



14 September 2010

Our ref: ICAEW Rep 86/10

Your ref: CP 10/13

Trevor Cooke
Prudential Insurance Policy
Financial Services Authority
25 The North Colonnade
Canary Wharf
London E14 5HS

Dear Trevor

Tracing employers' liability insurers

The ICAEW is pleased to respond to your request for comments on *Tracing employers' liability insurers*.

Please contact me should you wish to discuss any of the points raised in the attached response.

Yours sincerely

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ICAEW REPRESENTATION

TRACING EMPLOYERS' LIABILITY INSURERS

Memorandum of comment submitted in September 2010 by ICAEW, in response to the Financial Services Authority's consultation paper 'Tracing employers' liability insurers' published in June 2010

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INTRODUCTION

1. ICAEW welcomes the opportunity to comment on the consultation paper *Tracing employers' liability insurers* published by the Financial Services Authority.

WHO WE ARE

2. ICAEW operates under a Royal Charter, working in the public interest. Its regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the Financial Reporting Council. As a world leading professional accountancy body, we provide leadership and practical support to over 134,000 members in more than 160 countries, working with governments, regulators and industry in order to ensure the highest standards are maintained. We are a founding member of the Global Accounting Alliance with over 775,000 members worldwide.
3. Our members provide financial knowledge and guidance based on the highest technical and ethical standards. They are trained to challenge people and organisations to think and act differently, to provide clarity and rigour, and so help create and sustain prosperity. We ensure these skills are constantly developed, recognised and valued.

MAJOR POINTS

Focus on auditability

4. Our main interest in responding to your consultation paper is in ensuring that the proposals around audit will deliver useful assurance. Accordingly we restrict our comments to questions which concern the audit.
5. We felt the paper should have included more discussion around the decision to include an audit requirement, so that we understand better exactly what assurance is being sought and why. However, we appreciate the fact that, following publication, the FSA convened a meeting which involved various stakeholders in insurance audits and the tracing process and provided more information. Our comments are based on the paper and our meeting with you.
6. As the case for an assurance requirement was not made in the paper or explicitly costed in the cost-benefit analysis, any proposals the FSA seeks to bring forward should be reconsulted on with an explicit cost-benefit analysis.
7. It is unclear that a requirement for external audit will bring a significant benefit to potential claimants, for the following reasons:
 - a) The Employers' Liability Register (ELR) is not a complete register as it is not required to contain pre-1999 data. Information in respect of policies before the date of the rules only has to be included on a best efforts basis. The marginal benefit of mandating assurance work over something that is by nature incomplete is likely to be slim.
 - b) The FSA rule requirements backed up with the possibility of enforcement action or skilled persons reports should be sufficient to ensure that insurers are diligent in preparing their ELR.
8. We recommend that the FSA considers using its powers under section 166 as this is the most risk-based solution. Alternatively, should the FSA decide that routine involvement of reporting accountants is necessary, agreed upon procedures will be the most appropriate approach.
9. As the terms 'audit' and 'auditor' may be interpreted as referring to the statutory audit when this is not intended, we refer below to assurance work and the reporting accountant instead. We note that in practice the statutory auditor may well be approached to perform the proposed work.

RESPONSES TO SPECIFIC QUESTIONS

Q8: Do you agree with our proposal that the ELR should be certified by a director each time it is updated and that it should be audited annually?

10. The paper includes a raft of measures that cumulatively will make it easier for potential claimants to trace their employer's insurance company, including keeping an up-to-date register. In addition, we understand that under the auspices of the Association of British Insurers, a tracing office is being set up: as their members include a large proportion of the UK's employers' liability insurers, this is likely to be useful. The Department for Work and Pensions is also considering legislation to make things easier for potential claimants to track down the relevant policy.
11. In the light of all these changes, it is unlikely that an annual assurance requirement is going to add significantly to the quality of the information available to potential claimants. For example, if the information on the employer's liability register is incomplete, it would be impossible (from a practical point of view) for auditors to establish completeness. Omissions could correctly arise when a particular employer had no liability insurance (despite the legal requirements) or was insured by another company, or incorrectly arise when the employer was insured by the company which produced the register but had been left out by mistake. Although for potential claimants the completeness of the register is especially important, it is an area where reporting accountants would not be able to give a positive opinion such as the 'properly prepared' opinion suggested in the consultation paper. Furthermore, the register would be incomplete as no data before 1999 need to be included, and only need to be included if available for the period from 1999 to 2010. This means that regardless of what assurance is given (if any) the register will only provide a partial record of employers' liability insurers for potential claimants.
12. We recognise that the involvement of an independent external reviewer may help establish whether the processes set up by the insurer are fit for purpose. Accordingly, were the FSA and insurance industry to discuss the issue further with representatives of the auditing profession, it is likely that some agreed upon procedures, which checked the processes and controls around the compilation of the employers' liability register, could be developed. These would help the directors assess whether the systems they have in place around the production of the register are appropriate.
13. An alternative approach to agreed upon procedures would be the provision of limited assurance, which would involve more work. Existing guidance exists that would provide a useful starting point for such assurance, for example in Statement on Auditing Standards No.70: Reports on the processing of transactions by service and ICAEW Technical Release AAF 01/06 Assurance reports on internal controls of service organisations made available to third parties (Appendix 1 expanded June 2009). In our view, agreed upon procedures are likely to be more appropriate than the provision of limited assurance, as we think the former will be more proportionate. We would be willing to discuss the differences between these approaches with you in more detail if that would be helpful.
14. Were agreed upon procedures to be provided, we do not agree that the annual report would be an appropriate place for the reporting accountant's findings to be published. Most users of insurers' financial statements will have any interest in the operation of the employers' liability register, so it would add length and complexity to the annual report for little benefit. The current approach taken with some regulatory returns, where the assurance is given to the directors and the information privately reported to the regulator, may be more appropriate.
15. We are aware that the FSA is currently discussing the contribution of auditors to prudential regulation (DP 10/3). In the discussion paper, the FSA reflects on how it is using its powers under section 166: we suggest they could also be used in the context of employers' liability registers. For example, if the final database appears to have fewer entries from particular

insurance companies for certain years than might be expected, and the FSA thinks they are not properly updating the register, specific investigations could be required. This would be risk-based and more proportionate than standing requirements for all firms when no particular compliance problems are anticipated. Accordingly, we recommend this as the most appropriate route for the FSA to use in ensuring that potential claimants' interests are being served by insurance companies that provide employers' liability insurance.

Q9: Do you have any comments on our proposals to allow insurers to arrange for tracing offices to make tracing information available, the requirements that would apply to insurers using a tracing office and the conditions the tracing office needs to meet of which the insurers would need to have adequate evidence?

16. Looking at the detail of the conditions auditors would be asked to comment on, we do not think reporting accountants are likely to be in the best position to assess some aspects of the tracing offices' operation. For example, the proposals include that the auditor states whether the office has responded to requests from individuals or insurers without delay. 'Without delay' is too vague a term to audit and would not in any case necessarily add value: an automated response can be sent 'without delay' but may not be especially useful to the person raising the enquiry. As far as the paper relates to customer service aspects of the tracing office, there are likely to be more cost effective methods of checking this than those in the proposals.
17. Similarly, the language around 'adequate arrangements' for information security and business continuity may create expectations gaps which assurance would not address. What level of business continuity is 'adequate' for a tracing office? A policyholder who has no need of its services may be content for insurance firms to fund a level of service that means a tracing office could be out of business for a couple of months, whilst a claimant trying to track down a policy may consider a week's suspension of service to be inadequate.
18. Again, consistent with our comments in reply to question 8, reporting accountants may be able to perform agreed upon procedures. We would be willing to enter into further discussions with you and other stakeholders as to how this might best be structured, but as they currently stand the proposals do not provide a sound platform for the delivery of useful assurance.

Q11: Do you agree with our cost assumptions?

19. There is not sufficient detail around the costs of auditing the insurers' register and auditing the tracing offices' operations in the cost-benefit analysis. As it is not clear how they have been quantified, we are unable to agree with them. We recommend that any revised assurance or agreed upon procedure requirement the FSA seeks to bring forward be reconsulted on with a supporting cost-benefit analysis.

Q12: Do you have any comments on our cost benefit analysis?

20. We note the FSA comment that the 'potential increase in legitimate claims as a result of improved search facilities will not be material enough to have a significant effect on premiums and thereby on other policyholders' (A1:4). Given the costs that will be incurred, the fact that the potential increase in valid claims is expected to be small raises concerns over the proportionality of the proposals.

Q13: Do you have any comments on our compatibility statement?

21. We reiterate our concern that the proposed requirements may in places be disproportionate, given the size of the population that is affected by problems in tracing their employer's liability insurer, the range of measures that are now being implemented to address the problems and the fact that the FSA does not expect legitimate claims to increase materially.

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