

INSURANCE INSIGHTS

News for Insurance Internal Auditors

Welcome to the January 2018 edition of Insurance Insights, a regular round-up from PKF Littlejohn's Financial Services team of the main developments affecting the insurance sector.

In this edition, as we look ahead to the next 12 months, we identify some key topics that Internal Auditors in the insurance market should consider.

What to expect in 2018

1. Market conditions

2017 was a memorable year for the insurance market. The first half saw the continuing soft market conditions putting seemingly never-ending pressure on rates. The second half saw the devastation caused by a sequence of events including US/Caribbean hurricanes, Mexico earthquakes and US wildfires. These events have been costly for the market – with approximately £2bn of claims paid out by Lloyd's for hurricanes Harvey, Irma and Maria to date – but also brought to the fore the prospect of a change in market conditions. As we move into 2018, some improvement in market conditions and rates is being seen, although not on the scale of a 'market turning event' that some were hoping for.

As Internal Audit functions reflect on the events of 2017, they will need to consider how their organisations responded and performed and whether any weaknesses in their governance, risk management or internal control frameworks have come to light.

For example, some questions that you may want to consider are:

- How did your claims function perform in light of increased claims experience?
- Has your claims experience identified any issues around insurance coverage (e.g. unintended cover/claims)?
- How quickly was your exposure management team able to produce initial loss estimates?
- To what extent is your exposure management team now reviewing and validating the exposure management model in light of actual claims experience?
- Did your reinsurance programme respond in the way it was expected to?
- What has been the governance and decision-making process around revisions to business plans/strategies following the 2017 events?

Internal Audit functions may wish to flex their Internal Audit plans in response to these questions.

Whereas in previous years PKF Littlejohn has called on Internal Auditors in the insurance market to adopt a 'soft market mindset', we recommend that a 'market changing mindset' is now adopted in carrying out your 2018 Internal Audit reviews. In doing so, you should be alert to changes in strategies, controls or behaviours in response to the change in market conditions.

For example, we would expect that most Internal Audit functions will carry out some sort of underwriting review(s) in 2018. In reviewing this area, Internal Auditors should consider how any changes to underwriting risk appetite, guidelines or limits have been communicated to underwriters and whether the new requirements are being adhered to. Similarly, there may be evidence to suggest changes in underwriting behaviours and disciplines, particularly around pricing, and whether that is consistent with the stated policies and procedures.

At PKF Littlejohn, we believe that the year ahead will prove to be interesting as we see how market conditions evolve. It's an opportunity for Internal Auditors to approach their reviews with this 'market changing mindset' and challenge the status quo in all stages of their work.

If you would like to discuss anything mentioned above, please contact our Internal Audit Director, **Jessica Wills**.

2. Countdown to GDPR

The preparations for GDPR implementation will undoubtedly continue in 2018. PKF Littlejohn has been working with a number of firms in the insurance sector to support them with or provide assurance on their GDPR preparations. It's a challenging topic that most companies are grappling with and, in our experience, there is a wide variation in the state of each firm's preparation. This means that there is a lot of work to be done by businesses over the next few months to ensure that they are compliant.

As we move closer to the GDPR implementation date of 25 May 2018, Internal Auditors should, for example, be asking the following questions of their GDPR project teams to ensure that they are taking a suitable approach and are on track to meet the deadline. These questions relate to particular areas of GDPR with which we have seen firms grappling.

- Have you incorporated 'Privacy by Design' into your change management process?
- Have you established your legal basis for capturing and processing each category of personal information?
- Are you able to evidence the consent to hold and process a data subject's personal information?
- Are you able to respond to Subject Access Requests across all relevant systems within the required timeframe?

- Are you able to process 'Rights to be Forgotten' across all relevant systems within the required timeframe?
- Do you have clear guidelines around data/document retention?
- Do you have a governance framework for ensuring ongoing compliance with GDPR?

If you would like any support with or assurance on your GDPR preparations, please contact our IT Assurance Partner, Ian Singer.

3. Extension of individual accountability

On 26 July 2017, the FCA issued a consultation paper on the extension of the Senior Managers and Certification Regime (SMCR) to all FCA regulated financial services firms. This will bring a large number of firms (including insurers and insurance brokers) and individuals within the scope of SMCR. A policy statement is expected to be issued in the summer of 2018 and Internal Auditors should keep watch of these developments and assess the impact for their organisations.

For insurers, the impact of this extension will not be as onerous as insurers are already captured by the Senior Insurance Managers Regime (SIMR), which was introduced in March 2016. However, there will be some additional requirements as the extension of the SMCR will align the current insurer regime to the banking regime. For insurance brokers, the SMCR is a completely 'new' concept and there is a steep learning curve and a lot to do, on a practical level, in order to be compliant.

Overall, the SMCR is good news for Internal Audit functions. In light of their enhanced regulatory accountability, Senior Managers should be looking to their Internal Audit functions as a source of assurance on the adequacy and effectiveness of the control frameworks within their respective areas of responsibility. Internal Auditors may see greater buy in from Senior Managers within their firms and perhaps a wider scope or remit as they may be asked to look at 'new' areas. However, within the insurance broking sector, many (smaller) firms do not have established Internal Audit functions. Senior Managers within insurance brokers may potentially feel more exposed as a result of their enhanced regulatory accountability and should consider the ways in which they can get the assurance they need that their firms are functioning well, from both an operational and regulatory perspective. This may not be through a 'traditional' Internal Audit function but may take the form of specific, targeted assurance reviews.

If you would like to discuss the different Internal Audit options available, please contact our Internal Audit Director, **Jessica Wills**.

4. Financial reporting

It is currently that time of year when Internal Auditors will be giving their finance teams a wide berth as they are knee-deep in tackling their year-end reporting requirements. Particularly within the Lloyd's market, the financial reporting burden on finance teams is enormous, with a seemingly constant stream of market returns and deadlines to meet.

These pressures are becoming apparent and in the Lloyd's QMA and Pillar 3 Market briefing in October 2017 it was highlighted that, for the 2016 year end, the following resubmissions were required (out of a total of 111 managing agents):

Return	Number of resubmissions
QMA	62 then 22 further resubmissions
ASR	101
ASB	53
AAD	31

These statistics help to demonstrate the impact of the pressures that the financial reporting requirements are putting on finance teams. This is due to the volume of financial reporting as well as the tight reporting timescales. For the 2017 year end, the reporting timescales are starting to squeeze and this will only continue.

In our experience, Audit Committee's and Internal Audit functions are still very much looking to their external auditors to provide them with assurance around their financial reporting processes. However, this is no longer an appropriate approach to be taking, particularly where a lot of financial reporting to Lloyd's, for example, is outside of the scope of external audit. Internal Auditors should review their financial reporting processes; if this isn't part of your Internal Audit Plan for 2018, we recommend that you start to have some conversations with your finance teams to understand the pressures they're facing and ascertain how such a review might add value to their existing financial reporting processes. Although if you want to remain friends with your finance teams, you might want to leave that conversation until after the year end reporting deadlines!

Once again, Internal Auditors have a busy 12 months ahead of them. But you are not on your own: PKF Littlejohn's Internal Audit team of experienced professionals has in-depth knowledge of the key risks and challenges facing the insurance sector.

Contact us to find out how we can help you.

We hope you've found this issue useful. If anyone within your business would like to receive future issues, please send their details to Shannon Skeels (sskeels@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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