

## How Your Delegated Claims Handling Authority (DCHA) May Lead to an FCA Fine.

SX3 has found a common weakness when auditing third party administrator (TPA) arrangements that leaves clients exposed to serious censure and fines from the FCA.

Worryingly for clients, operational performance may be fine, however the FCA have still issued multiple fines for insufficient oversight of delegated claims handling.

**Laura Phillips**, Head of Operations, SX3 enlightens the situation.

### Why the FCA pay particular attention to Delegated Authority Arrangements

The FCA believe that delegation of authority may be accompanied by a 'delegation of accountability', citing failures in managing conduct risk, not recognising delegated authority as an outsource arrangement, failures in control of outsourced functions, lack of oversight (particularly through MI) and shortcomings in complaints processes. To quote their 2015 investigation:

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*"We found that many of the firms included in our review, both insurers and intermediaries, did not appear to have adequately considered or recognised their regulatory obligations. This was both in relation to outsourcing and the functions they performed and roles they carried out in the context of these outsourced arrangements."*

*Financial Conduct Authority Delegated authority: Outsourcing in the general insurance market June 2015 TR15/7*

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Moreover, as recently as 2019, the FCA published its review of the GI distribution chain. This work revisited aspects of their 2015 review of outsourcing in the GI market. Both reports offered insight into how delegated claims are handled by the market and neither report found much to praise.

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*"Our work on the GI distribution chain has revealed the extent to which many firms have failed to respond sufficiently to our previous work and interventions, most notably our 2015 report on DA arrangements and the expectations we set out there."*

*FCA Thematic Review TR19/2 General insurance distribution chain*

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## Where Your Claims Function may be at Risk

Over recent years, insurers have developed a range of business models to meet the needs of customers. One of the key components of these models is the delegation of authority to TPAs and beyond, through sub-delegation. In consequence, supply chains have become long and complex, often with multiple parties involved in the delivery of services. This adds complexity and, therefore, increased risk to the claims process.

SX3's own insight with a wide range of insurers and TPAs show that DCHAs often aren't providing the right framework to support the relationship. The reasons we have established are wide ranging:

- The DCHA can be an addendum to delegation of underwriting authority and the focus on claims is an afterthought.
- The DCHA is written by contract teams or persons remote from the claims process, with little input and consultation between the respective claims management teams.
- Service requirements are not considered sufficiently in advance, leading to unrealistic, unachievable or (in some cases) undesired service expectations.
- MI requirements aren't stated up front and the ability to produce any required MI isn't tested during the due diligence phase

## How to Get It Right

The acid test of a DCHA is whether, by following all the stated procedures, the insurer (and by proxy the TPA) will achieve the standards expected by the FCA. Outsourcing is woven into all aspects of the FCA's expectations and there is a wide range of standards that must be met. Compliance with these is critical to the success of the DA:

**ICOB 8.1** sets out in greater detail an insurer's claims handling obligations which, in line with general principles, remain with the insurer even if claims operations are outsourced.

**PRIN 2.1** further qualifies the obligations that all firms must comply with and PRIN 2, 3, 6 & 8 are particularly relevant if there is a delegation of authority.

**SYSC:** to increase certainty by amplifying Principle 3, under which a firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems

**SM&CR:** If your firm relies on a third party for the operational functions of the firm, your firm is still fully responsible for carrying out all of its regulatory obligations. While you may outsource the function, you can't outsource accountability for this function.

At first glance, these expectations can appear daunting, although in reality the requirement to achieve these is a blend of best practice, common sense and thoroughness.

SM&CR, in particular, is clear that delegation of authority doesn't absolve the insurer of its need to maintain its regulatory obligations. In addition, any TPA entering into a DA must also understand the requirement to fulfil those obligations. There remains a 'push / pull' of responsibility between both parties and performance is reliant on both businesses having a clear understanding of what is required in terms of terms of both oversight and service delivery.



## An Expert or an Audit

The DCHA is the cornerstone for all future interactions between insurer and TPA and sets the standards to which both parties must adhere. So, when transferring authority to a TPA, the definition of where oversight and service delivery begins - and ends - must be explicitly stated in the DCHA.

A poor DCHA poses a risk that claims aren't being handled correctly or (worse) that a TPA can be fully compliant, but still fail to meet good claim handling standards.

SX3 has expertise in a wide range of outsource arrangements. When entering into a DA arrangement or health checking an existing one, SX3 experts provide insight and support.

To establish if your existing contract arrangements might have the vulnerabilities discussed above, an SX3 Audit will quickly establish the facts and identify areas for improvement.

It is better to take the initiative than find yourself being asked awkward questions by the FCA.

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Laura Phillips, is Head of Operations of SX3, a leading provider of consultancy, audit & review and resourcing services designed to meet the needs of the insurance claims processing industry. Laura has a successful track record in managing delegated claims operations, with a particular focus on audit, quality assurance, performance management and strategy across multiple lines of business.

If you would like to more information on how freelancers can help your business, please [get in touch](#) with Laura.