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May 2025 update:
This letter is historical. See our supervisory correspondence page for more information and current views.

23 November 2020

Dear CEO

FCA Supervision Strategy for Lloyd's & London Market Insurers and Others (LLM).

We are writing to:

1. Set out our view of the key potential risks of harm to your customers or the markets you operate in, which are posed by firms in the FCA's Lloyd's and London Market Insurers Portfolio.

2. Outline our expectation of you and your firm, including how you should be mitigating these risks of harm.

3. Allow you to consider the degree to which your firm presents such risks and your strategies for mitigating them.

When we have contact with your firm, we will expect you to be able to explain what you did in response to this letter.

Changes to how we supervise your firm

On 24 April 2019, we published our revised Approach to Supervision, which sets out the purpose of, and our approach to, supervising firms and individuals. This document builds on Our Mission explaining how we supervise nearly 60,000 firms serving retail and wholesale consumers.

We are grouping firms with similar business models into at least 1 of approximately 40 portfolios. Your firm has been assigned to the Lloyd's and London Market Insurers Portfolio which covers Lloyd's & London market insurers, re-insurers, P&I clubs and run-off firms. Letters like this are being made available to all firms in each portfolio.

We are developing a series of supervisory strategies for each portfolio which allow us to monitor all firms effectively, and target those firms that pose the greatest risk of harm. We will be proactively looking for indicators of high risk firms for each area of harm outlined, and expect to undertake additional testing of these risks with these outlier firms. Where we conclude that firms, and/or individuals, are not meeting our expectations, we will act.

Our objective

Our overarching aim in supervising LLM firms is to enable the provision of a wholesale market that works well for its participants and customers and preserves the integrity of the markets.

We understand these are extraordinary times for firms during the coronavirus (Covid-19) pandemic, bringing challenges to their business models that many may not have anticipated. Despite these challenges and pressures, we still expect firms to behave ethically and responsibly in the way they treat their customers, their employees and their counterparties. We believe we have provided sufficient information to help firms meet this objective. This includes our:

- Business Interruption Insurance Test Case related communications including a Dear CEO letter and guidance on how we expect insurance firms to handle claims and complaints for business interruption policies
- Other coronavirus insurance related guidance
- Wholesale Insurance Broker Market Study which identified some areas of concern in relation to conflicts of interest, the information firms disclose to clients and certain specific contractual agreements between brokers and insurers

We are aware that we are issuing this letter while the final outcome of our Business Interruption Insurance Test Case is uncertain. On 15 September, the High Court handed down its judgment in the case. The FCA, one intervener and 6 insurers have all filed applications at the Supreme Court for permission to appeal. For those aspects of the case which are not being appealed and where the High Court judgment amounts to final resolution of those aspects, firms are expected to apply the judgment to affected claims and complaints. We will take the judgment into account when looking at whether insurers are handling claims for any resolved aspects fairly. For all other aspects, firms will need to consider our Dear CEO letter and the test case guidance when taking any actions for business interruption claims and complaints, and keep informed of developments pending conclusion of the case.

We also want firms to innovate, both individually and collaboratively, to create and maintain healthy competition, efficient distribution chains, good claims services and better use of data. The Society of Lloyds' blueprint for the Future of Lloyd's is one example of a modernisation initiative, already being undertaken (by relevant sections of the market), as it seeks to improve ways of working, with a heightened focus on digital, data and technology to deliver greater benefits to its customers. The risk of dysfunctionality, or from firms failing to engage in modernising the wholesale market, could lead to the market failing to improve, pose risks to market integrity and create harm to policyholders.

These improvements must be underpinned by a healthy culture in the market place, especially targeting the elimination of non-financial misconduct, as well as actively boosting diversity, inclusion and openness. We have written separately to all firms in this portfolio on the issue of non-financial misconduct, setting out our clear expectations and approach. You should read that letter carefully alongside this and ensure you have taken prompt steps to identify and address any shortcomings.

Our view of the key causes of potential harm

Firms in this portfolio are diverse, both in terms of size and business models: in addition to traditional London market insurers, the portfolio includes reinsurers, run-off firms and P&I clubs. Despite this, we have identified 3 key common potential drivers of harm to consumers and the markets and we will prioritise our supervisory work in these areas:

1. ineffective governance and oversight - which can impact all areas of a firm and result in customers being sold unsuitable products or receiving poor claims outcomes (directly or through delegated authority), or in run-off claims not being settled in a timely manner or fairly

2. culture and non-financial misconduct: a failure to confront poor culture - which leads to examples of bullying, discrimination and bias in all aspects of firms' activity

3. inefficient and poorly controlled general insurance distribution chains - which have been a source of substantial and persistent harm to customers in some parts of the insurance market

Governance and oversight

Good governance is central to the effective running of any financial institution. Some critical components of good governance include:

- clear accountabilities for those activities which affect outcomes with appropriate delegation and escalation

- a robust risk framework in which key risks of harm are identified, monitored and mitigated by accountable individuals

- strong and independent board oversight and challenge of key decision-making

Many of the key harms we have seen in the portfolio can be directly linked back to poor governance.

The Senior Managers and Certification Regime (SM&CR) came into effect for insurers on 10 December 2018. It aims to reduce harm to consumers and strengthen market integrity by creating clear accountabilities and standards for individual behaviour. It requires firms to be clear on individual responsibilities of senior managers and requires those senior managers to take responsibility not just for their own actions but for what happens in their areas of responsibility.

We will assess how firms have implemented and embedded the SM&CR. This work will involve us reviewing how firms have identified, assigned and documented senior managers' responsibilities. The SM&CR will help us to take a more interventionist approach if we see failings in future. We will hold senior managers accountable for the harms we identify. But we recognise that issues will always occur even in the best run firms. So we expect senior managers not just to take reasonable steps to prevent issues but also to act quickly and effectively to address and remediate when things go wrong. We will consider taking robust action, for long standing issues that remain unresolved despite our repeated engagement with firms (for example, poor Employers Liability insurance tracing procedures).

Lack of effective governance and oversight may lead to claims not being handled promptly and fairly, which means customers suffer financial detriment. This is relevant in both 'live' and run-off businesses. We are already carrying out extensive analysis to establish how firms are dealing with claims arising from the current pandemic. We also plan to carry out an in-depth review to assess run-off claims handling. This will consider the claims service and experience that customers of books of business in run-off receive, with a focus on retail/ SME policyholders or beneficiaries. Where we find poor outcomes in either case, we will use the SM&CR to hold senior managers accountable. You should now have completed your training of all your staff on our Conduct Rules and your staff should now understand how the Conduct Rules apply to them. We will challenge the adequacy of training programmes which adopt a one-size fits all process resulting in poor understanding of the relevance of rules to specific roles.

Culture and non-financial misconduct

We expect firms' culture and governance to drive good behaviours and produce fair outcomes, and for individuals to be accountable for their actions.

The Dear CEO letter published on 6 January 2020 drew attention to these important issues. Firms' cultures shape the outcomes for consumers and markets. Poor culture in financial services is a root cause of the major conduct failings that have occurred within the financial services industry in recent history, causing harm to both consumers and markets and we believe that a lack of diversity and a lack of inclusiveness at all levels within firms can lead to a poor culture.

We recognise that some firms have been taking steps to tackle these issues and we have been encouraged by some of the commitment we have seen in this area. However, these are often widespread and embedded cultural issues which will require considerable and consistent commitment to address at all levels of the organisation. We expect you to assess and address the drivers of culture in your firm, considering: leadership, purpose, governance and your approach to recruiting, managing and rewarding employees. Through our supervision of the industry, we will work to support and improve standards of behaviour in financial services firms and hold firms and senior managers to account for their cultures.

We would remind firms in this portfolio of our previous Discussion Paper on Transforming Culture in Financial Services, published in March 2018. We expect all firms to be able to show how they have incorporated it into their thinking on culture within their business and to demonstrate that they are working in the interests of consumers and the market.

General insurance distribution chain

We have identified a significant potential harm around the sale of products that could cause harm to customers, either directly or through delegated authorities. Firms will need to ensure they are meeting their obligations under our rules including our requirements implementing the Insurance Distribution Directive (the IDD). These requirements seek to deliver clear, fair outcomes for consumers, focusing on customers being better informed and firms providing products which meet their needs. We expect all firms to have implemented and embedded the requirements. However, we have seen evidence within the portfolio, that where business models employ elongated distribution chains, then product oversight is poor both in design and purpose. This could in turn, result in products that are poor value being distributed and cause direct customer harm.

We will continue our thematic work on GI distribution chains and expect all firms to address the risk of products of poor value being sold to customers, including the concerns identified in our thematic report 'General insurance distribution chain' (TR19/2). We expect all firms to have robust controls for sales and renewals arrangements, management of conflicts of interest and oversight of distribution arrangements.

Our Finalised Guidance 'The GI distribution chain: Guidance for insurance product manufacturers and distributors' (FG 19/5) published in November 2019, provides further clarity on our expectations of how firms should consider product value to the end customer and the impact the distribution arrangement has on product value.

Other areas of risk

The below areas will also be considered in our supervisory strategy and we expect you to act to address any gaps you identify:

- **Employers Liability insurance tracing procedures**

We have seen insufficient progress on meeting Employers Liability tracing obligations in some firms and will focus on how firms respond to findings from the annual independent audit of their liability register. While in response to the coronavirus pandemic (see 'Changes to regulatory reporting during coronavirus') we allow firms not to submit their Employers' Liability Register compliance return for 2020, we still expect firms to ensure that their Employers' Liability Register is accurate and up to date. Firms must also comply with ICOBS 8.4 (Employers Liability Insurance). Where firms have repeatedly failed to address shortcomings in their arrangements and oversight, or show significant deficiencies in this area, we will seek to use the full range of regulatory tools available to us. This includes holding relevant senior managers accountable under SM&CR for the remediation of outstanding issues.

- **Cyber risk and operational resilience**

The risk of harm to consumers and to market integrity from more frequent and widespread cyber-attacks is potentially exacerbated when using complex and ageing IT systems, by the outsourcing of operations, the growing transfer of data between firms and from the current remote working arrangements implemented in response to the pandemic. Third-party failures or weak controls can also lead to operational disruption, unauthorised losses or disclosure of consumer data.

Firms are expected to take into account existing requirements when addressing cyber and operational risk frameworks. We would also draw firms' attention to the papers we have published on operational resilience and cyber security.

- **Hardening market**

In many lines of business, we are aware of evidence of a hardening market. Where this is the case we expect insurers and intermediaries to work together to explain to clients why their premium may be rising, while available cover may be reducing. Inadequate insurance coverage poses harm for customers. And we have seen from our work on business interruption insurance that the meaning of terms and the consequent effects for coverage in policies are unclear for many customers. Firms need to ensure they are meeting their obligations under our rules. This includes requirements on assessing customers' demands and needs, product governance and oversight, acting honestly, fairly and professionally in the customer's best interest and providing appropriate product information to address the risk of customer harm that may arise from a hardening market.

EU withdrawal

The UK left the EU with a Withdrawal Agreement on 31 January 2020 and entered a transition period, during which it will negotiate its future relationship with the EU. The transition period is due to operate until 31 December 2020. At the end of the transition period, EU law will no longer apply directly in the UK and passporting in its current form will end.

You should make sure you understand how the end of the transition period will affect you and your customers, and what action you may need to take to be ready for 1 January 2021. Visit our website for information on Brexit, including what the transition period means.

Next steps

If you have any questions please contact your normal supervisory contact on 0300 500 0597. This is the primary point of contact for your firm's day-to-day interactions with the FCA, and further details of how we can be reached are available on our website at https://www.fca.org.uk/contact.

However, we recognise that there may be occasions in which your firm faces urgent issues of strategic importance. In such a significant circumstance, please contact me on 0207 066 0414, or at Charlotte.Cross@fca.org.uk.

Yours sincerely

Charlotte Cross

Head of Wholesale General Insurance