

# *Hot Topic: Employers' liability insurance registers – meeting the FSA's requirements*

## FS Regulatory Centre of Excellence 6 December 2011

### Summary

On 25 February 2011 the Financial Services Authority (FSA) published *Policy Statement (PS) 11/4 Tracing employers' liability insurers*. This PS confirms proposals consulted on in Consultation Paper (CP) 10/13 to introduce Employers' Liability Registers (ELRs) in order to help claimants trace insurers that provide commercial lines employers' liability (EL) cover.

ELRs deal only with the recording of policies entered into, renewed or for which claims are made from 1 April 2011. CP 10/13 had proposed that ELRs should cover historical policies as well but most respondents strongly objected to this proposal and FSA is to undertake further work to consider how to best address the issue of historical policies.

On 6 December 2011 FSA consulted in *Chapter 4 of CP 11/27* on rule changes to clarify the requirements regarding directors' statements and auditors' reports

over ELRs and to make other changes to the requirements.

Insurers should already have in place systems and controls to enable them to maintain their ELRs in accordance with the FSA's rules. Now that the FSA have set out their proposed reporting requirements insurers may wish to critically reassess the adequacy of those systems and controls and consider what additional processes need to be put in place to support the directors' statement on ELRs. Insurers should also engage with their auditors to discuss scope and timing of work to be performed. Overall, these requirements are likely to be quite onerous and time consuming, particularly in the first year of application.

## Who is affected by PS11/4?

Anyone carrying out UK commercial lines EL direct insurance is affected by these new requirements. This includes UK insurers, UK authorised branches of non-EEA insurers, EEA firms passporting into the UK and Lloyd's managing agents. However, the initial notification requirement applied to all general insurers including those not carrying out EL business.

## Why has the FSA made these changes?

Currently a number of potential claimants are unable to identify the relevant insurer against which to bring their claims. For example when, possibly many years after ceasing an employment, they are diagnosed with an employment-related disease, any records may have been lost or destroyed. The employer may no longer exist or may not be traceable and information about who the EL insurers were at the time of employment may not be readily available from other sources.

The introduction of ELRs is intended to support long-term structural change to the way insurers record EL information. This will ensure that, going forward, employees are able to access the relevant insurers, who provide EL cover, whenever they need. These changes are also intended to start to address the issues of historical cover by providing a comprehensive list of insurers that are liable or potentially liable for UK commercial lines EL insurance and including future claims in respect of historical policies.

## What are the new requirements?

### **Initial notification**

All general insurers should have notified FSA by 6 April 2011 whether they carry on UK commercial lines EL insurance. Those that do carry on such business must provide FSA with the internet address of the tracing office or their own web page on

which their ELR will be available together with other contact details. A director must sign the notification and state that to the best of their knowledge it is true and accurate. To date 235 insurers have notified FSA that they carry on UK commercial lines EL insurance.

### **Content of the ELR**

The following details of all EL policies entered into or renewed on or after 1 April 2012 must be recorded in the ELR:

- Policy number, inception date and end date.
- Name, address, HMRC employer reference number and Companies House reference number of all employers covered by the policy (e.g. all employers in a group where the policy is taken out by one entity in a group). The ELR must include all names by which an employer was known during the policy's life. Any trading names should be appended to the registered name.
- The name of the original insurer (which may differ from the name of the insurer preparing the ELR where, for example, the policy was assumed by way of a Part VII transfer).

For EL policies entered into or renewed between 1 April 2011 and 31 March 2012 the HMRC employer reference number and details of employers other than the principle employer are not required to be given. The other details set out above must be given to the extent the insurer holds those details.

For policies entered into or last renewed prior to 1 April 2011 where a claim is made on or after 1 April 2011 (or a previously notified claim is outstanding at that date) the policy details must be entered in the ELR to the extent the insurer holds those details. If the claim was made prior to 31 March 2012 the HMRC reference number and details of employers other than the principle employer are not required to be given even if the insurer holds that information.

The ELR should contain a statement that it does not cover policies commenced or renewed prior to 1 April 2011 where no claims have been made on or after that date. The statement must include contact details for enquiries in respect of policies not included on the ELR.

The ELR must have an effective search function. Requests for searches must be allowed from potential claimants and their representatives, employers and other insurers (or their intermediaries) potentially jointly liable for a claim. In addition, tracing offices must be allowed to access the ELR. Insurers may put in place appropriate screening on their ELRs to ensure they are being used for legitimate purposes.

### ***Updating the ELR***

Information must be made available on the ELR no later than three months from the date of policy inception, renewal or claim.

Until 1 April 2012 firms may treat the date of a claim as the date the claim was created in the firm's systems or the date it was settled by the firm, if that is how the firm's systems record claims. Information held on policies entered into or last renewed prior to 1 April 2011 in respect of which there is a claim outstanding as at 1 April 2011 must be recorded in the ELR within three months of the settlement of the claim.

The date of the initial version of the ELR must be 1 April 2011. The ELR must state the date at which it was updated and the date at which it can be relied on as being up-to-date. Even where there is no change in information the ELR must be 'updated' at least every three months.

### ***Availability of ELRs***

Insurers may either make the ELR available via their own website or, alternatively, make it available on the website of a 'tracing office' that meets the conditions set out in FSA's rules. In practice it is expected that the Employers Liability Tracing Office (ELTO) will be used by many insurers as the means to

publish their ELRs as 90% of the EL insurance market is already signed up as members of ELTO.

Where ELTO (or another tracing office) is used each insurer is not required to perform a separate assessment as to whether it meets the conditions set out in FSA's rules. However those insurers must have adequate evidence that the tracing office meets certain conditions. This evidence can comprise information produced centrally and available to all members of a tracing office.

### ***Directors' statement and auditors' report***

The FSA's rules require a directors' statement and auditors' report in respect of the ELR. The original rules contained comparatively little detail as to the form of the statement and report and, as discussed below, the FSA has in CP 11/27 brought forward more detailed proposals as to what is required.

The first directors' statement and auditors' report must be obtained by 1 July 2012 in respect of the ELR as at 1 April 2012. Subsequent statements and reports must be obtained at least annually thereafter.

## **What are the proposals FSA is consulting on in CP 11/27?**

### ***Directors' statement***

It is proposed that the directors will be required to state whether their ELR has been produced in a way that is 'materially compliant' with the rules meaning that it has an error or omission rate of less than 1%. The FSA recognise that achieving material compliance may be challenging and for some insurers may not be achievable in the short term. Where the directors are not in a position to state material compliance they should issue a qualified statement which:

- States that the register has not been produced in a way that is materially compliant with the rules and provide a description of the non-compliance.

- Quantifies the proportion of policies omitted from the register and the proportion of policies included on the register but in respect of which the information is incorrect or incomplete. Where this quantification is based on estimates the basis of estimation must be detailed.
  - Provides a description of the systems and controls used in the production of the register together with the steps, with relevant timescales, that are being taken to ensure material compliance as soon as practical.
- (i) testing a reconciliation of the number of policies on the register to the number of relevant policies in the underlying records;
  - (ii) an analysis of a representative sample of relevant claims to ensure they have been entered onto the register;
  - (iii) an analysis of a representative sample of policies on the register to ensure that the firm's data accuracy systems and controls have been applied to the information that appears, and that all required information is included and that the included information is accurate compared to the information contained in the underlying records; and
  - (iv) any other procedures agreed between the firm and the auditor as deemed necessary to be carried out by the auditor to assess the compliance by the firm with the rules tailored as appropriate to correspond to the firm's particular circumstances and the results of those procedures.

CP 11/27 clarifies that the FSA's expects all errors and omissions, including those below the 1% tolerance allowed for the purposes of the directors' statement, to be corrected as soon as they are identified.

### ***Auditors' report***

The FSA is proposing that auditors will be required to perform a limited assurance engagement under which they will opine as to whether they have found no reason to believe that the firm has not materially complied with the rule requirements in the production of its ELR. The FSA's intention is that the auditors should have particular regard to the extraction of data from the underlying records rather than on the underlying records themselves and guidance is provided as to the procedures the FSA expects auditors to undertake.

However, for the first year of reporting, the FSA is proposing a transitional arrangement under which it will be acceptable for auditors to perform an agreed-upon procedures engagement as opposed to a limited assurance engagement. Under an agreed upon procedures engagement the tests performed, and the results of those tests are reported but no opinion is expressed by the auditor. In practice we expect many insurers are likely to take advantage of this transitional provision.

Under an agreed upon procedures engagement the procedures performed by auditors will include:

For populations of less than 1,000 claims or policies, a representative sample means at least 25. For larger populations the sample size increases in proportion to the square root of the population (so a population of 4,000 will require a representative sample of at least 50 and a population of 16,000 a representative sample of at least 100). Differing methods of selecting representative samples may be used where the above approach is not considered appropriate.

No specific guidance is given as to how it should be determined when procedures other than those specified in the rules should be performed although the procedures should address the identified key risks that the ELR is not completely and accurately compiled from the underlying data.

The sample sizes and the scope of any additional procedures are likely to be a key

determinant of the scope, and therefore cost, of an auditors' agreed upon procedures engagement.

In the second and subsequent reporting years, the FSA has indicated that it will consider granting rule modifications to allow insurers to use tracing offices (e.g. ELTO) as opposed to auditors to prepare reports, provided the tracing office is independent and has sufficient appropriately qualified resources.

It is proposed that auditors' reports will be available to the insurer, the FSA and any tracing office the insurer uses.

### ***Other changes***

It is proposed that certain co-insurance arrangements (where the insurer is not the lead insurer) and excess cover arrangements (where the insurer is only

providing cover above a limit of £5m or more) will no longer be required to be recorded on ELRs. This will codify into the rules existing 'modifications by consent' that FSA has granted in these areas.

A transitional provision is proposed whereby, until 1 April 2012, firms will not be in breach of the rules if information is not included on the ELR because the insurer is unable to obtain that information from third parties.

In addition, another transitional provision is proposed whereby, until 1 April 2013, only one HMRC employer reference number is required to be included for each employer even where the employer has more than one HMRC employee reference numbers.

## Timeline

<b><i>From 1 April 2011</i></b>	Insurers set up initial ELRs (not necessarily with any policy information included) dated 1 April 2011.
<b><i>From 1 April 2011</i></b>	Insurers start to include on their ELRs information they already have (other than the HMRC reference number and details of employers other than the principle employer) for policies that, on or after 1 April 2011, are entered into, renewed or for which claims are made or are outstanding.
<b><i>By 6 April 2011</i></b>	All general insurers notify FSA of their actual or potential liability for UK commercial lines employers' liability cover, and, where applicable, the internet address of the tracing office used or their own web page and other contact details.
<b><i>By 1 July 2011</i></b>	Information must be made available on ELRs no later than three months from the date of the entry, renewal or claim. So, information for a transaction on 1 April 2011 (the first date in respect of which data is required to be included on the ELR) must be made available no later than 1 July 2011.
<b><i>From 1 July 2011</i></b>	The ELR must be updated so that the information available on it is never more than three months out of date.
<b><i>By 6 February 2012</i></b>	Responses due on amendments proposed in CP 11/27
<b><i>From 1 April 2012</i></b>	Insurers begin to obtain all information required (including information on all employers covered by EL policies and their respective HMRC reference numbers) for policies entered into or renewed from 1 April 2012 and start to make it available on their ELRs. For claims made after 1 April 2012 (unless the claim relates to a policy also entered or renewed after that date) firms provide information required to the extent that they already have it.
<b><i>By 1 July 2012</i></b>	A directors' statement and auditors' report for the ELR as at 1 April 2012 must be obtained. The auditors' report may relate to an 'agreed-upon-procedures' engagement.
<b><i>From 1 July 2012</i></b>	A directors' certificate and auditors' report for the ELR is obtained at least annually thereafter. The auditors' report must be a limited assurance report. FSA will consider granting rule modifications allowing independent tracing offices, as opposed to auditors, to prepare these reports.

## What do I need to do?

All general insurers should have made a notification to FSA by 6 April 2011 as to whether they conduct EL business.

Those insurers that conduct EL business should have built an appropriate database to record the required information and established systems and controls to capture this information. Details are required in respect of policies taken out, renewed or in respect of which a claim is received or is outstanding on or after 1 April 2011.

Insurers should have put in place procedures to allow interested parties to access their ELRs. In many cases this will be through the ELTO. The first information should have been made available by 1 July 2011.

Now that the FSA has published its detailed proposals for directors' certification insurers should be considering the processes they will put in place to support this. Consideration should be given as to whether it is expected that the directors will be in a position to certify that their register is materially compliant as at 1 April 2012. Where this is not expected to be the case the firm should consider what steps it will take to achieve material compliance as soon as practicable.

Insurers may also wish to start discussing with their auditors the scope and timing of the work that will be performed for the auditors to produce their report. In the first year of reporting this may be an 'agreed-upon-procedures' engagement.

Insurers may also wish to comment to the FSA on its proposals for directors' certification, auditors' report and other rule changes by the 6 February 2011 deadline. Areas that insurers might wish to highlight in their responses to the FSA include the potential difficulty in achieving material

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compliance over the register, the costs of compliance and tight timing for issuing directors' statements and auditors' reports.

## Contacts

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