Jersey Financial Services Commission

Themed Examination Programme 2006/7:
Client Money and Solvency Management

Introduction

Ernst & Young were appointed as agents of the Commission for the purpose of carrying out themed on-site examinations, during the last quarter of 2006, under Article 10(1) of the Financial Services Commission (Jersey) Law 1998.

Fourteen general insurance intermediaries were selected for the themed on-site examinations in relation to the management of client money and the maintenance of solvency margins.

As with all on-site examinations, a business is assessed in terms of its performance against the relevant Laws and Orders. The objective in publishing summary findings from a programme of themed examinations is to share experiences as to how different firms seek to meet the requirements of the regulatory regime and to highlight the difficulties that are sometimes encountered.

Purpose

The purpose of this paper is to summarise the key findings of the visit programme to provide assurance that insurance intermediaries are operating in compliance with the specified regulatory requirements and laws. The visit programme was designed to:

- Assess risks and related controls, policies, procedures, and processes;
- Ensure the collation of sufficient evidence to support visit findings;
- Obtain a greater understanding of the entities' activities to focus current and future visits on higher risk areas; and
- Ensure that existing information is used to direct the visit, review the resolution of any previous visit issues and obtain assurance over any deficiencies highlighted through off-site reviews.

Scope

The examinations assessed the degree of compliance with the following specific regulatory requirements:

- Articles 2 to 12 (Part 2) of the Financial Services (General Insurance Mediation Business (Client Assets)) (Jersey) Order 2005 ("GIMB Client Assets Order"); and

- Articles 12 to 15 of the Financial Services (General Insurance Mediation Business (Accounts, Audits, Reports and Solvency)) (Jersey) Order 2005 ("GIMB Accounts Order")

(Together the "GIMB Orders")

Process

A review was taken of the information and documentation held by the Commission that was relevant to the proposed scope of the examination. The staff of Ernst & Young then conducted a series of on-site examinations. Following that, draft reports were prepared which were reviewed by the intermediaries and the Commission before being finalised. The reports in their final format were issued with recommended remedial action and the timetable for the completion of the remedial action points by the individual intermediaries.

Specific areas identified as requiring attention

The following observations were compiled from the on-site visits:

- Eleven of the insurance intermediaries (79%) did not perform the general business solvency margin calculation correctly. The solvency calculation template states the Approved Assets required in accordance with Article 12 of the GIMB Accounts Order. There was some confusion from those performing the calculation as to whether audited figures, or more recently available figures, should be used in the calculation. The most recent figures available should always be used for this calculation. Brokerage income receivable, accounts receivable, cash held at an approved bank, and other figures for the captions referring to the value of liquid assets should be available from business records.

- In five cases (36%), the net brokerage income figure required for the general insurance business calculation was not being calculated on a regular basis, or a static figure was used where the insurance intermediary entity believed that 5% of annual net brokerage income would always be less than £10,000. The insurance intermediary is required to calculate the net brokerage income to ensure its relevance. Solvency of the business should be monitored and managed actively. The net brokerage income figure should be available from the management information systems.

- Eight out of the fourteen intermediaries (57%) were unaware of the requirement to perform the monthly insurance broking account margin of solvency calculations as stated in Article 14(1) of the GIMB Accounts Order.

- Ten of the fourteen insurance intermediaries (71%) were unable to produce a letter of undertaking from their bank stating that the insurance broking account will be treated in accordance with Article 7(3) of the GIMB Client Assets Order. This requirement ensures that the bank is aware that the account holds client money, and will treat it accordingly.

- Three of the insurance intermediaries (21%) did not provide terms of business to clients, or potential clients. The examination looked at the disclosure of the treatment of interest on the insurance broking account, and the risks of using an intermediary outside Jersey. Clients must be made aware of these risks, as required by Articles 10 and 7(7) of the GIMB Client Assets Order. Five of the insurance intermediaries (36%) who issued terms of business did not disclose one or both of these pieces of information to their clients. Issuing Terms of Business is the most common method of informing clients and potential clients of the salient points of the client intermediary relationship.

- The GIMB Orders stipulate that the insurance broking account bank reconciliation and the calculation of the two solvency margins occur at specified times. To prove that the reconciliation and calculations were undertaken at the appropriate time, they should be dated and signed by those carrying out the work. Four insurance intermediaries (29%) were able to prove the date of completion of all these calculations in respect of the insurance broking bank account.

- Only one insurance intermediary (0.07%) had drafted procedures governing the segregation of insurance money from business funds and margin of solvency calculations. Procedures are required as a matter of good internal governance. The creation of procedures should ensure that client assets and solvency margin calculations are treated in compliance with the GIMB Orders and industry best practice.

Overview

There was considerable confusion across the entities visited regarding the appropriate processes to adopt in order to comply with the Orders, and hopefully the reports and visits have been of some assistance in enabling registered persons to comply with the Orders reviewed.

However, the findings of the visit programme do appear to suggest that the industry, as a whole, might benefit from a review of the relevant Laws and Orders in adhering to their regulatory requirements, significantly, but not least, in the Regulatory requirement to perform the insurance broking account calculations. To assist intermediaries in performing the solvency calculations, the Commission will shortly publish guidance notes together with an Excel spreadsheet that will assist intermediaries to complete this exercise within the regulatory timeframes.

Any comments on the contents of this paper would be welcomed. We would also be happy to address any concerns or questions that the reader may have in this respect. Any such communications should be addressed to:

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