Specimen coursework assignment

M81 – Insurance Broking Practice

The following is a specimen coursework assignment including questions and indicative answers.

It provides guidance to the style and format of coursework questions that will be asked and indicates the length and breadth of answers sought by markers. The answers given are not intended to be the definitive answers; well-reasoned alternative answers will also gain marks.

CII

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Top tips for answering coursework questions

- A coursework assignment should be between 5,000 and 10,000 words in total, depending on your writing style.
- The coursework questions link to the learning outcomes shown on the M81 syllabus as follows:

Questions	Learning Outcomes	Chapter(s) in the Study Text – it is important to remember that your answer requires applied knowledge and you will need to build upon the material shown in the Study Text	Maximum marks per answer
1	Learning Outcome 1	Chapters 1, 2 & 3	10 marks
2	Learning Outcome 2	Chapters 4 & 5	10 marks
3	Learning Outcome 3	Chapter 5	10 marks
4	Learning Outcome 4	Chapter 6	20 marks
5	Learning Outcome 5	Chapters 5 & 7	20 marks
6	Learning Outcome 6	Chapter 8	20 marks
7	Learning Outcome 7	Chapter 9	20 marks
8	Across more than one Learning Outcome	Across more than one chapter	30 marks
9	Across more than one Learning Outcome	Across more than one chapter	30 marks
10	Across more than one Learning Outcome	Across more than one chapter	30 marks

- Read each question carefully and highlight key words such as **analyse, describe, discuss, explain, identify, justify, recommend with reason(s)** and **state**. Please refer to the 'Glossary of key words' in this document.
- Read the Learning Outcome/s and related study text for each question before answering it.
- Ensure that you spend time planning each answer before writing them.
- Ensure that your answers reflect the context of the questions. Your answers must be based on the facts and/or figures used in the questions.
- Ensure that you answer **all** questions. Address **all** the issues raised in each question. For example, if **three** issues are required, check that you have addressed all **three** issues.
- Do **not** group parts together. If there are parts (a) and (b), answer them separately.
- Unless other instructions are given, assume that there is equal weighting for each point raised or asked.
- Ensure that the length and breadth of each answer matches the maximum marks available. For example, a 30 mark question requires more breadth than a 10 or 20 mark question.

Coursework – assignment

Submission Rules

Before commencing work you need to fully familiarise yourself with the Mixed assessment candidate guidelines, including:

- A coursework assignment should be between 5,000 and 10,000 words in total, depending on your writing style.
- Font type and size to be used in your assignments (Arial – size 11).
- Rules relating to referencing third party work.
- Penalties for contravention of the rules relating to plagiarism and collaboration.
- Deadline for the submission of coursework assignment (within 6 months from enrolment date).

Important notes

- Make sure you read each question carefully – marks will not be awarded for irrelevant material.
- Check the number of marks allocated to each question and ensure that your answer is sufficient in its scope and depth.
- This assignment consists of 10 questions which range between 10 and 30 marks.
- Questions 1 to 7 follow the syllabus learning outcomes in order.
- Questions 8, 9 and 10 encompass a number of syllabus learning outcomes.
- The total marks available are 200. You need 120 to pass this assignment.
- There is not always a single correct answer for the questions and marks will be awarded for all valid responses.

M81 SPECIMEN COURSEWORK QUESTIONS

Question 1 - Learning Outcome 1 (10 marks)

CJ plc, a UK-based insurance broker, transacts business directly with customers as well as with other insurance brokers. It also operates delegated authority schemes on behalf of insurers.

Explain the duties imposed on CJ plc, with use of appropriate diagrams, by the law of agency in **two** of the following three roles:

(i) Retail broker.
(ii) Wholesale broker.
(iii) Coverholder. (10)

Question 2 - Learning Outcome 2 (10 marks)

XY plc, an insurance broker specialising exclusively in commercial lines business, has received criticism from one of the insurers it places business with regarding the extent of underwriting information provided as part of the risk acceptance process.

Explain the role of XY plc in ensuring that the insurer receives all relevant underwriting information. (10)

Question 3 - Learning Outcome 3 (10 marks)

Your company, an insurance broker who provides clients with insurance products on a non-advised basis, has been approached by a client requesting a quotation and a recommendation.

Explain how you would present terms, on an advised basis, to enable the client to make an informed decision. (10)

Question 4 - Learning Outcome 4 (20 marks)

XYZ plc, an insurance broker, subscribes to the information services provided by rating agencies. KB plc, an insurer with which XYZ plc trades, has just been downgraded by all the rating agencies.

(a) Explain the importance to XYZ plc of insurers' financial security when selecting the insurers they trade with. (10)

(b) Describe the range of actions that XYZ plc might take relating to both KB plc and the clients whose risks are currently placed with this insurer. (10)

Question 5 - Learning Outcome 5 (20 marks)

ABC plc, a manufacturing company with subsidiaries in several countries, insures all its risks in a global programme in the London market placed through a single insurance broker.

The London market cycle is changing from 'soft' to 'hard'.

(a) Explain the potential implication for ABC plc if it retains its current global programme. (10)

(b) Explain the potential implications for ABC plc if it decides to give each subsidiary the authority to make their own insurance arrangements. (10)

Question 6 - Learning Outcome 6 (20 marks)

You are the Claims Manager of CDE plc, an insurance broker. You have been contacted by another insurance broker who states that one of their clients has recently informed them of an employer's liability claim that occurred several years ago when they were a client of your company.

(a) Explain the circumstances in which CDE plc could be responsible for dealing with the claim. (15)

(b) Explain the records policy CDE plc should keep following any placement and the records CDE plc are required to keep in relation to employers' liability cover. (5)

Question 7 - Learning Outcome 7 (20 marks)

You are an insurance broker who offers both traditional risk transfer and alternative risk transfer services. One of your clients, who insures on a traditional risk transfer basis, is considering reducing their insurance costs.

(a) Explain to your client the types of organisation that could benefit from owning a captive insurance company. (10)

(b) Describe the services that an insurance broker could provide for a captive insurance company wholly owned by one of its clients. (10)

Question 8 - Across more than one Learning Outcome (30 marks)

DP plc, a UK-based personal lines insurance broker, has received a complaint from a client, who has just had a claim declined by an insurer. DP plc have a formal complaints procedure which meets the Financial Conduct Authority's (FCA) requirements. On investigating the complaint, it is established that a new employee of DP plc failed to inform the insurer of material facts that had been provided by the client.

(a) Explain the FCA's requirements for insurance brokers regarding complaints. (5)

(b) Describe **three** different ways in which the broker might respond to the complaint and the impact **each** course of action is likely to have on the client. (15)

(c) Explain the actions that DP plc could take to prevent a similar complaint in the future. (10)

Question 9 - Across more than one Learning Outcome (30 marks)

GB plc, a clothing retailer with a chain of shops, is a long-term client of NZ plc, an insurance broker, and has asked for an extensive review of its insurance programme. Currently GB plc transfers most of its risks to a single insurer and has a very low deductible.

(a) Describe how NZ plc could conduct a 'fair analysis' of the market. (10)

(b) Explain **four** key programme design issues which should be considered by NZ plc when designing a new insurance programme for GB plc. (20)

Question 10 - Across more than one Learning Outcome (30 marks)

MBR plc, an insurance broker, operates a delegated authority which includes authority to settle claims.

(a) Explain how MBR plc delivers claims service, through the delegated authority, to its clients, whilst meeting its duties to the insurer and its relevant regulatory obligations to the Financial Conduct Authority. (20)

(b) Explain how MBR plc could use claims data and trends to assist its clients to manage their risks to minimise the frequency and cost of future claims. (10)

M81 SPECIMEN COURSEWORK QUESTIONS AND ANSWERS

Coursework – assignment

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Question 1 - Learning Outcome 1 (10 marks)

CJ plc, a UK-based insurance broker, transacts business directly with customers as well as with other insurance brokers. It also operates delegated authority schemes on behalf of insurers.

Explain the duties imposed on CJ plc, with use of appropriate diagrams, by the law of agency in **two** of the following three roles:

(i) Retail broker.
(ii) Wholesale broker.
(iii) Coverholder. (10)

Answer to Question 1 (Learning Outcome 1)

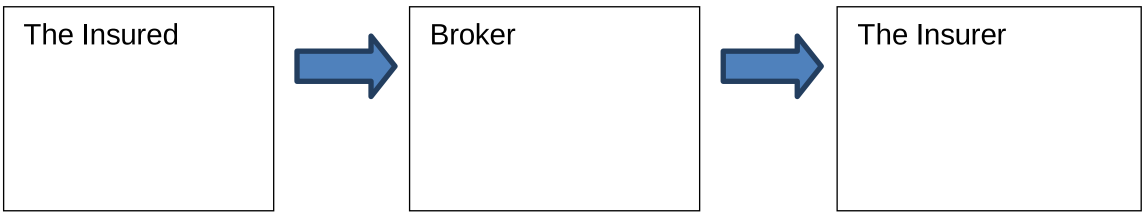
Candidates must choose **two** of the following;

(i) **Retail broker**: The duties of CJ plc, under the law of agency, are imposed on the broker as agent of their principal, which in this case as they are the retail broker, is their client, or the insured. A retail broker is one which has a direct relationship with the client.

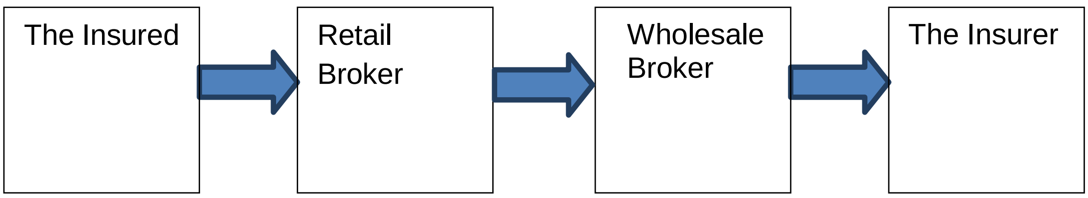
As agents of the insured, CJ plc must account for all monies held on behalf of their principal and keep a record of all financial transactions. They must disclose the level of commission if asked and some brokers disclose this information as a matter of course. CJ plc's duties are likely to include:

- giving advice on cover or the placing of insurance; or
- giving advice to the insured on how to make a claim.

The relationship between a retail broker, the client and the insured is shown below:



(ii) **Wholesale broker:** When the broker is acting on a wholesale basis and placing business for another broker, they are acting as an agent for the sub-broker/retail broker/producing broker and not the insured. This is shown below:



So the duties of the wholesale broker, under the law of agency, are owed to the retail broker and money held on their behalf must be accounted for, recorded and income should be disclosed in accordance with any agreement held between them. A wholesale broker places insurance business on behalf of another broker and has no direct relationship with the insured. For example, this is a common arrangement for Lloyd's brokers where a retail broker, perhaps from another country, wishes to access the Lloyd's market.

(iii) **Coverholder:** In the case of CJ plc acting as coverholder, the organisation may be acting as agent for the insured and also the insurer. Depending on the level of delegation (underwriting or claims for example), the broker as coverholder, owes a duty to the insurer (their principal), in the following situations:

- an insurer authorises an insurance broker to receive and handle proposal forms on its behalf and confirm cover;
- the insurance broker surveys and describes the property on the insurers' behalf;
- the insurance broker underwrites risks in accordance with the delegated authority;
- the insurance broker settles claims in accordance with the delegated authority; and
- the insurance broker has authority to collect premiums and does so.

However, if CJ plc places the risks of its clients on the delegated authority scheme, they also owe a duty to the insured. This is shown below:

The Insured	Broker	Insurer

(10)

<u>Question 2 - Learning Outcome 2 (10 marks)</u>

XY plc, an insurance broker specialising exclusively in commercial lines business, has received criticism from one of the insurers it places business with regarding the extent of underwriting information provided as part of the risk acceptance process.

Explain the role of XY plc in ensuring that the insurer receives all relevant underwriting information.

(10)

<u>Answer to Question 2 (Learning Outcome 2)</u>

Making sure that the underwriter receives all the underwriting information about a particular risk is a fundamental part of XY plc's role as a commercial insurance broker. The more complete the information, the better the terms they can obtain. Insurance contracts are contracts of utmost good faith and, therefore, rely on all parties disclosing the facts that are material to the risk. Material facts are defined in the Marine Insurance Act 1906 as:

'Every circumstance is material which would influence the judgement of a prudent insurer in fixing the premium, or determining whether he will take the risk.'

Full disclosure also lessens the risk of a claim being declined or reduced by an insurer on the grounds of non-disclosure, or inadequate information. The Marine Insurance Act 1906 clarified the duties of brokers regarding the provision of 'material facts'. Brokers must disclose:

- every material fact known to the brokers, including facts which in the ordinary course of business ought to have been communicated to them; and
- every material fact which the insured is bound to disclose, unless it comes to the insured's attention too late to communicate to the brokers.

XY plc should collect the underwriting information from the client by asking them to complete a proposal form and/or an insurer's supplementary questionnaire. Some brokers may have their own questionnaires. In some cases, a survey may need to be conducted either by the broker or the insurer.

It is then XY plc's task to present the risk to insurers, documenting:

- the cover required, the class of business, sums insured, limits of indemnity and the wording that is to apply; and
- all material underwriting information to support the request.

XY plc's role is to present all the underwriting information to the insurer and to present the risk in such a way as to obtain the best possible terms for their client. Therefore, some information which could improve the risk, but which may not necessarily be material, should also be included. (10)

<u>Question 3 - Learning Outcome 3 (10 marks)</u>

Your company, an insurance broker who provides clients with insurance products on a non-advised basis, has been approached by a client requesting a quotation and a recommendation.

Explain how you would present terms, on an advised basis, to enable the client to make an informed decision. (10)

<u>Answer to Question 3 (Learning Outcome 3)</u>

Currently the broker provides insurance products on a non-advised basis. When presenting terms to the client, on an advised basis, it is now the broker's role (and a regulatory duty) to explain the differences between terms and to give an appropriate recommendation to the client in line with their demands and needs. That is to explain how the extent of the cover provided by the contract, the cost of the contract and any exclusions, excess, limitations and conditions, meet the requirements of the client. To do this, the broker must identify and record the client's demands and needs prior to obtaining cover.

The objectives of presenting terms to the client on an advised basis are to:

- convey the terms accurately and concisely to the client;
- ensure that the client understands, particularly important aspects of the cover and the terms and conditions;
- ensure that the client understands where the cover on offer does not match their requirements;
- provide a record of the advice to the client;

- bring special payment or standard credit terms to the client's attention; and
- provide full details of the insurers.

If there are any terms and conditions, these must be confirmed in writing, and a formal report may be prepared (the complexity depending on the size of the client) which emphasises the key features of the broking exercise. The report may include the following:

- an analysis of different excess levels, the difference in premium and the potential impact taking into consideration the loss history;
- an explanation of differences in cover if the new terms are compared to previous cover;
- a summary of the scope of the marketing exercise making reference to any objectives agreed with the client previously;
- an analysis of the marketing completed in order to place the policy;
- if the terms are a renewal of a contract, the following headings could be used:

    - last year's terms and last year's values
    - last year's terms on this year's values
    - this year's terms on this year's values
    - alternative terms on this year's values
    - percentage differences
    - key cover differences

As well as the original demands and needs, the presentation should include a suitability statement that explains how the recommendation addresses the client's demands and needs and the reason/s behind the recommendation. The overall aim when presenting terms to the client should be to provide enough information for them to make an informed choice about what, and if, to purchase. (10)

<u>Question 4 - Learning Outcome 4 (20 marks)</u>

XYZ plc, an insurance broker, subscribes to the information services provided by rating agencies. KB plc, an insurer with which XYZ plc trades, has just been downgraded by all the rating agencies.

(a) Explain the importance to XYZ plc of insurers' financial security when selecting the insurers they trade with. (10)

(b) Describe the range of actions that XYZ plc might take relating to both KB plc and the clients whose risks are currently placed with this insurer. (10)

<u>Answer to Question 4 (Learning Outcome 4)</u>

(a) Like any insurance broker, for XYZ plc the overriding factor to be taken into account, when they select the insurers they trade with, will be an insurer's financial security. Or in other words, their ability to pay claims. When the world's largest insurer, AIG, almost ran out of money it took the whole insurance industry by surprise. Their resulting downgrading by the credit rating agencies meant that brokers had to reassure their clients that AIG were still capable of paying claims.

There are tight rules regarding the capitalisation of insurance companies and the broker has a responsibility to ensure the interests of their clients are upheld by only recommending insurers who are financially stable.

Insurance is about trust. If a client does not have trust in their insurer to pay potential claims, they are likely to take their business elsewhere. That is the reason why many brokers have specialist security departments whose primary role is to monitor the security of insurers. Subscription to the credit rating agencies, such as Standard and Poor's, A.M. Best and Moody's, is only one source of information. Broker security departments are also likely to monitor the financial press, look for clues such as changes in an insurer's underwriting policy and the speed with which they pay their claims.

An insurer's financial security is not the only factor brokers will take into consideration when choosing which insurers to trade with, but it is probably the most important factor. (10)

(b) If KB plc is downgraded by the rating agencies it could indicate that their financial security is less stable. The overriding factor for a broker when deciding which insurer to recommend to their clients is the ability for that insurer to pay claims. The insurance broker may have a specialist security team who will be able to identify if the financial security of an insurer is in question. Even if the broker does not have a specialist security team, it will have procedures to follow and monitoring the rating agencies may be one of those procedures. The action the broker could take with regard to KB plc might include:

- removing them from its panel of insurers and not placing any new business with them;
- running off the insurer account by not placing any further business with them and not renewing any policies;
- cancelling the agency with immediate effect and re-broking all the policies with other insurers; or
- continuing to trade with the insurer, but writing to them to ask for assurances and then to continue to monitor the situation carefully.

The action taken will depend on the change in the rating, what it was before and what it is now.

The broker's clients may have read about the downgrade in the financial press and may be concerned about the insurer's ability to pay potential claims. It is important that the broker is able to provide accurate and timely advice and is able to reassure the clients that their interests are being safeguarded or highlight any issues arising. A decision may be taken not to inform the clients as any reassurance may cause more concern. There are a number of actions that XYZ plc could take in relation to their clients and the action taken will depend on the class of business:

- take no action, but reassure the clients if they ask;
- write to all clients reassuring them that they are monitoring the situation and/or asking them for written confirmation that they are happy to continue to insure with KB plc;
- call all or some of the clients and reassure them;
- request from the client permission to re-broke their policy.

Once again, the action will also depend on the change in the grade. (10)

Question 5 - Learning Outcome 5 (20 marks)

ABC plc, a manufacturing company with subsidiaries in several countries, insures all its risks in a global programme in the London market, placed through a single insurance broker.

The London market cycle is changing from ‘soft’ to ‘hard’.

(a) Explain the potential implications for ABC plc if it retains its current global programme. (10)

(b) Explain the potential implications for ABC plc if it decides to give each subsidiary the authority to make their own insurance arrangements. (10)

Answer to Question 5 (Learning Outcome 5)

(a) Currently ABC plc insures all its risks in a global programme, placed in the London market through a single insurance broker.

This has a number of benefits for the company, including:

- Consistency in cover across each country.
- Central control of insurance costs and cover and broking arrangements.
- Worldwide losses can be identified and analysed more easily.
- Allowing for a global approach to risk management rather than piecemeal.
- Participation in the risk can be controlled by the level of self-insurance or through a captive.
- Premiums can be allocated in line with losses to facilitate better risk management.
- Overall losses to the program can be aggregated easier and analysis completed.
- Having a captive can bring tax benefits to the group.
- Ability to buy cover in bulk through the global program.
- Implementation of a Global DIC/DIL umbrella policy giving wider coverage than local policies can in some territories and making sure a wide cover safety net is in place.
- Global claims coordination to enable one effective claims procedure worldwide.

However, the London market cycle is changing and premiums are increasing and cover may be only available on a more restricted basis. If ABC plc gave each subsidiary the authority to make its own insurance arrangements, there would be a number of implications.

(b) Many of the benefits identified above would be lost, however, there are certain advantages. Firstly, different insurance markets may be at different stages and giving each subsidiary autonomy may mean they can access markets which are still relatively ‘soft’.

It is not clear what the management style is, however, if each subsidiary is managed on an autonomous basis, giving them control of their own insurance arrangements would make sense and be in line with the existing management arrangements.

The subsidiaries may already have to purchase some level of cover locally and have existing relationships with local brokers. Giving each subsidiary autonomy to approach their local insurance market, may enhance these local relationships and have additional benefits.

It may result in premium savings in aggregate terms.

If insurance is sourced locally, it may avoid potential legislative conflicts as each subsidiary will fall under the jurisdiction of the local regulator. Standards and regulations will be easier to manage locally.

There may be a wider choice of markets which can be accessed across the group, which may improve terms and lead to cost benefits. In addition the following benefits may be achieved:

- Avoidance of any potential conflict when allocating premiums, as some subsidiaries may feel the central costs for the insurance is unfair, exerting unwelcome managerial interference. Some subsidiaries may also feel the premium allocation is unfair as their risk is better managed than other subsidiaries, or that they have made fewer claims. Allowing each subsidiary to make their own decisions will avoid such conflicts.

- Provide the subsidiary with flexibility to design a more bespoke programme to suit their needs. For example, a global programme may have unrealistically large limits or cover that is not required at a local level.

- Improve local risk management. If subsidiaries can see that investment in risk management has a direct impact on their own insurance spend, they may be more inclined to do it.

However, in the end, the decision will be based on a detailed cost analysis and the desire for effective corporate management. (20)

Question 6 - Learning Outcome 6 (20 marks)

You are the claims manager of CDE plc, an insurance broker. You have been contacted by another insurance broker who states that one of their clients has recently informed them of an Employer's Liability claim that occurred several years ago when they were a client of your company.

(a) Explain the circumstances in which CDE plc could be responsible for dealing with the claim. (15)

(b) Explain the records policy CDE plc should keep following any placement and the records CDE plc are required to keep in relation to employers' liability cover. (5)

Answer to Question 6 (Learning Outcome 6)

(a) Employers' liability (EL) insurance covers the cost to employers of providing compensation to their employees for disease or injury arising from their employment. Disease claims, in particular, can arise many years after the disease was caused. The situation for someone whose disease may have been caused as long ago as 40 years (as is the case with asbestosis) is a complex one, as the individual will need to find their old employer and establish if any employers' liability insurance was in place. Both the employer and the old insurer may no longer exist. EL insurance is compulsory, but it only became so in 1972.

There is an increasing trend for insurance brokers to charge fees to their clients for their services. Many argue that charging a fee is more transparent than taking a commission, in the form of brokerage from the insurer based on the premium charged. However, when a fee is charged, the amount is calculated based on the work undertaken. Therefore, it could be argued that no financial provision has been made for any work that falls outside the period when the fee was calculated. This includes any potential work for a claim, regardless of when the claim arose.

The legal position is much clearer if CDE plc had been paid by brokerage. CDE plc would be responsible for handling the claim under the policy they arranged, regardless of the time frame and even if the client has been lost to another broker, because CDE plc's brokerage payment relates to the relevant policy period/s. EL claims, indeed many liability claims, are often not made until after the policy period has expired, but CDE plc would still be liable to handle the claim if they had taken payment in the form of brokerage originally as long as the business had not been transferred to the new broker in the meantime.

The move from brokerage to fee payments and the issue of legacy claims - claims against an insurance policy which has expired, but which originate from a period when the policy was live - have caused much debate in the broking industry as to a broker's responsibility for dealing with such claims. In addition to the issue of fee verses brokerage, there are a number of circumstances when CDE plc would be responsible for dealing with the claim, or when they might choose to do so regardless of their specific responsibilities in law.

It could be that CDE plc has made provision for this circumstance and has included a note in their Terms of Business Agreement with the client allowing them to charge an additional fee for any ongoing claims service. This could make it financially attractive for CDE plc to manage the claim.

Many brokers have established specific teams to look after 'legacy' claims that manifest themselves many years after they were caused. Liability claims written on an occurrence or causational basis involving industrial deafness, pollution, asbestos are examples of types of claim that may only come to light many years after they originated.

Regardless of how CDE plc were paid, if there is any ambiguity in the fee/service agreement over who is responsible for claims after termination of the broker's contract with the client, it may be argued that CDE plc should take responsibility, even if they are unlikely to be paid for their work. This would be particularly relevant if the client's expectations were for CDE plc to manage the claim and the service agreement is unclear on the issue.

CDE plc may also wish to protect their position if there is any ambiguity over the claim or the claim is unclear and which could result in an error & omission claim against CDE plc by their former client.

Finally, it may be prudent for CDE plc to manage the claim, regardless of their responsibility as it might provide an opportunity to win back the client from the current broker. If CDE plc do a good job in handling the claim, it might create sufficient goodwill which is enough to persuade the client back. (15)

(b) The FCA's Handbook, Senior Management, Arrangements, Systems and Controls' (SYSC) provides guidance on record keeping, although there are no specific record keeping rules in the Insurance: Conduct of Business Sourcebook (ICOBS). The guidance states, due to potential customer complaints and requests from the FCA for certain information, that it is prudent to maintain evidence of such matters as the reasons for a specific recommendation at placement and evidence of the documentation supplied to customers. Many firms have a specific policy on how long they retain records, so they are able to respond to complaints, legal requirements or, particularly in the case of potential long tail claims, for future claims which may arise, even after the client has been lost. Often the time period is six years, but for Employers' Liability (EL) policies, where there is an increased possibility of long tail claims, this period may be much longer.

EL insurance is a compulsory insurance and covers the cost of employers providing compensation to their employees for disease or injury arising from their employment. Disease claims, in particular, can arise many years after their original cause. As such, brokers may find it prudent to maintain a record of employers liability cover in case there are future claims. The Employers' Liability Tracing Office (ELTO) is an independent body set up to help those who have suffered injury or disease in their work place to trace their employer and the employer's insurer. However, ELTO's members are the insurers providing EL insurance, not the insurance brokers themselves. Despite this, many insurance brokers will maintain their EL insurance placement documents for much longer than for other types of insurance. **(5)**

Question 7 - Learning Outcome 7 (20 marks)

You are an insurance broker who offers both traditional risk transfer and alternative risk transfer services. One of your clients, who insures on a traditional risk transfer basis, is considering reducing their insurance costs by increasing their own share of the risk.

(a) Explain to your client the types of organisation that could benefit from owning a captive insurance company. (10)

(b) Describe the services that an insurance broker could provide for a captive insurance company wholly owned by one of its clients. (10)

Answer to Question 7 (Learning Outcome 7)

(a) Captive insurance companies are a tax-efficient method of transferring risks and, as in this instance, can be a wholly owned subsidiary of a client. However, a captive insurance company may not be beneficial for all types of client.

As is the case for every insurance company, captives must be capitalised and managed, both of which are potentially expensive. Therefore, only certain types of client, with an insurance programme that suits this form of risk transfer, would benefit from owning a captive.

For a client to benefit from owning its own captive, the client company would need to have sufficient capital to set aside to satisfy the regulator that it has the ability to pay claims. For many organisations, capital is in short supply and where it is available, it may be more effectively invested in other parts of the business, or even in risk management to better manage its risks, rather than simply transfer those risks to a captive. Sufficient capital would need to be tied up to form a risk pool from which claims are paid. That capital could not be used for anything else. Therefore, any client with ambitions to expand or with plans for future growth involving investment, should think carefully about the viability of capital in the short and long term and understand exactly what they want to do with any capital that may become available.

In addition, only clients with the right risk profile would benefit from owning a captive. Clients with smaller insurance programmes may find it financially more effective to transfer their risks in the traditional way. For a client to really benefit from owning a captive, they would need to have a high insurance spend on risks which are most appropriately managed by transferring them rather than self-insuring them or reducing them through effective risk management. For example, property risks may be more suitable for a captive than liability risks. (10)

(b) Where an insurance broker's client owns a captive insurance company, the broker could provide a number of services for the captive.

The first thing a broker should do is conduct a feasibility study into the suitability of a captive for the client. A captive needs to be managed and capitalised and this involves the allocation of capital. The captive is subject to the same regulatory requirements as other insurance companies in any given jurisdiction, and capitalisation cost can be a drain on the client's finances. The broker can help to reduce management costs which can be quite high. Some insurance brokers have captive management specialists.

If the captive is established on-shore in the UK it will be subject to relatively stringent regulation. The broker may be able to advise the client on off-shore locations for the captive, such as Bermuda, the Channel Islands, the Isle of Man or Dublin, which offer a relatively light regulatory regime and a more favourable fiscal environment. The broker could advise on the set up, capitalisation and structure of the captive, managing the day-to-day operations of the captive and acting as the captive's underwriters.

As agent of the client, the broker will always have the interests of their principal at heart and will be able to advise the client if the captive remains the best option for them. Captives are only suited to certain companies and the risks must be large enough to justify the cost. In addition, the tax authorities in the UK and the US are examining the use of captives very closely. (10)

Question 8 - Across more than one Learning Outcome (30 marks)

DP plc, a UK-based personal lines insurance broker, has received a complaint from a client, who has just had a claim declined by an insurer. DP plc have a formal complaints procedure which meets the Financial Conduct Authority's (FCA) requirements. On investigating the complaint, it is established that a new employee of DP plc failed to inform the insurer of material facts that had been provided by the client.

(a) Explain the FCA's requirements for insurance brokers regarding complaints. (5)

(b) Describe **three** different ways in which the broker might respond to the complaint and the impact **each** course of action is likely to have on the client. (15)

(c) Explain the actions that DP plc could take to prevent a similar complaint in the future. (10)

Answer to question 8 (Across more than one Learning Outcome)

(a) The FCA has defined a complaint as:

"Any oral or written expression of dissatisfaction, whether justified or not, from, or on behalf of, a person about the provision of, or failure to provide, a financial service or a redress determination, which:

- Alleges that the complainant has suffered (or may suffer) financial loss, material distress or material inconvenience; and

- o Relates to an activity of the firm, or of any other firm with whom the firm has some connection in marketing or providing financial services or products, which comes under the jurisdiction of the Financial Ombudsman Service."

In summary a complaint does not have to be made in writing and the client doesn't have to say, 'I am making a complaint'.

The FCA provides rules and guidance for brokers in their *Handbook* in relation to complaints. The FCA requires all brokers to have a formal procedure for dealing with complaints and to inform their clients of this procedure (including the address and telephone number to write to or call). They must also inform their clients how to complain to the Financial Ombudsman Service (FOS).

The FCA requires that all insurance brokers manage complaints in accordance with their stated procedures. (5)

(b) Potentially, the broker could react in three ways. Firstly they could follow their complaints procedure and resolve the claim as a simple complaint. Secondly they could follow their complaints procedure and resolve it as a complex complaint, or they could not report the issue and try and conceal the issue.

In order for the complaint to be resolved as a simple complaint, the circumstances must be easy to resolve. The complaint should be recognised as such even if it is not received in writing. For a simple complaint, it is likely that a telephone call will be received from the client.

The complaint should then be reported correctly (to the right person, and logged in the right format as established in the complaints procedure).

Once reported, the complaint should be dealt with in the appropriate way. For a simple complaint this would mean that the person receiving the complaint is able to resolve the complaint to the client's expectation, within 24 hours at no cost. If this is possible, then the client would be happy with the outcome and take no further action. The complaint would still be logged. However in this example, the complaint is not likely to be a simple one.

Complex complaints would receive a similar response, but when dealing with the complaint, the person who received the complaint would need to consult a colleague or a superior if they are unable to resolve it, or cannot resolve it within 24 hours in accordance with the client's expectations and/or a cost may be involved.

In this instance, it looks likely that an error and omission (E&O) claim may arise due to an error by a DP plc employee. If the person receiving the complaint realises that they have made a mistake, there may be a temptation to 'freeze' or even to try and cover up their mistake. All circumstances/claims must be reported to senior management. In this instance, the complaint may become an E&O claim and would be dealt with by a senior manager (independent of the broker(s) involved with the client), or even a specialist legal/compliance/E&O claims director.

Making a mistake is not necessarily a disciplinary offence in itself; concealing the problem or lying about it will be. In this instance the client is likely to be compensated through the broker's E&O insurance policy. This has financial implications for the broker as the first part of any E&O claim will be paid for by the broker in the form of a deductable. It is also quite likely that the E&O premium in future years may increase as a result. If there is a delay or the client is still unhappy, they could make a further claim to the FOS. (15)

(c) In this instance the circumstances should be fully investigated so that procedures are put in place to prevent a similar thing happening again, or at least reduce the likelihood of reoccurrence. Some brokers have a ‘buddy/buddy’ system where a second pair of eyes can check the documentation and work of a colleague. Others have introduced a ‘right first time’ initiative or procedures are in place for team leaders to check work. The firm should have a Training and Competence policy in place to provide adequate training for every role and a ‘probationary’ period should be served in key roles, so that adequate supervision is provided until a member of staff is considered competent for the responsibilities of their job.

The broker could also create a check list for all underwriting submissions to ensure adequate and accurate information is always included. This should be signed off by a team leader and, in some circumstances, should also be shown to the client to confirm accuracy.

All employees should keep accurate and concise written or durable evidence of all conversations and dealings with clients. This will ensure that information is compiled accurately and that it is possible to provide this to the client to obtain their agreement that, what is recorded, is accurate. It is particularly important to confirm to the client in writing everything that relates to advice or comments related to how, and in what circumstances, the policy would operate. If all communication is not recorded in writing it becomes very hard to prove what actually happened. Many brokers invite their E&O insurers to review their procedures, to look for potential weaknesses, and make recommendations to improve the way they operate, in order to avoid potential E&O claims.

E&O claims are rare, but instances that could potentially lead to a claim are more common. All should be recorded and reported to the broker’s E&O insurer so that the risks can be managed, patterns identified and corrective action taken. (10)

Question 9 - Across more than one Learning Outcome (30 marks)

GB plc, a clothing retailer with a chain of shops, is a long-term client of NZ plc, an insurance broker, and has asked for an extensive review of its insurance programme. Currently GB plc transfers most of its risks to a single insurer and has a very low deductible.

(a) Describe how NZ plc could conduct a ‘fair analysis’ of the market. (10)

(b) Explain **four** key programme design issues which should be considered by NZ plc when designing a new insurance programme for GB plc. (20)

Answer to Question 9 (Across more than one Learning Outcome)

(a) If NZ plc wishes to review the risks of GB plc on the basis of fair analysis of the market, it will have to consider a sufficiently large number of insurance contracts available in the relevant sector or sectors of the market, to enable it to make a recommendation in accordance with professional criteria.

According to the FCA in its Insurance: Conduct of Business Sourcebook (ICOBS), only then can the broker claim to have carried out a fair analysis of the market.

The question of whether or not the number of insurers is adequate or not will depend on the broker's ability to approach a sufficiently large number of insurers. The broker needs to demonstrate their knowledge of the insurers operating in the relevant market sector and/or writing that line of business.

This is often done instinctively, rather than by a set number. The issue is that the broker must be able to evidence their analysis. They will need to adhere to and document a set process. An example of the process is as follows:

- Identify all the possible insurers who write that class of business
- Refine the list based on the client's demands and needs, producing a shortlist of insurers
- Using specialist broking knowledge, experience and expertise, refine the list, to identify a minimum of five insurers, all of whom should be approached.

The reasons for including some insurers and discounting others should be recorded. In this case, the broker should be certain that it has identified and updated the client's demands and needs and made sure that any new markets that have become available are considered as part of the fair analysis. (10)

(b) The key issues in programme design are:

- The level of risk to retain.
- Can the policies be combined or packaged in any way.
- Are there potential savings for longer agreements?
- Required limits.
- Required specialist covers.
- The insurers to use.

There are a number of programme design issues that need to be considered in the design of a new insurance programme for GB plc. Four have been chosen from the six identified above. The four key issues chosen are:

- The level of risk to retain.
- Are there potential savings for longer agreements?
- Packaging.
- Limits.

The first is the level of risk retained by the client. Depending on the client's attitude to risk, it can retain more or less risk by adjusting the deductible. The terms excess and deductible are interchangeable and refer to the amount of any claim the insured has to pay. An insurer will generally reduce its rates in exchange for a higher excess, depending on the expected loss profile. For our client, a clothing retailer, it will probably experience a high volume of low value theft losses. These can be retained by the company through the deductible, leaving the more major risks to be transferred. This is known as self-insured retention.

From an insurer's perspective, the higher the level of risk retained by the insured, the further away the insurer is from being called upon to pay a claim. There needs to be a trade-off, as the client will want protection at the lowest cost. It is the broker's job to find the balance between the level of excess the client is prepared to accept and the premium discount the insurer is prepared to offer.

Other advantages for an insurance programme with a high level of self-insurance are that the insurer exerts less control over risk management for the lower end losses, leaving the insured with more control. The broker will need to have a good understanding of the client's attitude to self-insurance, its cash flow position and the risk management measures in place to control the lower value losses that will fall under the deductible level. The broker may be able to assist the client in improving its risk management.

In addition, there may be differences between public sector bodies, private companies and not-for–profit organisations, all of which may have differing attitudes to risk, different stakeholder influences and potentially different regulations.

The second issue affecting programme design is the insurance term, or the length of time the policy provides an indemnity, from inception to expiry.

The availability of longer term policies is very much dependent on the stage of the market cycle. Some insurers are willing to offer long-term agreements (LTAs) where they fix the premium rate for, say, three years. This guarantees the renewal and suits the insurer if they expect rates to fall during the term. The client benefits in that it avoids potential rate rises and can make long term financial plans based on stable pricing. Typically insurers might offer a 5% premium reduction for a three year LTA and 10% for five years.

If price is the key issue, the broker would need to be confident that other markets would not become available and offer a lower premium during the term of the LTA.

There are time and cost implications for an insurer taking on a client and they may not be happy to lose the client at the first renewal. If an insurer suspects that the market is simply being 'tested' it may decline to offer a quotation, so there may be more impact in the market for being tied in to a particular insurer for an established period. It is also time consuming for the broker to remarket larger risks every year and the insured may benefit from being loyal to one insurer if a difficult claim needs settling, particularly where the client has had relatively few losses and has been profitable for the insurer.

The third area to be considered are the limits of cover. The limits of cover purchased should be optimised to ensure that the amount being purchased reflects the risk. Very often an arbitrary figure for some covers is selected and this may be either more than is required, resulting in unnecessary premium payments, or too little leaving potential exposures uninsured. The limits should reflect the maximum potential losses, i.e. the facts, wherever possible. For some covers, such as the cost of reinstating a shop premises, may be easier to calculate, whereas some covers, such as liability covers, may be more subjective, but all should be carefully considered.

GB's broker should consider how the programme could be structured to achieve the limits the client actually needs and to identify the optimum point for completing and starting a new excess layer.

Fourthly, when designing the insurance programme, consideration should be given to the use of packaging or combining policies together to generate potential economies of scale and premium savings, which could also be traded for additional cover. The higher risk, less attractive business, could be offered to an insurer when bundled together with a lower risk, potentially more profitable, type of business. It will not all be about price, instead it is about understanding packaging and combining covers in order to achieve the optimum cover at the optimum price. This will depend on the risks involved and what GB wants from their insurance programme. This will be a key risk management consideration which should be carefully priced. (20)

Question 10 - Across more than one Learning Outcome (30 marks)

MBR plc, an insurance broker, operates a delegated authority which includes authority to settle claims.

(a) Explain how MBR plc delivers claims service, through the delegated authority, to its clients, whilst meeting its duties to the insurer and its relevant regulatory obligations to the Financial Conduct Authority. (20)

(b) Explain how MBR plc could use claims data and trends to assist its clients to manage their risks to minimise the frequency and cost of future claims. (10)

Answer to Question 10 (Across more than one Learning Outcome)

(a) Delegated authority agreements exist where an insurer has given a third party, known as a coverholder, authority to conduct business on its behalf within the limitations of the agreement. Probably the most common form of delegated authority is when an insurer delegates authority, to underwrite business, to an insurance broker. However, authority to settle claims can also be given, but usually only to a limited extent. For example, authority may be granted to settle claims directly with an insured up to £10,000 per claim. Some insurers may even provide an insurance broker with a 'loss fund'; a sum of money that can be used to pay claims under the delegated authority directly to the client. However, larger claims would normally still be settled by the insurer.

When operating a delegated claims authority, MBR plc is acting as an agent of the insurer and not the insured. However, it still needs to deliver service to its clients, whilst meeting its duties to the insurer and operating within the relevant regulatory obligations. Balancing the operation of the agreement with all parties can be quite challenging and there is an increased potential for conflicts of interest to arise ifs the needs of all parties are to be met.

The provision of a high quality claims service is of great importance to insurance brokers. The only tangible product is the policy documentation, the service is what is actually being paid for by the client and if the service does not meet client expectation, the client will take their business elsewhere. It has been said that the client needs their broker most when they have a claim. However, many brokers do not offer any claim service. Through the operation of a delegated claim service, MBR plc has the opportunity to add value and deliver service at a key point in the client relationship. Many brokers strive for service excellence in all their interactions with the client. Service excellence will ensure that client expectations are exceeded or at least met every time.

MBR plc has a responsibility to see that their client is treated fairly, so that they receive a true indemnity in accordance with the terms of the policy by provision of a claim service within the limitations of the delegated claims authority. MBR plc, as coverholder's with claims authority, have the opportunity to stand in the place of the insurer and ensure their clients are treated fairly. Because the claim may be managed by the broker in its entirety (depending on the terms of the delegated authority), the broker has the opportunity to offer a high quality service. In particular, provided the claim falls within their authority, the broker should be able to more quickly advise the insured on the following as there is no need to refer to the insurer:

- Advise the client on whether the loss is insured or not.
- Advising the client on their rights and obligations under the policy.
- Appointing adjusters and briefing the client on their role.
- Assisting the client in completing forms.
- Pay the claim directly.
- Attend site meetings.

There should be fewer delays in the claim process as the insurer will not be involved (except with larger losses) and the broker will always know what is happening at every stage of the claim, so communication will be improved.

Some brokers provide a commitment for minimum service standards with their clients in their Terms of Business Agreement.

However, the broker, as coverholder, is the agent of the insurer and so will also have obligations to their principal. These obligations should not be in conflict to those of their clients. On the one hand, the broker will need to follow the wording of the delegated authority agreement, on the other the broker will feel obligated to pay as many claims as possible as quickly as possible. This may sound as though there could be potential for a conflict of interest. In order to meet the needs of their clients and their duties to the insurer, their principal, many brokers separate staff who operate the delegated authority from client service staff. By separating these two functions into different business units the potential for conflict is reduced. Client service staff use the delegated claims authority as they would a normal insurer and the delegated claims authority staff act as insurers would and treat the claims staff as they would any other broker.

MBR plc can also satisfy the regulator, the Financial Conduct Authority, that they are following the rules relating to claims handling, laid down in Insurance: Conduct of Business Sourcebook (ICOBS) 8. These rules impose specific requirements on insurance intermediaries such as understanding timescales for settlement, the importance of keeping clients reasonably informed of progress.

However, in this instance, by operating a delegated claims authority, MBR plc must comply with the claims handling rules of the insurer. In particular, the broker must inform the client that they are acting for the insurer, and not the client, when settling a claim made by the client, through the delegated authority agreement. In this instance, MBR plc are required to disclose to the client the potential for a conflict of interest and must obtain consent from the client before continuing to act in relation to the claim. In summary, the broker must disclose and obtain consent. There may even be occasions where the broker decides not to act for both the insurer and the client.

From a regulatory perspective, it may also be prudent to have one individual manage the delegated claims authority and another to act as the client adviser.

Clearly, not all claims will fall within the authority of the agreement. Where this is the case, the broker must inform the insurer of the loss promptly and tell their client that they cannot deal with the claim on behalf of the insurer. (20)

(b) Many brokers now operate sophisticated claims analysis systems which are designed to aid their client in managing their risks efficiently. If MBR plc operated a computerised claims analysis system, it could review claims statistics against the premiums paid to determine loss ratio and evaluate any trends over time, allowing its clients to identify potential risks and where to concentrate their risk management resources.

The premiums insurers charge are based on a premium rating base such as the wage roll, turnover, number of vehicles or a total sum insured. Evaluating the actual claims rate against these rating bases provides both the insurer and the client, a better understanding of where the real risks are.

An analysis of claims by business unit, location or product, for example, allows clients to identify key risk areas and may help them to consider alternative funding to traditional risk transfer. In the same way, an analysis of the types of claims which are occurring may help identify trends and assist the client to stop a particular activity that is, for example, causing the injuries of employees.

Claims analysis, whether computerised, or simply in the form of maintaining claims records allows brokers to compare previous loss estimates with the actual amounts paid or settled or even closed at no cost to the insurer. This is known as 'triangulation'. If an insurer is frequently over reserving for claims, this data can be presented to the insurer as it will effect renewal terms.

Finally, MBR plc may be able to analyse the claims data over time, which will help identify if claims, either by frequency or severity are increasing or decreasing in any given period. (10)

How to plan an answer for a coursework question

The following three plans are based on 10, 20 and 30 mark questions respectively.

Question 1 - Learning Outcome 1 (10 marks)

CJ plc, a UK-based insurance broker, transacts business directly with customers as well as with other insurance brokers. It also operates delegated authority schemes on behalf of insurers.

Explain the duties imposed on CJ plc, with use of appropriate diagrams, by the law of agency in **two** of the following three roles:

(i) Retail broker
(ii) Wholesale broker
(iii) Coverholder. (10)

Question deconstruction

- Review learning outcome 1 in the course material and the relevant information in the study text.
- Highlight the instruction within the question (which is circled in red above).
- What is the context? UK-based broker, transacts direct, on a wholesale business, operates delegated authority.
- The question asks for the duties imposed on the broker by the law of agency. Note that a diagram is required. Only two of the three roles should be answered. Also note that there is no split in the marks, so each of the two parts should be answered equally and five marks will be available for each.

Answer plan

- Identify the role of all parties in each case by identifying who is the agent and who is the principal. Examples of the duties imposed can be given, but there is no need to write large amounts on the law of agency. The question is quite specific and only five marks are available for each situation.
- This should then be illustrated with a diagram, showing all parties involved.
- As this is a 10 mark question, your answer should be shorter than the answers to either a 20 or 30 mark question.

Question 4 - Learning Outcome 4 (20 marks)

XYZ plc, an insurance broker, subscribes to the information services provided by rating agencies. KB plc, an insurer with which XYZ plc trades, has just been downgraded by all the rating agencies.

(a) Explain the importance to XYZ plc of insurers' financial security when selecting the insurers they trade with. (10)

(b) Describe the range of actions that XYZ plc might take relating to both KB plc and the clients whose risks are currently placed with this insurer. (10)

Question deconstruction

- Review learning outcome 4 in the course material and the relevant information in the study text.
- Highlight the instructions within the question (which are circled in red above).
- Consider the context which includes the fact that the insurance broker has access to the rating agencies and that one of the insurers it trades with has been downgraded.
- The marks in part (a) and (b) are equally weighted so spend an equal amount of time and effort in explaining the importance of financial security as describing the range of actions available.
- The marks for part (b) are awarded for a description of the actions relating to both the insurer **and** the client. A description does not require a full explanation. See the glossary of terms at the end of this guide to understand exactly what is required. If the word explain, for example, was inserted instead of describe, then this would involve more detail.

Answer plan

Part (a): You need to explain the importance of insurers' financial security from the perspective of the broker (which includes their obligations to their client) within the context of insurer selection. By explaining, you need to do more than list the reasons, you need to show why it is important.

Part (b): Requires only a description, but the key is to include the actions relating to the insurer and to clients who have existing policies with the insurer. Any other actions taken with any other party are not required and marks will not be awarded.

As this is a 20 mark question, your answer should be longer than the answer to a 10 mark question but shorter than the answer to a 30 mark question.

Question 9 - Across more than one Learning Outcome (30 marks)

GB plc, a clothing retailer with a chain of shops, is a long-term client of NZ plc, an insurance broker, and has asked for an extensive review of its insurance programme. Currently GB plc transfers most of its risks to a single insurer and has a very low deductible.

(a) Describe how NZ plc could conduct a 'fair analysis' of the market. (10)

(b) Explain **four** key programme design issues which should be considered by NZ plc when designing a new insurance programme for GB plc. (20)

Question deconstruction

- Review learning outcomes 4, 5 and 7 in the course material and the relevant information in the study text.
- Highlight the instructions within the question (which are circled in red above).
- Consideration of the context: the nature of the client's business, the chain of shops, the fact that they are a long term client and the fact that they are reviewing the insurance programme which consists of a highly transferred programme on a low deductible.

Answer plan

Part (a) is worth 10 marks and part (b) is worth 20 marks, so each needs to be answered accordingly in length and depth.

In part (a) a description of fair analysis is required and not a full explanation, nevertheless, in describing the conduct of such an analysis, a depth of knowledge will be required in accordance with the ten marks available.

In part (b) a full explanation is required, but note that only four 'key' design issues are requested. By asking for an explanation of key design issues implies that a justification of why they are key in this particular scenario is required

In fact, the whole of part (b) should be answered within the context given. Application of the relevant facts is vital here to achieve the full 20 marks available.

As this is a 30 mark question, your answer should be longer than the answers to 10 and 20 mark questions.

Glossary of key words

Analyse

Find the relevant facts and examine these in depth. Examine the relationship between various facts and make conclusions or recommendations.

Describe

Give an account in words of (someone or something) including all relevant characteristics, qualities or events.

Discuss

To consider something in detail; examining the different ideas and opinions about something, for example to weigh up alternative views.

Explain

To make something clear and easy to understand with reasoning and/or justification.

Identify

Recognise and name.

Justify

Support an argument or conclusion. Prove or show grounds for a decision.

Recommend with reason(s)

Provide reasons in favour.

State

Express main points in brief, clear form.