FINANCIAL CONDUCT AUTHORITY

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Dear CEO

FCA Supervision Strategy for Lloyd's & London Market Intermediaries and Managing General Agents (LLMI)

This letter:

1. sets out our view of the key 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 Intermediaries (& Managing General Agents) Portfolio

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

3. allows you to consider to what extent your firm presents such risks and your strategies for mitigating them

When we contact 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 Intermediaries (& Managing General Agents) Portfolio. Letters like this are being made available to all firms in each portfolio.

We are developing a series of supervisory strategies for each portfolio. These 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 in 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.

The supervision strategy in this letter covers the period to November 2021.

Our objective

Our overarching aim in supervising LLMI firms is to enable 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 Covid-19 pandemic, bringing challenges to business models that many may not have anticipated. We expect firms' models to remain financially resilient during this period and for firms to continue to meet our prudential rules, and our threshold condition on adequate financial resources. If a firm is not able to, you must disclose this to the FCA at the earliest opportunity and ensure you have plans to wind down the firm in an orderly fashion to minimise any potential harms to customers from a firm's failure.

We want firms to behave ethically and responsibly in the way they treat their customers, their employees and their counterparties. We believe that we have provided sufficient information to help them do so. For example, our Wholesale Insurance Broker Market Study identified certain areas warranting further action, including conflicts of interest emanating from remuneration practices that intermediaries in the distribution chain employ. We also recognise that the market requires modernisation and careful monitoring to ensure that the interaction between brokers and underwriting capacity does not become dysfunctional.

We believe that firms need to innovate, both individually and collaboratively, to create and maintain healthy competition, efficient distribution chains, good claims services and better use of data.

These improvements must be underpinned by a healthy culture in the market place, especially targeting the elimination of non-financial misconduct, and actively boosting diversity, inclusion and openness. We have written separately to all firms on the issue of non-financial misconduct in firms in this portfolio, 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 drivers of harm

Firms in this portfolio are diverse, both in terms of size and business models. In addition to traditional London market intermediaries, the portfolio includes: managing general agents, consolidators, service companies and Lloyd's member agents. Despite this, we have identified common themes in drivers of harm across firms against which we will prioritise our supervisory work:

1. Financial Resilience and Orderly Wind down
2. Ineffective Governance and Oversight of businesses
3. Culture and Non-Financial Misconduct
4. Business Models which provide poor oversight of distribution chains

Financial resilience and orderly wind down

As the prudential regulator for firms in this portfolio, we remain vigilant for the harms posed by firms who fail to meet our capital requirements under MIPRU and our threshold conditions for authorisation to maintain appropriate and adequate financial resources. Further, we recognise the significant challenges that many firms continue to face as a result of the disruption arising from the Covid-19 pandemic. To aid our understanding of these challenges we recently invited firms in this portfolio to complete a short survey on the pandemic's impact on firms' financial resilience and you will be receiving a follow up survey shortly. We are aware that many firms have been forced to operate in a very different manner with most or all staff working from home, with the attendant challenges that such arrangements bring for many people. We also believe those firms that have put their customers at the heart of their business model will prosper and emerge from the crisis in a positive position.

As a general approach, we expect all firms to ensure that they review for relevance and impact any material developments that could affect a business model, including significant changes in market or economic conditions. This is to ensure that firms can continue to meet our capital requirements under MIPRU 3 and Threshold Condition 2.4. You should be aware that these requirements include having appropriate PII cover. We also expect firms to disclose these developments to the FCA at the earliest opportunity if they result in them not meeting our capital requirements and threshold conditions.

On 17 April 2020, we updated our guidance on 'FCA expectations on financial resilience for FCA solo-regulated firms', first published on our website on 26 March 2020. The guidance includes these key messages:

- During this time of stress, we expect firms to plan ahead and ensure they manage their financial resources soundly. This means taking appropriate steps to conserve capital, and to plan for how to meet potential demands on liquidity.

- If a firm needs to exit the market, it should plan ahead and consider how to achieve this in an orderly way by taking steps to reduce the harm to both consumers and markets. Firms should maintain an up-to-date wind-down plan that takes into consideration the current market impact of Covid-19.

- If a firm is concerned it will be unable to meet its capital requirements, its debts as they fall due, or if its wind-down plan has identified the potential for customer harm, it should contact the FCA (or its named FCA supervisor), with its plan for the immediate period ahead.

In a wind-down situation, firms must continue to meet our Rules and Principles, including those relating to Customers' Interests (Principle 6), Communication with clients (Principle 7), Clients' assets (Principle 10) and Relations with regulators (Principle 11). Arrangements for the orderly continued provision of service to a firm's customers are of paramount importance. This applies whether transferring customers to another regulated firm or arranging for another party in the distribution chain, such as the underlying insurer itself, to handle ongoing, routine servicing and renewal of policies.

Governance and Oversight

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

Good governance is central to the effective running of any financial institution and is a key driver of culture. 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 accountable individuals identify, monitor and mitigate key risks of harm
- strong and independent Board oversight and challenge

The Senior Managers & Certification Regime (SM&CR) aims to reduce harm to consumers and strengthen market integrity, by ensuring 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 responsibilities. Since 9 December 2019, it presents a unique opportunity to set a new standard of personal conduct for everyone working in financial services. It will allow us to take a more interventionist approach if we see failings in the future.

During this regulatory period, we will assess how firms have implemented and embedded SM&CR. We will review how firms have identified, assigned and documented Senior Managers' responsibilities. We will hold senior managers accountable for the harms we identify; we recognise that issues will always occur even in the best-run firms. We therefore 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.

You will be aware that the FCA asked the Treasury for a delay to the start date of the Certification Regime until 31 March 2021. We published a consultation paper (CP20/10) proposing to delay the start date of the Conduct Rules for all financial services staff and the deadline for submitting data on directory persons, also to 31 March 2021.

The Treasury has now made the necessary statutory instrument and we have received positive feedback on our consultation. We will publish a Policy Statement in due course. This delay gives firms significantly affected by the coronavirus pandemic (Covid-19) time to make the changes they need. We do, however, believe that most firms will be able to meet the original deadlines and we encourage them to do so.

These changes will provide extra time for firms that need it and enable them to deliver effective training on the Conduct Rules and to perform fit and proper assessments of certified staff to a high standard. The proposals seek to reduce the burden to firms affected by the pandemic, while ensuring that regulatory standards and consumer protection are upheld.

Your firm has until the agreed deadline to ensure all staff in Certified roles are fit and proper to perform their roles. A Senior Manager must be identified as having individual responsibility for ensuring your firm carries out proper assessments of Certified staff. But all your senior management need to take ownership for ensuring that robust arrangements are in place for having the right people, with the right skills and expertise, performing key roles in the areas they are responsible for.

Staff who do not meet fit and proper standards must not be certified, and firms mustn't assume someone is fit and proper just because the individual had been approved by the FCA or indeed the FSA at some point in the past. The Certification Regime places the responsibility on firms to make sure the people performing these roles are suitable to do their jobs, rather than relying on the regulator for pre-approval.

We expect firms to make proper assessments of certification staff both now and in the future, ensuring that the fit and proper test is integrated into firms' people management processes. Certification connects to almost every stage of the people management process for affected staff, including recruitment, performance management, training and development, exit and disciplinary processes, on an ongoing basis. Firms that do not integrate certification into these processes are unlikely to be able to operate certification effectively.

We anticipate that in firms with large numbers of certification staff, some individuals will not meet these standards. Firms should remove staff who are not fit and proper from certified roles.

We will be monitoring processes and outcomes and engaging robustly with firms and the relevant Senior Managers.

Senior Managers and Certified staff should already have been trained on our Conduct Rules; your firm also has until the agreed deadline to train its other staff. This training must ensure that staff 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.

We have published positive and negative indicators for Fit and Proper assessments and for Conduct Rules training.

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 sets the FCA's expectations for this area. 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.

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 therefore expect you to assess and address the drivers of culture in your firm, considering: leadership, purpose, governance and your approach to managing employees, including how they are remunerated and trained. 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 remind firms of our previous Discussion Paper on Transforming Culture in Financial Services in March 2018. Firms need 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.

Business models - General insurance (GI) distribution chain

We are supportive of initiatives to modernise the market and improve the way that the market and business models work for all participants and customers. The Society of Lloyds' blueprint for the Future of Lloyd's is an example of an attempt at modernisation already being undertaken (by 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 UK implementation of the Insurance Distribution Directive (IDD) in October 2018 sought 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 where business models employ elongated distribution chains, with poor product oversight both in design and purpose. This could, in turn, result in poor-value products being distributed and cause direct customer harm.

We will continue our thematic work on GI distribution chains and expect all firms to work to address poor-value products being sold to customers, including the concerns identified in our thematic report (TR19/2). We expect all firms to have robust controls for sales and renewals arrangements, managing conflicts of interest and overseeing Appointed Representatives.

Our Finalised Guidance (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 areas below will also be considered in our supervisory strategy and we expect you to act to address any gaps you identify.

- **Cyber risk and operational resilience**

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

Firms should prepare for, and manage their responses to, these incidents considering the needs of those affected, including customers. Firms are expected to take into account existing FCA guidance when addressing cyber and operational risk frameworks. We will also draw firms' attention to the papers we have published on operational resilience and cyber security.

- **Hardening market**

In certain lines of business, we are aware of evidence of a hardening market. Where this is the case, the intermediated market will need to (re)acquire the skills to explain and educate clients about why their premium is rising, while cover may reduce. We understand some intermediaries have been active in addressing this issue, but we remind firms that inadequate insurance coverage is a potential outcome of a hardening market and poses harm for customers; firms will need to ensure they are meeting their obligations under our rules (when providing cover). This includes requirements on assessing customer demands and needs, product oversight and governance, 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, which is due to operate until 31 December 2020. Passporting will end with the end of the transition period. Firms should assess the impact on them and their customers, and ensure they are ready. For information on Brexit, including preparation for what the end of the transition period means, visit our website.

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; 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 when 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