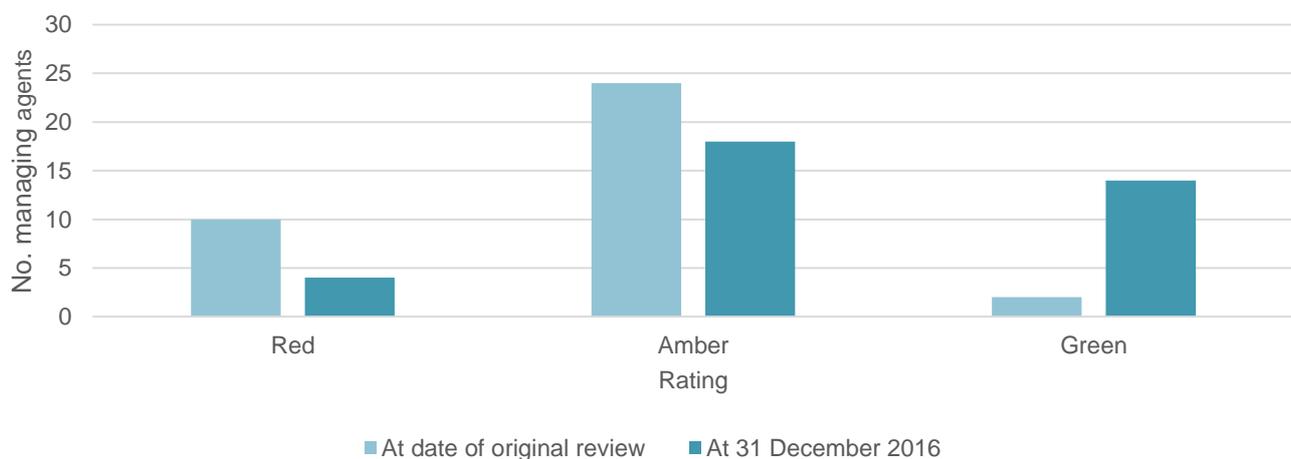
Overview

Our recent Breakfast Briefing highlighted that although conduct risk has been an important topic for insurers and their Internal Auditors over the last few years, compliance with conduct risk requirements continues to prove a challenge. In particular, we focussed on the key aspects of the Lloyd's Minimum Standards for Conduct (MS11) – namely the high level Conduct Standards (CR1 and CR2) and product risk assessment (CR5) – as well as the recent Lloyd's thematic review of conduct management information and the implications for Internal Auditors.

On the same day as our Breakfast Briefing, the Lloyd's Conduct Standards Assurance Team published its latest [Conduct Standards Newsletter](#), which contained a summary of the results of its Conduct Standards Reviews to 31 December 2016. Broadly speaking, the results reveal that the level of compliance is showing an 'encouraging trend'; however, it is clear that there is still a lot of effort to be undertaken by the Market to achieve full compliance:

"Since the second half of 2015 our expectations of agents' ability to meet the Standards have increased; the Standards were published in July 2014 and as time passes we expect agents to be able to demonstrate increased degrees of development in managing conduct risk...our reviews are showing an encouraging trend amongst the 36 agents reviewed to date moving towards achievement of compliance with the Conduct Standards."

Overview of Lloyd's Conduct Standards Reviews to 31 December 2016



High level Conduct Standards

CR1 and CR2 of MS11 set out the high level framework and requirements for organisations to pay due regard to the interests of their customers and to treat them fairly at all times. They impose a responsibility to put conduct risk at the heart of their organisations and to ensure that there is a culture whereby the organisation regularly assesses its actions from a conduct risk perspective. Furthermore, it places responsibility for conduct risk onto the board and senior management.

Considerations for Internal Auditors

The Lloyd's Conduct Standards Assurance Team has taken a very detailed approach to reviewing compliance against MS11 in its Conduct Standards Reviews. As a result, Internal Auditors need to closely scrutinise the conduct risk management frameworks and culture of their organisations. In particular, you should:

- Consider the extent to which conduct risk is included within your organisation's key documents, such as your financial reports and ORSA
- Consider the role and responsibility of senior management in driving forward the conduct risk agenda within your organisation
- Consider the extent to which your organisation has clearly communicated and defined the conduct risk appetite and associated tolerances.

Conduct risk assessment

Getting the product risk assessment 'right' is critical to your organisation's conduct risk management framework. It determines the conduct risk profile which, in turn, determines the level and nature of conduct risk controls that your organisation will establish to manage high product risk contracts.

The risk assessment will be dependent on factors such as customer type, product complexity, nature of the sales chain and whether there are any intermediaries acting on behalf the customer. Most organisations have established risk assessment tools to consider these factors and to determine whether their products are low, medium or high from a conduct risk perspective.

Considerations for Internal Auditors:

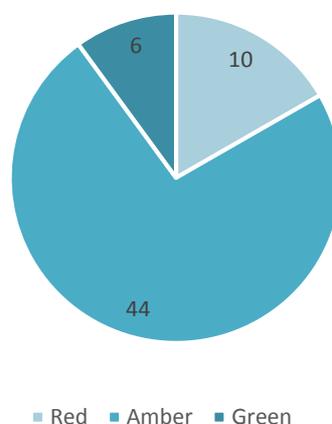
Understanding the methodology and tools used in the product risk assessment should be one of the first things that Internal Auditors look at. In particular, they should:

- Assess whether the logic within any risk assessment tool is consistent with the intended methodology
- Test a sample of contracts to assess whether the risk assessment is reasonable based on the underlying features of the contract
- Review the adequacy of the documentation of the risk assessment process
- Determine whether there is any scope for overriding the results of any risk assessment tool and, if so, challenge whether any overrides can be justified and adequately documented.

Conduct Management Information (MI)

The Lloyd's Conduct Standards Assurance Team performed a thematic review of conduct MI in the second quarter of 2016. Overall, the review found that there is a "*wide variance in the state of agents' compliance*" with the conduct MI standards.

Overall compliance against CR13



The key findings include:

- Mixed success in collecting conduct data from third parties
- Inadequate content of conduct MI packs
- Weaknesses in conduct MI frameworks and the use of conduct MI
- Lack of quality assurance over conduct MI
- Failure to plan for future enhancements of conduct MI

The [Lloyd's thematic review report](#) provides further details on each of these

Considerations for Internal Auditors

If you haven't already planned or performed an Internal Audit review of conduct MI, the Lloyd's thematic review indicates that you should do so now. At the time of its review, only seven managing agents had performed such a review. The review should include, for example:

- Assessment of whether your organisation has undertaken a full gap analysis to identify any gaps in collecting conduct data from third parties. Where gaps exist, examine their nature – do they pertain to particular coverholders or TPAs or particular types of data?
- Assessment of whether your organisation has a clear understanding of the barriers to collecting conduct data from third parties and whether these barriers have been clearly communicated and escalated to senior management
- Assessment of whether there is clear responsibility and allocation of resources to ensure effective collection of conduct data from third parties
- Application of a 'critical eye' when reviewing the content of conduct MI packs produced by your organisation and bringing to bear some of the wider insights and knowledge that you have of your organisation from other internal audit work that you have undertaken (e.g. in the areas of underwriting and claims)
- Seeking views of the clarity and usefulness of conduct MI from your Board, including non-executives
- Inspecting evidence of conduct MI driving change or action within your organisation
- Providing assurance over the completeness and accuracy of data used in the preparation of conduct MI
- Consideration of and benchmarking against the examples of good practice for conduct MI contained within the Lloyd's thematic review report
- Understanding whether there is a clear project plan and road map for the future development of conduct MI

We hope you've found this issue useful. If anyone within your business would like to receive future issues, please send their details to Lia Twiner (ltwiner@pkf-littlejohn.com).

Our specialist team is here to help. If you would like advice on any of the issues discussed in this newsletter, please contact one of our Insurance - Internal Audit team members.

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