



Insured Interest

Business partners to the insurance industry

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Plugging the gaps

Some companies in the insurance industry have put in place effective internal audit procedures. Others perhaps think they have. And others might still think they have done enough by simply ticking a few boxes to keep the regulators happy. Experience shows, however, that internal audit as practised in the insurance sector may sometimes be full of holes, to the detriment of both regulatory compliance and business efficiency and security.

The FSA is now actively promoting internal audit practice in the insurance industry. It requires firms to demonstrate that the internal audit function is robust enough to challenge senior management. And it is looking for an understanding of the adequacy and effectiveness of risk management and control within firms; evidence of action taken to improve the control framework and to mitigate risk and confirmation of senior management's regard for internal audit and audit reports. In principle, all firms should consider the need for or their arrangements in respect of internal audit, at least annually.

Outsourcing and co-sourcing of the internal audit function are becoming the preferred options in the insurance industry because they provide immediate access to experts and specialists who understand the industry and who can utilise modern methodologies, tools and techniques. In addition, this option also enables benchmarking with peers in the industry.

Research shows that internal audit functions within the insurance industry rarely have a full skills set in place. And even those firms which believe they have proper internal audit procedures may benefit greatly from supplementing the skills and experience of their existing internal audit departments with additional expertise to fill the resource gap, and thereby plug the holes through which business efficiency and profitability may leak. Many Heads of Internal Audit and Audit Committees are now beginning to recognise this and the internal audit function of the future will likely consist of a broader range of skill sets, well beyond traditional financial or auditing skills biases.

A truly effective and compliant internal audit procedure needs to embrace a range of skills and experience not automatically found within an insurance business. For example, specialist knowledge of local markets and particular classes of business, language skills, financial, regulatory, corporate governance and IT expertise - this in addition to operational-related audit skills covering underwriting, reinsurance and claims issues.



There are compelling arguments in favour of outsourcing internal audit function to a truly independent specialist, with genuine international presence, which can provide these resources, and which can supplement them with extensive experience in such areas as strategic modelling, due diligence, solvency planning, business management transfer, claims inspection, litigation support, corporate governance, risk management, and stochastic modelling.

An independent internal audit can be used to challenge the company's business strategy and compliance procedures in a positive manner, and to deliver improved performance throughout. It has benefits for every part of the company's operations and provides a constructive way of bridging the gap that sometimes exists between oversight and executive management.

Many firms make the mistake of thinking they are too small to benefit from internal audit. But internal audit has nothing to do with size. Rather, it should be seen as an integral part of a prudent quality control system.

How many insurance firms can honestly say their internal audit procedures are best of breed? Traditionally, the internal audit function within insurance firms has not been especially innovative, or visionary. These days, however, it needs to be, to ensure that a company's profitability and efficiency are not being allowed to leak away through the holes in its internal systems.

Moore Stephens is currently conducting a survey on internal audit within the insurance market, holes and all, and will be in a position to share the results in due course.



Insured Interest

Are you Treating Customers Fairly?

Treating Customers Fairly (TCF) should be a priority for all firms in the insurance industry. But not all firms fully understand what TCF entails, or appreciate the systems and procedures which they must have in place to satisfy the increasingly stringent requirements of the Financial Services Authority.

The FSA has expressed its concern that principal firms are not doing enough to ensure that their Appointed Representatives (ARs) are treating customers fairly. Senior management of small firms which have ARs are ultimately accountable for the product sales and advice given to customers. They must, therefore, be in a position to ensure that all customers receive the same fair treatment. The FSA has stated in a recent guidance notice, for example, "A well-structured system of control over your ARs will provide a solid foundation, reducing the risk to your firms and to customers".

Principal firms must ensure that ARs are delivering the six TCF consumer outcomes and implement adequate competency checks. They should also be able to demonstrate that rigorous management information is in place, including - but not limited to - regular monitoring processes and suitable recruitment checks to ensure that the AR and its employees are 'Fit' and 'Proper'.

If you are interested in arranging TCF training, or would like advice in developing an Appointed Representative monitoring plan, Moore Stephens can help.

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Enter the virtual data room

Protecting confidentiality is a priority for companies engaged in mergers and acquisitions activity and in the attendant exit planning strategies required. Prospective buyers, not unreasonably, will want to take every opportunity to examine at first hand, warts and all, any business they might want to buy, particularly in the case of smaller businesses. This can lead to disruptive and invasive consequences for both the business and its staff. But there may be a solution, and one which will make the whole process quicker and more efficient.

It is now possible, with the help of a professional financial adviser, to make available to prospective buyers, via a virtual data room, all information and data relating to a possible transaction. The information is stored securely in electronic format and can be accessed, with the agreement of relevant parties, via the internet.

In this way, ordered and methodically presented information can be accessed by authorised prospective buyers via what is a virtual library of pertinent data. Prospective sellers can monitor - as well as control - activity on the site. They can see whether the information is being accessed by senior executives, for example, and can be alerted to particular items which may be attracting regular interest and which may later become major negotiating points in any deal. A simple rights management agreement can meanwhile prevent any unauthorised copying or dissemination of private information.

Virtual data rooms, used properly, help to streamline and speed up the bidding and acceptance process, and can be used to the advantage of prospective buyers and sellers alike. They can be particularly efficient when the prospective buyers and sellers are in different



countries, since all issues can be handled online. And they can be used to facilitate business in an efficient and cost-effective manner.

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Be careful who you share with

Data sharing is one of the principles upon which modern commerce flourishes. But sharing your data, inadvertently, with the wrong people, is a recipe for potential disaster. And there is compelling evidence to suggest that, in many cases, insufficient care is being taken to safeguard data, with a consequent threat to business security.

In the UK, we have had recent scares involving the loss of sensitive data by government agencies. And, in the insurance industry, we have seen Norwich Union fined £1.26m by the FSA for "failure to protect customers' confidential details" following incidents in which fraudsters used publicly available data, such as names and dates of birth, to gain confidential information from the insurer's call centres.

Examples of data security breaches are beginning to surface, with some regularity. Web-based customer service platforms, for example, pose a major potential threat, and one which the Payment Card Industry has responded to by imposing strict standards, including encryption requirements, on those who accept credit card payments by telephone or over the internet.



Data security, like all good things, begins at home. It is essential to monitor internal controls and areas of exposure to risk, to conduct regular audits, and to properly classify data. Businesses which fail to conduct these - and other - checks are not taking security seriously.

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P&I contemplates a new level of claim costs

Twelve months ago, the protection and indemnity market was pondering whether 2006 - then the worst ever in terms of International Group Pool claims - was a rogue year. Now, we know that it was not, because 2007 looks like being every bit as bad as 2006.

This is no great surprise. Suspected rogue years invariably turn out to be, instead, step changes in the ever-spiralling cost of marine claims. And the experience of 2006 and 2007 can be seen as tacit recognition of a new level of claims costs.

In some respects, the effects of 2007 will be harder to absorb than those of the previous year. In 2006, the clubs did at least have the benefit of a comparatively good year in terms of investment performance to set against poor underwriting results. This may not be the case, however, for 2007, during which the credit squeeze really began to bite.

Who, at this stage, can predict that 2008 will be better - or, for that matter, worse - than 2007? In a way, that encapsulates the advantages and the disadvantages of P&I. Underwriters must sit down in, say, October, and decide what premiums to call for next year. They must do that in the knowledge that shipping, by its very nature, is at the mercy of conditions which are outside its control. As this year has once again shown, a harsh winter in the Northern Hemisphere, where a large percentage of the world's tonnage is regularly employed, can take a heavy toll of shipping and play merry hell with underwriting calculations.

The mutual system operates differently from the commercial market. It must retain the flexibility valued by those whose interests it insures, but that flexibility is being increasingly tested by demand and by the



requirement under regulatory initiatives such as the EU Solvency 2 regime for businesses to demonstrate, upfront, that they are properly capitalised. Ultimately, P&I clubs must preserve equity between members, and bad results, like good, must be shared around.

Only the most optimistic market observer would currently predict a good year for any insurer in 2008. World trade is booming, and that is good for shipowners. But more trade means more ships, and more ships increases the probability of claims, and that is not good news for the clubs, who these days are retaining higher levels of risk individually, whether reinsured or otherwise.

It may be time to stop talking about rogue years, and to recognise instead that we have reached a new plateau. This is the world in which we now live, and operate. Welcome to it. It demands mutual respect, all round.

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Companies Act seminars

Although it is almost ten years since it was first formally proposed that company law in the UK be updated, the implementation of the Companies Act 2006 continues to be subject to considerable uncertainty.

The original intention had been to implement the entire Companies Act by October 2007. But in November 2007, the implementation of many of the changes affecting, among other things, company formation, shares and company constitutions were deferred from October 2008 to October 2009.

Similarly, detailed consultations on the impact of the Companies Act on limited liability partnerships have only recently been published.

Despite the problems, parts of the Companies Act have already come into force. In particular, many of the provisions concerning directors' duties, company

meetings, and resolutions have been in effect since October 2007. And the more optimistic among us still expect most of the accounting and audit changes to come into force in April this year.

The insurance industry will be among those watching these developments with interest. Moore Stephens is hosting two seminars, on 9 and 29 April, both at 4:00p.m., to provide an update on the latest Companies Act 2006 developments. These will be held at the Old Library at the Lloyd's Building in London. To attend, please contact shona.conacher@moorestephens.com.

Poles apart

Katarzyna Kasperek reckons the pace of life in London is much faster than that in Warsaw. But she is currently enjoying her role as part of the Moore Stephens Insurance Industry Group, which she joined in January 2007.

Kasia studied foreign trade and economics at university, before joining an accountancy practice in Warsaw. And although she misses her family and friends in Poland, she is relishing the opportunity to be part of a busy, expanding team at Moore Stephens.

Kasia spends a great deal of her time onsite at clients' offices, where she performs a variety of specialist outsourced accounting functions, including bookkeeping, balance sheet and cashflow reviews, and VAT returns. She says there is not a huge difference between accountancy practices in Poland and those in the UK, although she feels that the VAT laws in England are "more flexible, or at least not so restrictive." Most of her clients are in the insurance industry, although she has some in others areas, including the music business.

Kasia has always been a keen tennis player and regular skier. But since moving to London she has had little opportunity to pursue these activities because most of her spare time is taken up with her three-year-old son. And at the moment, she takes whatever chance she can to read English literature to enrich her vocabulary.

Who to contact

Simon Gallagher
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Stuart Markley

Personal effects: Claire Crossley



Claire Crossley is involved in what is arguably one of the fastest-growing areas of the insurance industry these days - compliance management. She joined Moore Stephens as a Compliance Consultant in the Insurance Industry Group in 2006, having previously been in charge of compliance and training for, firstly, a travel insurance provider, and then a Lloyd's broker. And she is finding that there is no shortage of work to be done.

Claire explains, "The FSA has been regulating UK insurance industry intermediaries now for three years. And while

that might suggest that some of the immediacy has gone out of regulatory compliance, the fact remains that there is still a great deal to be done, particularly since the FSA continues to bring its focus to bear on different aspects of industry practice.

"At the moment, for example, Treating Customers Fairly is very much under the spotlight, with FSA deadlines to be met this month and then in December. And the FSA has made it very clear that it wants to see evidence that customers really are being treated fairly."

The great majority of Claire's work is for insurance intermediaries, and she explains, "There is a continuing need for ongoing health-checks. Although our experience is that most brokers, for example, are in many respects in good regulatory health, it is often more a question of

their being able to demonstrate that good health to the regulators, and to show evidence of compliance.

"Our work for the insurance industry covers everything from assessing and developing internal audit programmes for brokers to designing and implementing training programmes, and other ad hoc work. We are able to put in place the procedures and programmes which might be needed to achieve regulatory compliance, and to ensure that the proper mechanism exists to provide evidence of compliance to the FSA."

Claire enjoys working as part of the Moore Stephens team. She values the support and encouragement she gets from her colleagues, and the interchange of ideas and experience which results in a complementary service to the client covering all aspects of audit and compliance.

Claire enjoys meeting up with friends when she can, but she admits that, because she is studying for her ACCA exams, most of her time these days is accounted for. Pun intended.

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The devil's dictionary

The fifteenth in a series looking at classic and alternative definitions of accountancy terms.

O is for **Off-Balance Sheet**

The textbook definition

Off-Balance Sheet (OBS) is a not fully documented accounting transaction which can potentially incur risks of loss that are not fully transparent to investors.

The alternative definition

OBS is a term for something that comes without a receipt and is likely to end in tears. It is frequently - although not often - confused with an OBE, which some people returned in disgust after The Beatles got theirs. This led those same people to ask what the difference is between a rock musician and a personal pension.

Clearly, a personal pension eventually matures and earns money. But an OBS comes with a string of liabilities. There is extensive case-law on the subject, most of it under the

Marine Insurance Act, which covers everything but marine insurance. The most famous case was a 1784 judgment in which the House of Lords held that the string of liability passed from Company A to Company B, to Company A to Company B, and back again to Company A, who passed for the lanky Chamberlain to promptly bury a thirty-yard screamer into the roof of the net. The incident led to a change in the offside law (OSL) which made it harder for women to understand men.

Most recently, evidence of the extent to which the OBS mentality has permeated the beautiful game was found in London's Senegal Fields, when Millwall supporters were heard to chant, "We got shares, We got shares, We got shares, You ain't" to a group of impoverished Blackpool followers huddled together for warmth around a cocoa tin brazier behind the away goal at the New Den. Blackpool won on penalties (Reuters).

We believe the information in Insured Interest to be correct at the time of going to press, but we cannot accept any responsibility for any loss occasioned to any person as a result of action or refraining from action as a result of any item herein.

March 2008

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