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Commercial claims  
A customer focussed  
claims journey



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# Introduction

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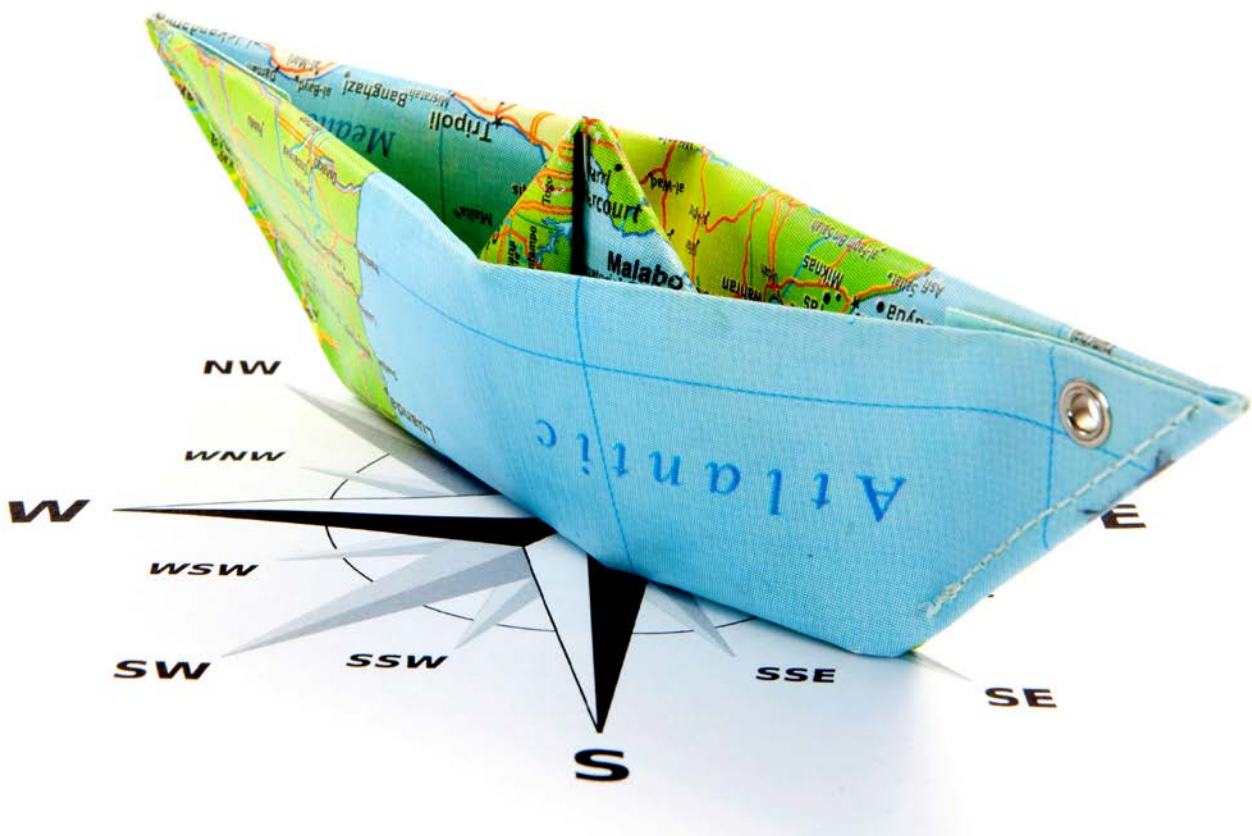
Conduct risk has traditionally been seen only as a concern for retailers of personal lines insurance. However, since its inception in April 2013, the Financial Conduct Authority (FCA) has dramatically widened the focus of conduct risk to cover all firms in the supply chain and all consumers of general insurance – from personal lines, to commercial lines including large risks and reinsurance. This expansion in scope has brought many more firms, lines of business and products into the regulator’s line of sight.

Following on from their thematic review of retail claims handling in early 2014, the FCA 2014 business plan indicated to the market that commercial claims handling would become the next material area of post sales handling focus for the insurance sector.

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“Building on findings from current retail claims work, we will consider whether commercial customers’ expectations are met in the claims process, where poor behaviour could have a wider impact on trust in the market, as well as leading to poor customer outcomes.”

FCA 2014 business plan



# Commercial claims overview

Commercial claims customers range from micro enterprises to large corporate entities, with an assumption that a large corporate represents a more sophisticated buyer and accordingly a lower level of conduct risk than a micro enterprise, which, in reality, may align more closely with a personal lines consumer in terms of the risk of unfair customer outcomes.

At either ends of this spectrum, there is a clear difference in the expectation of how commercial claims will be approached. At one end, with micro enterprises, it is expected that claimants are treated in line with personal lines consumers and a “fair and reasonable”<sup>1</sup> interpretation of the policy will be taken, in accordance with the Financial Ombudsman Service’s approach to customer complaints.<sup>2</sup> At the other end of the spectrum, for large corporate entities, it is assumed that claims decisions will be made on a legal interpretation of the policy.<sup>3</sup>

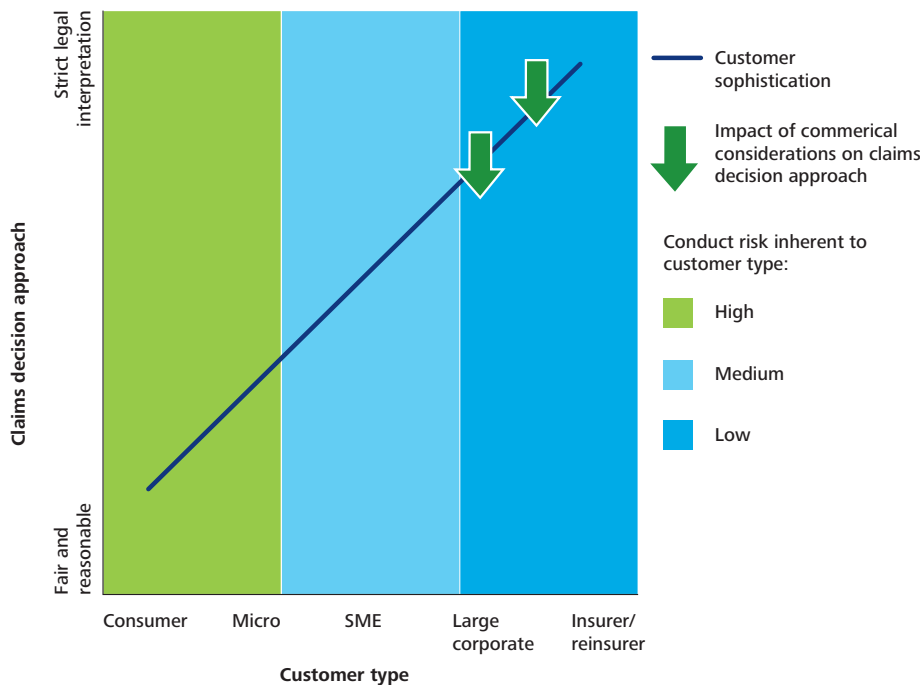
For SME customers however, it is often unclear the point (and triggers) at which the approach to claims decisions should shift from fair and reasonable to a strict legal interpretation. Ensuring the appropriate claims handling approach is adopted for such customers is a key area of regulatory focus.

It is worth noting that commercial considerations can provide impetus for a shift in an insurer’s approach to claims handling. For example, a firm could potentially pay a claim in good faith where the insured is a large or strategically important client and the claim is not clearly excluded by the insured’s policy. This practice could be seen to lead to unfair customer outcomes where claims decisions are driven by the importance of a client to a firm rather than case merit.

The diagram to the right broadly illustrates the expectations around claims handling and their relationship to customer type outlined above.

Conduct risk arises throughout the commercial claims process, and must be appropriately monitored and mitigated in order to ensure consumer protection.

## Conduct risk



1 In relation to consumers and micro businesses, the Marine Insurance Act 1906 has been overlaid by the rules in the FCA handbook and approach of the Financial Ombudsman Service. Law Commission Issues Paper, Micro-businesses – should micro-businesses be treated like consumers for the purposes of pre-contractual information and unfair terms?, April 2009 “The Ombudsman will determine a complaint by reference to what is, in his opinion, fair and reasonable in all the circumstances of the case.” FCA Handbook, Dispute Resolution: Complaints, DISP 3.6 Determination by the Ombudsman, 3.6.1 R

2 The Financial Ombudsman Service handles complaints by private individuals or micro-enterprises. FCA Handbook, Dispute Resolution: Complaints, DISP 2.7.3 R

3 According to the Law Commission this Act is “insurer friendly” and “allows an insurer to refuse a claim irrespective of the merits of the case” although it is noted “It would be rare for an insurer to deliberately exploit these defects in the law and refuse claims without a good commercial reason”. Law Commission Report, Insurance Contract Law: Business Disclosure; Warranties; Insurers’ Remedies for Fraudulent Claims; and Late Payment, July 2014

# Claims responsibilities throughout the distribution chain

This paper will consider, at a high level, key areas of conduct risk in relation to commercial claims throughout the distribution chain. Given the complexity of the distribution chain, there is inevitable overlap of risk types throughout. This paper considers the main areas of conduct risk facing:

- brokers and MGAs;
- insurers including Lloyd's managing agents;
- coverholders and TPAs; and
- loss adjusters and loss assessors.

In addition we will look more broadly at how remuneration arrangements can impact the risks associated with claims handling.



## BROKERS AND MGAs

**Brokers can play multiple roles in an insurance placement and who they represent can be a potential cause of conflicts of interest.**

**Brokers** involved in the placement of insurance contracts on behalf of customers are typically holding themselves out to be agents of the customer. At a broker, where the same business area might handle claims under delegated authority of the insurer, ICOBS 8.3.3(G) indicates that the claims function is acting as agent of the insurer. These separate agency responsibilities may lead to a conflict of interest due to the potentially opposing interests of the insurer and insured in relation to claims.

This risk can be mitigated through effective segregation of duties. However, if the insurance relates to a very niche or specialist area, the effective segregation of duties becomes more complex due to a potentially limited number of individuals with sufficient knowledge and skill to adequately assess claims.

Further conflict may also arise where a broker's errors and omissions ("E&O") insurer is involved. The E&O insurer will look to minimise their exposure to a claim, which may conflict with the broker's position as claims handler.

These are also key areas of risk in relation to MGAs, where the level of conduct risk is further increased if the MGA and broker are part of the same group.

For **MGAs**, commercial reality may also impact on conduct risk. Where underwriting authority and claims handling is delegated, claims may be declined or delayed in order to protect the profitability of the binder (see above section on remuneration arrangements). Consequently this is a key area of risk for classes of business where profits margins are narrow.



## INSURERS USE OF COVERHOLDERS AND TPAs

**For insurers there is a further layer of conduct risk where commercial claims are handled under delegated claims authority.**

**Coverholders** and **TPAs** are a key feature of the wholesale Insurance Market. The key question in relation to delegated claims handling by an insurer is "does the insurer have adequate oversight of the coverholder or TPA?".

In order to answer this question, firms need to look at whether the level of conduct risk associated with their coverholder or TPA has been appropriately assessed, and whether adequate and proportionate monitoring is in place to evaluate whether customers are treated fairly. This includes whether claims handlers are accurately recording and reporting complaints in relation to claims as this can be a key indicator of unfair customer outcomes. This is also a key consideration for insurers, brokers and MGAs.

Historically, in the London market, managing agents have a reputation for treating customers appropriately in relation to claims, with an expectation that claims are likely to be handled fairly and paid.

However, there is a conduct risk that where claims are handled by an outsourced provider that the claims handling culture is not aligned to that of the insurer, with claims being rejected where the insurer would have acted in good faith and paid the claim.

The key to mitigating the level of conduct risk for insurers is appropriate governance arrangements, controls and oversight of claims handling, evidenced through MI.

This is especially important for conflicts of interest. Commercial claims are more likely to involve complex horizontal or vertical integration of parties, which could potentially compromise the interests of customers.

The conflicting interests of parties could lead to unfair customer outcomes if governance and controls are not appropriate. An example of this could be where a flood in a shopping centre causes damage to a number of shops requiring them to close, and where an insurer has insured the shop where the flood started as well as a number of others which were damaged by the flood. Information barriers, with separate claims handlers and files for all conflicted parties would be appropriate to mitigate the risk of unfair customer outcomes in this scenario.



#### LOSS ADJUSTORS AND LOSS ASSESSORS

**Loss adjustors and loss assessors present a unique conduct risk in relation to commercial claims and have historically been subject to little regulatory scrutiny.**

**Loss adjustors** are generally appointed by the insurer and loss assessors by the insured. Clear differentiation between the definition of each beyond this is difficult because the roles and definition can differ per class. We have provided below conduct issues which may arise in relation to loss adjustors and loss assessors as they are typically appointed.

**Loss assessors** are usually appointed and paid by the insured to handle the claims process on their behalf.

Loss Assessors are regulated by the FCA. However, as loss assessors are predominantly smaller firms, they have historically had limited regulatory oversight and scrutiny. Accordingly, there is a risk that these firms do not yet have the level and sophistication of conduct systems and controls that are now starting to become embedded in the wider market.

Further, where a loss assessor provides assistance including notification of the claim to the insurer and helping negotiate its settlement, collecting claims money and passing this to the insured, there may be a client asset risk.

This is on the basis that loss assessors working on behalf of the insured are likely to be carrying on an insurance mediation activity per PERG 5.7.1 which would bring them into the scope of the CASS 5 client money rules.

Loss adjustors are generally appointed and paid by the insurer to investigate claims and may provide advice to the insurer or insured on repair and replacement techniques. Loss adjustors fall under the regulatory responsibility of the insurer, and therefore are not directly regulated by the FCA.

As with coverholders and TPAs, conduct risk manifests in relation to how insurers gain comfort that the loss adjuster's conduct in the claims handling process do not lead to unfair customer outcomes.

## Remuneration arrangements

For all parties discussed above, it is important to consider whether remuneration arrangements may incentivise handling claims in a way which could lead to unfair customer outcomes. This is an inherent area of conduct risk for commercial claims. This is a key issue where claims handling is delegated to coverholders or TPAs, or where claims are handled by brokers. The following types of remuneration arrangements, without appropriate controls, governance and monitoring, could lead to unfair customer outcomes in relation to commercial claims:

- **Profit commissions** could incentivise claims declination;
- **Commission payments** to coverholders could lead to poor claims handling after expiry of the binder, on the basis that the coverholder is no longer receiving remuneration for claims handling;

- **Fixed fee per claim handled or volume based remuneration** could lead to claims not being properly investigated; and
- **Hourly rate payments** pose a lower level of inherent conduct risk but could lead to poor customer outcomes because claims are not dealt with promptly with claims handlers being incentivised to spend more time than necessary dealing with claims.



# How to minimise the risk: effective controls

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For all firms, regardless of their position in the distribution chain, the following controls are key to ensuring fair outcomes for all types of commercial customer:

- Governance, controls and mitigation of conflicts of interest;
- Monitoring over post sales MI;
- Effective claims considerations as part of the product design processes;
- Robust oversight of delegated claims handling arrangements;
- Clear governance frameworks over claims declination and disputes;
- Appropriate and effective training for claims handlers and individuals involved in claims decisions;
- Benchmarks to identify when claims handling processes are taking longer than expected;
- Policies and procedures that embed strong risk culture and processes that promote fair customer outcomes;
- Thorough root cause analysis over claims declination and complaints; and
- Feedback loops to underwriters to determine whether the product is suitable or if changes need to be made.



## Conduct driving commercial success

The FCA is taking an increasingly forensic approach to its evidence based review in relation to conduct risk and will expect to see evidence of how conduct risks in relation to commercial claims are being mitigated. The findings from the thematic review are likely to be published in early to mid 2015 and firms will be expected to take account of any findings with respect to their own operations at that stage.

The key risk factors highlighted in this paper are just a snapshot of the conduct issues that may arise in relation to commercial claims handling. The extent to which such risk factors will be applicable to firms varies across the different business models present in the market.

What is clear is that many firms are going to need to review their business models in accordance with the FCA's Threshold Condition 2.7 and review, and if necessary, update their governance oversight, MI, controls and monitoring in respect of claims.

The fair and proportionate treatment of all general insurance customers throughout a firm's product lifecycle is key to ensuring effective mitigation of conduct risk.

As highlighted in our paper 'Striking the right balance' on the proportionate approach to conduct risk in the wholesale insurance market, successful mitigation of conduct risk such as those relating to claims handling can support strategic decision making and drive long-term profitable relationships with consumers and counterparties.

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# Contacts

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