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

28 September 2021

Dear CEO

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

We wrote to you in November 2020 setting out our view of the key risks of harm LLM insurers posed to their consumers and the markets in which they operate. While we have seen improvements in some areas, we remain of the view that there are risks of harm that both the market and individual firms within the portfolio need to address. In this letter, we:

1. Provide an updated view of the key risks of harm LLM insurers pose.

2. Outline our expectations of you and your firms, including how you should be mitigating these harms.

3. Provide an overview of our supervisory strategy and programme of work to ensure that firms are meeting our expectations, and harms are being appropriately remedied.

We expect you to consider the degree to which your firm presents such risks and review your strategies for mitigating them. We expect firms to be able to demonstrate the steps being taken to address the risks we cover in this letter.

Our objective

In our previous letter, we stated that our overarching aim in supervising LLM firms is to enable the provision of a wholesale market that works well for its participants, customers, and consumers and preserves the integrity of the markets. This is still our aim.

More specifically, we want the wholesale market to support itself to do the right thing, firms to embrace the spirit of regulation, and put the end-customer at the heart of their business model; for example, by having appropriate product governance and oversight of their distribution chain to provide products that meet customers' demands and needs.

We want firms to learn from their mistakes, such as the market's initial handling of business interruption insurance claims and find a market solution to market issues. Our website provides a wealth of information around guidance and supervisory expectations, with a recent example being our update on general insurance product value and pandemic guidance.

We expect you to monitor our website and take into account any information relevant to your business that we publish.

We are aware of several ongoing initiatives led by the Lloyd's Market Association and the International Underwriting Association to simplify and clarify contract wordings – we welcome these types of initiatives where they will lead to positive customer outcomes.
We see the effective implementation of regulatory changes, such as the incoming pricing practices rules, as fundamental to ensuring the general insurance market treats consumers fairly and that consumers purchase products that meet their needs.

Our view of the portfolio and key risks of harm

Through its collective expertise, the market plays a crucial role in insuring complex risks across the world. As a result of the complexity of some of the risks underwritten in the London market and of the complexity of distribution chains, some issues, such as lack of contract clarity are more prevalent in the London market than in the personal lines and commercial market.

The insurance sector, alongside the financial services industry, has faced significant challenges in the past year as a result of the pandemic and EU Withdrawal.

Despite these challenges, firms in the portfolio have generally proved to be operationally resilient, adapting to the operational demands of home working, onshoring services at pace and some responding to consumers' changing needs.

The wholesale insurance market has made some progress towards delivering good outcomes for customers, for example in relation to how they considered the expectations set out in our guidance in our pandemic related work. We also recognise the industry's commitment and actions to date on driving change and reducing the impact of climate change.

However, in terms of our expectations of the treatment of customers, our view is that firms in the portfolio have not embraced some of our key messages (for example around firm culture and purpose) or kept up with the pace of regulatory change.

Although some progress has been made on diversity, the industry still has a long way to go, both as employers and in serving the diverse needs of customers.

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 believe that the risks of harm we have identified apply to most firms in the portfolio.

Below we outline what we consider to be the key harms for consumers and the market. We outline our expectations of LLM insurers alongside our planned supervisory strategy to ensure that firms are meeting these expectations, and harms are being appropriately remedied.

1. Value of products

There is a risk that customers may purchase products (directly or through delegated distribution) which do not provide fair value or do not meet their needs resulting in unsuccessful or low levels of claims.

Last year, we issued guidance for general insurers highlighting what we consider firms should be doing to meet their obligations under our rules to identify any material issues from the pandemic that affect the value of their products, and their ability to deliver good customer outcomes.

Despite the progress made by some firms in this area, we remain concerned that there are firms still not fully meeting our existing requirements and expectations. We continue to see consumers buying products which do not always offer fair value, for example, where there is questionable utility demonstrated through low loss ratios. This can result in some consumer groups paying for products which may offer poor value due to low claims success or a low likelihood of ever needing to make a claim. This is particularly the case where there is a long distribution chain, leading to customers paying high prices due to remuneration paid to firms in the chain. Our findings in this area are outlined in our updated guidance published in August.

2. Claims outcomes

We have observed a number of issues in relation to claims handling suggesting that firms do not always deliver claims outcomes that are fair and timely.

This has been particularly observed with business interruption insurance, where we continue to observe claims outcomes through our monthly data return. On historic claims, intelligence suggests that some insurers' approaches have created undue barriers for customers or third-party claimants (e.g., for civil claims of child sexual abuse, as highlighted by the Independent Inquiry into Child Sexual Abuse).

3. Operational resilience

There is a risk that important business services may not be provided to policyholders or other market participants in the event of a significant operational disruption. This may include inability to service customers in a timely manner, unauthorised losses or disclosure of customer data.

We are seeing increased adoption of cloud technology as well as major digitalisation and re-platforming programmes taking place. This creates significant risk of harm to market and consumers if these major transformation programmes are not managed and executed appropriately. Third-party and outsourcers failures or weak technology controls can lead to operational disruption, unauthorised losses or disclosure of consumer data. In addition, reliance on third parties and technology outsourcers presents the potential for systemic risk if a large number of firms rely on the same service provider (concentration risk) which could cause customer detriment if the third-party is impacted by operational resilience including cyber issues.

4. Uncertainty over insurance cover including due to ambiguous contract terms

There is a risk that a lack of clarity from ambiguous contract wording or misaligned customer expectations may lead to uncertainty regarding the extent of cover or confusion regarding the insurance cover purchased.

The Business Interruption (BI) test case sought to address key elements of contractual uncertainty around the validity of many non-damage BI claims through the Courts. We are concerned that the issue may be more widespread. The issue arises or is exacerbated if disclosure and communication does not align with the policy or explain sufficiently clearly the cover, leading to customers taking out insurance that does not provide the level of cover they expected they had in place.

5. Culture

Although we have seen positive evidence from the market of seeking to improve products to better serve changing needs of customers, we are still observing other examples where there remains a significant conflict with commercial performance.

There remains a significant risk that poor underlying cultures may lead to poor customer outcomes and impact the integrity of the market.

We view both lack of diversity and inclusion (D&I), and non-financial misconduct as obstacles to creating an environment in which it is safe to speak up, the best talent is retained, the best business choices are made, and the best risk decisions are taken.

Whilst firms talk about the importance of attracting diverse talent, we hear less on the work being done to build an inclusive environment. It is encouraging to see that the market has been engaging with the issue and D&I is increasingly on firms' agenda. But most efforts to date have focused on gender diversity, and there is still a long way to go before the London market becomes a truly diverse and inclusive sector.

We see the break from office life, as creating an opportunity for firms to evolve their expectations of individuals and their behaviours, both as participants in firms and as members of the market, as the return to the office and in person engagements rises.

6. Access to certain business lines

We have seen reports that an effect of the pandemic has been the potential to increase the risk for market hardening for certain lines of business such as Employers Liability, Professional Indemnity (PI) or building insurance; some customers have experienced large premium increases or were unable to find insurance that met their needs (for example, MIPRU requirements for intermediaries in PI insurance).

Our expectations and supervisory strategy

We want you to be clear of our expectations. Over the next two years, our supervisory work on this portfolio will prioritise the 6 risks of harm we have set out in this letter. Below we set out what this supervisory strategy will consist of and what we are looking for in terms of our expectations of firms. Where we see new risks of harms arising, we will re-prioritise our strategy to address those risks that potentially create the highest level of harm for customers and the integrity of the general insurance market.

1. Value of products

We expect firms to continue to monitor the impact of the pandemic on product value as part of their product governance processes and take appropriate action to mitigate customer harm where necessary. We will continue to include a focus in our supervisory work on how firms are considering the value of their products in light of any continuing effects of the situation.

More generally, we expect firms to consider the value products deliver for consumers during their product development and review process, taking action when products that do not provide fair value are identified.

We also expect firms to demonstrate that distribution strategies, including remuneration arrangements, are appropriate when considering and evaluating customer outcomes.

As part of the Pricing Policy Statement PS21/5 published in May, we are introducing new product governance rules to ensure that firms deliver fair value on all their insurance products. The rules emphasise that all manufacturers including insurers, regardless of the distribution chain, are responsible for ensuring that their products are appropriate for the intended target market and will provide fair value. We expect firms to be ready to meet these rules within the required timeframes.

We are planning a broad supervisory programme of work, which will be supported by the firms' reporting data, to measure compliance with the rules, identify consumer harm, and monitor the market.

Our proposed Consumer Duty would also provide additional obligations for firms to ensure that their products and services are fit for purpose and offer fair value. We said in CP 21/13 that we expect to publish a second consultation by 31 December 2021 to set out the proposed text for any new rules or guidance to implement our proposals for the new consumer duty. Additionally, firms are required to report on value measures for products sold to UK consumers.

The intended outcome of our supervisory activity is that customers receive value from the products they hold, in line with their demands and needs, and irrespective of the method of distribution.

2. Claims outcomes

We expect firms to treat claimants in a fair and timely manner and communicate clearly at the claims stage, in line with their regulatory obligations. Where claimants are vulnerable, firms should ensure that their processes and approach do not create additional distress or undue barriers to claims.

Where we see firms failing to meet our regulatory expectations, we will act using the full range of regulatory tools available to us.

The intended outcome of our supervisory strategy is that customers purchase products that are suitable for their needs and deliver on their promises at the time of claim, including when the product is in run-off.

3. Operational resilience

In March 2021, we published our Policy Statement PS21/3 Building Operational Resilience in partnership with the Bank of England and the PRA. This introduces final rules and guidance on requirements to strengthen operational resilience in firms.

We expect the firms to proactively manage the increased operational resilience and cyber risks and take appropriate steps, including the necessary investment, to implement these requirements and address any gaps that may exist between current arrangements and these new standards.

The intended outcome of our supervisory strategy in that area is that firms are more resilient to technology outages and cyber-attacks, reducing the risk and frequency of disruption and data loss.

4. Uncertainty over insurance cover including due to ambiguous contract terms

We welcome the market's various initiatives to simplify insurance products and improve contract clarity, and expect firms to continue to address this issue, so that customers will receive the level of protection they should do when they make a claim.

The intended outcome of our supervisory activity is that firms ensure that their contract terms are not ambiguous and that product lifecycles are considered to allow policies to deliver on their promises at the time of claim.

5. Culture

Purpose

To understand the culture of the firms and portfolios we supervise, we assess the effectiveness of four drivers of culture in reducing the potential harm that could arise from a firm's business model and strategy. These are: leadership, purpose, governance, and firms' approach to recruiting, managing and rewarding employees. In our interaction with firms, we will be assessing how effective a firm's purpose is at reducing harm from their business model. This would include examining firms' stated purposes, how they influence strategy and how they are communicated and operationalised through the organisation.

The intended outcome of our supervisory strategy is that a firm's purpose sits at the heart of its business model, strategy and culture, and contributes to reducing potential harm to consumers and markets. And firms' culture, governance and remuneration structures are linked to purpose and drive good behaviours and produce fair outcomes for consumers.

Diversity & Inclusion

On 7 July, we published a Discussion Paper on D&I, jointly with the PRA. There is growing evidence that diversity of thought, when part of an inclusive culture, supports better decision making by firms. We believe that more diverse and truly inclusive firms will benefit from better risk management, as diverse perspectives are valued. Inclusion includes psychological safety, meaning that individuals will feel more empowered to have open discussions and debates, without fear of having their views shut down. As we stated in the Discussion Paper, we intend to develop more detailed proposals, including on potential reporting requirements which we will consult on in H1 2022.

Through our supervision, we will be engaging with firms on D&I. We expect firms to be able to show how they are working towards having a diverse workforce at all levels and an inclusive culture, with the view to drive innovation in the best interest of customers, and help firms understand the diverse needs of customers.

6. Access to certain business lines

Regardless of the potential for market hardening in relation to certain general insurance products, we expect firms to continue to ensure they are meeting all regulatory obligations. For example, where any premium increases are contemplated, firms should consider the information needs of its customers and how best to communicate any premium rise (i.e. whether this is necessary to be reflective of the insurable risks).

Our intended outcome is that the market functions well and provides affordable insurance products that meet customers' needs.

Other areas of focus

Governance and oversight

We expect firms to demonstrate strong governance, control and oversight arrangements throughout their business and in mitigating the key risks of harm outlined in this letter. Firms' arrangements should adapt to the changing internal and external risk environment and risk profile of the firm. We expect the functions supporting these arrangements to be appropriately resourced with the required level of skills and capabilities. Robust governance and oversight arrangements are of paramount importance and demonstrating this will be the focus of our engagement with firms.

We will rely on those holding Senior Management Functions (SMF holders) to discharge their responsibilities and demonstrate they are meeting our expectations. We will hold SMF holders accountable where they fail to take reasonable steps to prevent breaches of our requirements.

Vulnerable customers

In February 2021 we published our Finalised Guidance on the fair treatment of vulnerable customers. We expect firms to consider the guidance, what it means for them and what steps they need to take to make sure they treat vulnerable customers fairly.

Brexit

The EU withdrawal transition period came to an end on 31 December 2020. We expect firms to have considered how this affects them and their customers and taken any required actions. We also expect firms to have considered the changes made to the FCA Handbook to reflect the UK's exit, and the FCA's approach to using the temporary transitional power (TTP). The TTP came into effect at the end of the transition period and ends on 31 March 2022. For more information visit our Brexit website and insurer specific website.

Next steps

We will continue to engage with LLM insurers over the next two years through our planned programme of work. We also invite you to read our business plan that was published on 15 July 2021. This explains how we see our future role and priorities, how we intend to deliver them, and how we will measure our performance.

We expect firms to keep up to date with regulatory developments generally and with the areas covered in this letter.

We will write to you again in 2023 to provide our updated view of the key risks firms in this portfolio pose, the extent to which these risks are being mitigated, and our updated supervisory plans as a result.

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. 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 significant circumstance, please contact me on 020 7066 0414, or at Charlotte.Cross@fca.org.uk or the portfolio lead, Maria Benchoukroun, on 020 7066 8476 or at Maria.Benchoukroun@fca.org.uk.

Yours sincerely

Charlotte Cross

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