FINANCIAL CONDUCT AUTHORITY

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Dear CEO

Insurance Market Priorities 2023-2025

We want to update you on the FCA's priorities for the Insurance market 2023-2025, the specific risks of harm we are most concerned about and what we want firms to do about them. We are also updating you on what we are focusing on in the wholesale insurance portfolios specifically. These are 'Lloyd's and London Market Insurance Intermediaries (and Managing General Agents)' and 'Lloyd's & London Market Insurers and Others'.

The insurance market is essential to the UK economy, providing a vital service for millions of consumers and businesses. The market has 3 key sectors: personal and commercial lines insurance, wholesale insurance and life insurance. The wide variety of products and services within it includes personal and commercial lines products such as home and motor insurance that provide financial protection, wholesale products and services that price and underwrite risks from around the world, and life insurance products that invest and provide income to millions of customers before and at retirement, as well as long-term protection products.

The wholesale insurance market is a fundamental enabler to the UK and global economy allowing risks to be pooled and covered with around £55bn of Gross Written Premiums (GWP) written in 2021 alone. In personal and commercial lines markets, our 2022 FCA Financial Lives survey shows 84% of adults surveyed hold an insurance product, with over two-thirds (68%) of them reporting they always or usually shop around for these products. Life insurers manage about £2.35trn of customer assets across around 90m policies (at end 2022). The health of the UK insurance market remains significantly important to the UK economy.

As with all financial services, the insurance market has faced, and continues to face, significant challenges such as the aftereffects of COVID-19, supporting customers with cost-of-living pressures and adjusting to higher inflation and interest rates. Additionally, climate change, artificial intelligence, resourcing challenges and strains on profitability have the potential to materially increase the existing risks of harm about which we are concerned. Ensuring we have the right data to assess both current and emerging risks of harm is a key priority for us.

Our strategic objective under the Financial Services & Markets Act (FSMA) is to make financial services markets function well. A key aim for the UK insurance market is that it continues to be a successful industry that helps customers achieve their long-term financial goals and is there for consumers and companies when the worst happens. Where insurance works well, we see claims being met quickly and fairly at the time of the customer's greatest need.

However, when we take a closer look at specific areas, too often we find significant failings. For example, in the last year, we have taken supervisory action against firms where we have seen:

- the continued sale of products not providing fair value
- paying away significant amounts of commission to third parties where it was not clear how those commission levels had been assessed as being fair value
- discriminatory pricing practices
- undervaluation of motor claims
- failure to implement general insurance pricing practices rules

- weak identification of vulnerable customers
- poor business interruption claims handling, and,
- instances of very long waiting times/settlement delays.

As a regulator, we are required to comply with our statutory obligations, we do this by focusing our resources on ensuring firms achieve good outcomes for consumers to meet their needs and to ensure the market is functioning well. We expect Boards to do the same and oversee firms and ensure their objectives are in line with our priorities. While we generally see good intent from Boards, we are concerned that not enough action is being taken to ensure good outcomes. We therefore expect firms' Boards to ensure concrete, proactive action is taken throughout the firm to improve outcomes in line with our rules and expectations and not to treat them as a compliance exercise or wait for us to force action.

Market-wide priorities

While the UK insurance market covers a broad and diverse range of firms, our focus is on 4 market-wide priorities alongside sector-specific priorities under our strategic outcomes and commitments:

Setting & Testing Higher Standards

Strategy for positive change – our Environmental, Social & Governance priorities: **Governance and Culture**

Poor governance and culture in the insurance market leads directly to poor outcomes for consumers, market participants and employees and these have been key root causes of recent major conduct failings.

Firms should be able to show how they are actively working towards having a diverse workforce at all levels in their organisation. This will help firms understand customers' diverse needs and make the market an attractive career proposition for future talent. We expect firms to assess and address the drivers of culture in your firm, considering leadership, purpose, governance, and your approach to recruiting, managing and rewarding employees. We have seen encouraging market commitments in this area but remain disappointed on the general lack of progress within the market overall, especially in the wholesale market.

Minimising the impact of operational disruption: **Operational Resilience and the increasing reliance on Third Parties**

Operational resilience is the ability of firms, financial market infrastructures and the financial sector as a whole to prevent, adapt and respond to, recover and learn from operational disruption. We have recently seen incidences of a lack of operational resilience within firms to the detriment of customers and the wider market. We are particularly concerned with the level of governance, oversight and contingency planning on outsourced services where, if a problem occurs, customers suffer harm because adequate controls and contingency plans are not in place.

Our Operational Resilience Policy (PS21/3) accompanied rules and guidance. Firms had a year implementation period until the rules came into force on 31 March 2022. After that firms needed to as soon as reasonably practicable and no later than 3 years, show that they are able to remain within Impact Tolerance (ITol) in severe but plausible scenarios for their Important Business Services (IBSs). To meet this requirement firms must have scenario tested their IBSs to identify any vulnerability in their operational resilience and acted on any findings before March 2025, when the 3-year transitional period ends.

It is good practice for firms to have credible plans in place to manage and recover from operational problems, take remedial action where necessary and notify the regulators promptly as appropriate. In particular, we draw attention to the risks of cyber-attacks and the need to ensure you have adequate controls in place where information is held by third parties.

Putting consumers' needs first: **Embedding the Consumer Duty**

We have a strong focus on Consumer Duty implementation, especially in the current tough macro-economic environment – for both consumers and firms. We expect firms to assess and address issues with Products & Services, Price & Value, Consumer Understanding and Consumer Support. We also expect firms to put the consumer at the centre of their business to ensure they are delivering good consumer outcomes – both for open products and services now and in readiness for the Duty applying to closed products and services from 31 July 2024. We set out our expectations on implementing the Consumer Duty for Personal & Commercial Lines Insurance and Life Insurance earlier this year. We will consider using our range of regulatory tools to assess the effectiveness of this implementation, which may include mystery shopping exercises across different sectors.

Reducing and preventing serious harm

Improving oversight of Appointed Representatives

Many firms in the insurance market operate as principals with Appointed Representatives (ARs) to bring benefits such as supporting innovation as some firms use the model to trial new services and propositions, providing increased customer choice and driving competition by providing market access for smaller firms. However, we have seen a wide range of harms where firms operate with the AR model, as set out in our policy statement last year. Our strengthened rules, which came into force on 8 December 2022, give principals more responsibility to ensure their ARs are fit and proper. We are using data and analytics to help us identify higher risk principals and taking appropriate action on outlier firms. We will be testing that firms are properly embedding the new rules across the AR regime and increasing and improving our engagement with principal firms and other stakeholders. We expect principal firms to ensure high standards both within their firm, and at their ARs. Principals need to take steps to ensure their ARs operate within those high standards and to take assertive action with those ARs that fall below the principal firm's standards.

In addition to the Market-wide priorities, we will also be focused on wider regulatory priorities over the next 2 years. These include the Future Regulatory Framework and its impact on the Insurance market, our new secondary competitiveness objective – with particular significance for the wholesale market, and climate change risks. On the climate change risk, we encourage firms to be systematically informed about the climate change risk impact across their organisation and continually challenge inputs and outputs of the climate change models they use. Wholesale insurers can have a significant impact in driving the net zero transition and should ensure that their underwriting and investment activities are aligned with any ESG and sustainability-related public commitments that they make.

We will also be focused on the following areas in your sector.

Wholesale Insurance specific priorities

Promoting competition and positive change

***Preparing financial services for the future:* Competitiveness of the London market**

The London market is one of the largest global centres for placing large-scale, complex commercial and specialty risk. Our new secondary objective commits us to facilitating (subject to aligning with relevant international standards) international competitiveness of the economy of the UK (including the financial services sector) and growth in the medium to long term, as far as reasonably possible, when discharging our general functions. We want this market to continue developing as a hub for large commercial and specialty risk underwriters to provide critical, innovative and cost-effective solutions for the insurance needs of UK and global customers.

We expect the London market will continue to evolve by improving its efficiency and resilience. This will provide further capacity and expertise in a global insurance marketplace to secure better outcomes for all consumers. We will follow these developments through our engagement with firms and trade bodies.

We will continue to engage with the London market trade bodies when developing future proposals as well as looking at the impact of our current rules. We encourage your firm to work with your trade bodies to give feedback on how we can continue to support the growth of the London market.

Setting & Testing Higher Standards

Strategy for positive change – our Environmental, Social & Governance priorities: Governance, culture, and non-financial misconduct

All insurance firms should reflect on their culture. However, the wholesale insurance market in particular has a long way to go in having an inclusive culture with the appropriate channels for staff to feel psychologically safe to speak up and raise concerns. This is especially important where tolerance of such behaviours can create or indicate unsafe or unhealthy cultures. Areas for improvement include diversity, equity and inclusion (DEI) at all levels. They also include preventing and handling non-financial misconduct, including discrimination, harassment, victimisation and bullying. We previously wrote to wholesale insurance firms about this in 2020 and many firms were focusing on this area before the pandemic. But over the past year we have seen a concerning increase in incidents involving non-financial misconduct that have been reported in the wholesale market.

We know that a sizeable portion of firms have taken steps to tackle these issues. However, despite our emphasising the importance of this in previous letters, firms have generally not been prioritising these issues. Some have claimed it will take a generation to fix as an excuse for not taking action now.

We are ready to use our full range of regulatory tools, including enforcement action, against firms and individuals where we see instances of non-financial misconduct. Firms must report instances of serious non-financial misconduct to us promptly and ensure appropriate systems and controls are in place to deal with such misconduct. We will work to support and improve standards of behaviour in firms and hold senior managers to account for their firm's cultures. We expect firms to be ready to show us how they are making progress in this area. We will soon be holding a new round of conversations with non-executive directors on their firms' approach to culture and non-financial misconduct.

Minimising the impact of operational disruption: Operational resilience

Good operational resilience is important for the London market, given it is a highly integrated market. As the London market holds a great amount of information on sensitive risks in the UK, data losses could pose substantial harm to wider society.

When incidents occur, we want to see firms proactively demonstrate accountability, a culture of resilience, effective intervention and resolution. As noted in our market-wide section, firms should have credible operational resilience plans in place and meet our expectations set in PS21/3.

We are using a data-led approach to identify instances of operational disruptions. We want to see firms reporting incidents in a timely and transparent manner as we believe they are largely under reported. Firms must report to us when an operational incident has occurred. We expect firms to continue proactively managing operational resilience exposure and take steps to address any gaps within their operational resilience arrangements. Dependent on incident, and using the data we receive, we will take action where we see incidents and track outlier firms for closer scrutiny.

Putting consumers' needs first: Cyber insurance

Cyber insurance is a rapidly growing product line which is estimated to grow globally from \$16.7bn in direct written premiums in 2022 to \$33.4bn in 2027. It is a critical risk management and crisis recovery tool for many businesses, big and small. With cyber-attacks on the rise, we are concerned that uncertain cyber policy wordings may result in firms not meeting their customers' needs. We want to see a cyber insurance market where firms can demonstrate that customers buy products that meet their needs and provide value, to avoid misalignment between customer expectations and policy outcome.

Firms offering cyber insurance must make sure their policy wordings are clear and that customers understand the coverage they are buying. We also expect firms to manage cyber claims handling in a fair and timely way. We encourage the market to continue improving their knowledge of cyber risk so firms will have sufficient expertise, including at Board and second/third line of defence level, to understand the risks involved with cyber insurance underwriting and ensure appropriate product oversight. We will continue monitoring the cyber insurance market and take action on firms we deem to be outliers.

Putting consumers' needs first: Embedding the Consumer Duty

The Consumer Duty applies to all firms in the wholesale insurance market who can determine or have material influence over retail customer outcomes, even if they do not have a direct relationship with retail customers. The scope of the Duty follows our Insurance Conduct of Business Sourcebook (ICOBS). So 'retail customers' are current or prospective policyholders who are either consumers, or commercial customers (SMEs). This is subject to certain exclusions, such as contracts of large risks for commercial customers and reinsurance. All insurers (other than where an exemption applies for example in relation to reinsurers and large risks) should already be meeting our product governance and pricing rules under PROD 4 which continues to apply. PROD 4 also applies to general insurance and pure protection insurance in relation to legacy non-investment insurance. Firms meeting these rules will be meeting the requirements of the Consumer Duty's products and services, and price and value outcomes.

We have seen evidence in our data of high commission rates and poor practices in the wholesale insurance market. Such practices are not consistent with driving fair value and good outcomes to the end retail customer. For example, in our review of broker remuneration in multi-occupancy buildings insurance, we found that absolute levels of remuneration, including commissions, had risen by nearly 40% between 2019 and 2022. Firms need to do better in justifying how their commission levels are appropriate for the price all retail customers pay under the Consumer Duty.

Firms must consider the end retail consumer in the distribution chain when designing or distributing a product and assessing fair value – even if firms do not have a direct relationship with them. For example, evidence of robust fair value assessment could be reducing commission levels for products or withdrawing those failing such assessments from the market. Firms will also need to meet the Consumer Duty's consumer understanding and support outcomes, where applicable to their business, for example the support outcome applies to wholesale firms where they provide support to retail consumers. We remind firms that they must handle claims fairly and promptly. Our claims handling lessons learned from business interruption insurance set out examples of good practice and areas of improvement for all firms, whatever their product line, to consider.

We expect to see wholesale insurance firms that can determine or have material influence over retail customers to embed the Consumer Duty into their business so these customers achieve good outcomes. Through our data-led approach, we will use our supervisory and enforcement powers to act where we see evidence of poor outcomes for retail customers.

Reducing and preventing serious harm

Reducing and preventing financial crime: Financial crime

We continue to see financial crime problems across the wholesale insurance market, particularly due to the rapid imposition of sanctions from the war in Ukraine.

Wholesale insurance firms have an increased risk of financial crime due to the international nature of business and increased exposure to politically exposed persons. Intermediaries with poor anti-bribery and corruption controls and insurers with poor sanction controls will increase this risk.

We expect firms to have robust and effectively implemented policies, procedures, systems and controls to detect, prevent and combat financial crime. We will act where we receive data or intelligence of incidents of suspected financial crime, or of firms without appropriate financial crime controls.

Reducing harm from firm failure: **Prudential risk to debt servicing**

This risk only applies to wholesale insurance intermediaries, including traditional London Market brokers, Managing General Agents, service companies, consolidators, and Lloyd's Members' Agents.

In the past few years, we've seen significant mergers and acquisitions activity in the wholesale intermediary market. With higher interest rates, the cost of financing could increase in the future. If firms are highly leveraged with material amounts of debt, there is a risk of severe liquidity problems if they cannot service this debt.

We expect to see firms having adequate financial resources to satisfy threshold conditions and to service debt over time, even under stressed scenarios. Firms should conduct realistic stress-testing, regularly review and update their wind-down plan and have strong arrangements in place to protect their clients. That includes safeguarding clients' money. Firms should consider our recently published findings from our multi-firm review on assessing liquidity for orderly wind-down.

We use a data-led approach to assess firms' financial positions through our reviews of the regular prudential returns. We will continue monitoring data trends from regulatory returns alongside the continued mergers and acquisitions in the insurance market and take action on any outlier firms we identify.

Action for firms

You are responsible for making sure that your firm meets our requirements including the obligations and expectations set out above. You should take all necessary action to ensure these are met and that you are prepared for the additional relevant requirements that the Consumer Duty bring to these areas of priority. We will use the Senior Managers & Certification Regime to engage directly with accountable individuals on areas of concern.

A significant part of our work over the next 2 years will be to test firms against our priorities and expectations. We will also continue to use data to identify outliers and, where firms are not meeting our rules and expectations, we will take action.

If you have any questions, please contact your normal supervisory contact or call us on 0300 500 0597. This is the primary point of contact for your firm's day-to-day interactions with the FCA. Our website has further details of how to contact us.

However, we know there may be occasions when your firm faces urgent issues of strategic importance. In such significant circumstance please contact the Head of Department responsible for the wholesale insurance portfolios, Caroline Gardner, at Caroline.Gardner@fca.org.uk.

Yours sincerely,

Matt Brewis
Director of Insurance
Supervision, Policy & Competition – Consumers & Competition