One of the benefits of the FSA’s principles-based regulation is that there are no hard and fast rules that can become elephant traps for those that take reasonable care, but sometimes miss a point of detail.

The Insurance Conduct of Business (ICOB) rules that regulate demands and needs are sufficiently broad and objective to allow scope for interpretation. Yet they are also clear enough to set boundaries that a reasonable intermediary could be expected both to understand and work within.

Despite this, it is evident from claims experience that some brokers are far from compliant.

The importance of achieving the ICOB demands and needs standards seems to be underestimated by some brokers and they risk damaging the future value of the broking sector. Why else would clients go to a broker if they did not want their skill in helping them get the best cover? It is not just about getting the best price or a case of “never mind the quality, feel the width, sir”.

The duty of a broker is, among other things, to exercise reasonable skill and care in the performance of their service. And this undoubtedly includes a duty to advise the insured of what is and what is not in their best interests when purchasing insurance – unless, of course, the broker makes it clear that they are not giving any advice.

The fact that the FSA has created the ICOB rules that sit very closely with the common law duty of care has escaped the attention of too many brokers. So it is now on the agenda of BIBA to bring this powerful combination of legal requirement and regulatory compliance to the notice of members.

“Brokers now tend to believe that they only have to be FSA compliant to be safe,” says Mark Roddis, director with Lockton International’s professional indemnity division. “This is very far from the truth. They also owe a simultaneous duty of care to their clients, for which they can be sued if they are in breach.”

In the recent case of a broker acting for a substantial UK engineering
business, the broker’s failure to use reasonable care to appreciate what the business was actually doing led to a successful claim for negligence against it. And, the sum comfortably exceeded their limit of indemnity.

The business suffered a loss caused by machinery that it had exported to South Africa and which failed to meet the buyer’s specifications. There was no cover for the claim made against the engineering company and so the broker was sued for the amount of the insured’s loss.

It was found that the broker had no demands and needs statement on file – which is a breach of ICOB 4.4.7. – there was no other documentary record showing that the broker had taken any trouble to find out anything about the

FSA regulations – covering the risk

The Insurance Conduct of Business Sourcebook makes things quite clear, says compliance consultant Branko Bjelobaba.

For example, ICOB 4.3.2 R says: In assessing the customer's demands and needs, the insurance intermediary must:

Seek such information about the customer's circumstances and objectives as might reasonably be expected to be relevant in enabling the insurance intermediary to identify the customer's requirements. This must include any facts that would affect the type of insurance recommended, such as any relevant existing insurance.

Furthermore, under ICOB 4.3.6R:

In assessing whether a non-investment insurance contract is suitable to meet a customer's demands and needs, an insurance intermediary must take into account at least the following matters:

1. Whether the level of cover is sufficient for the risks that the customer wishes to insure;
2. The cost of the contract, where this is relevant to the customer’s demands and needs, and;
3. The relevance of any exclusions, excesses, limitations or conditions in the contract.

Says Richard Bowdidge, partner with FirstCity: “Some brokers interpret “cover” (as in 1 above) to mean only the sum insured or limit of indemnity but in fact it means all the aspects of the policy that contribute to a policy that meets the insured's needs.”

“The broker must do a ‘proper’ job,” adds Mr. Bjelobaba, “which, in the end, will also lead to a compliant job.”

In principle, there are four key critical risk factors to every kind of business.

1. Who are their clients and what do their clients buy from them?
2. What are the components and skills of the company’s workforce, both employed and indirectly employed or engaged?
3. What is the underlying infrastructure of the company, i.e., how is it managed, controlled, systemised and generally bound together as an operating entity?
4. How does it earn its money and what is its financial status?

Each of these questions leads to many others. It is not possible to achieve a definitive list, but the broker should use their knowledge of insurance to dig down until they are satisfied they have the information that is needed. This is a fundamental skill of the professional broker. If an authorised insurance intermediary does not have that skill, they should not be giving advice.

What a broker takes as commission or fee is of no material consequence to their duty to comply with ICOBS...

nature of the business beyond the values required for each sum insured.

If a reasonable demands and needs assessment had been undertaken, the broker would have found out that machine parts were being sent to countries in the world beyond South Africa that would be considered politically unstable. This should have alerted them to some special insurance cover required by the insured.

The broker put forward some unsatisfactory defences to the claim, including one remarkable comment that does no credit to the industry whatsoever: “There is a limit to what a broker can do – we don’t get paid much now.”

“What a broker takes as commission or fee is of no material consequence to their duty to comply with ICOBS and exercise their duty of care in law,” says Alan Eyre, director of professional indemnity for Towergate Finch.

Roger Flaxman is BIBA’s professional indemnity consultant.