FCA FINANCIAL CONDUCT AUTHORITY

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25 May 2022

**Dear Board of Directors**

**FCA Supervisory Strategy for Lloyd's and London Market Insurance Intermediaries (and Managing General Agents) (LLMI)**

We are writing to you to set out our view of the key risks within the Lloyd's and London Market Insurance Intermediaries (and Managing General Agents) (LLMI) portfolio. Please consider the extent of these risks in your business and act where you identify harm.

## Who this letter applies to

This letter is for firms in the LLMI portfolio. This includes:

- Traditional London Market Brokers;
- Managing General Agents;
- Service companies;
- Consolidators; and
- Lloyd's Member Agents.

## Our view of the portfolio

Our overarching aim in supervising LLMI firms is to enable the provision of a wholesale market that works well for its participants, customers, and preserves the integrity of the markets. This was referenced in our previous portfolio letter and continues to be our aim. A strong market reputation underpinned by effective regulation ensures that participants are confident in the market, and the products and services they offer.

More specifically, we want the wholesale insurance market to be competitive whilst supporting itself to do the right thing, firms to embrace the spirit of regulation, preserve the integrity of the market by being operationally as well as financially resilient, and put the end-customer at the heart of the business model; for example, by having appropriate product governance and oversight of the distribution chain to provide products that meet customers' demands and needs.

We paid close attention to the benefits and challenges that participants from the market presented to the Industry and Regulators Committee at the House of Lords particularly in relation to competitiveness and proportionality. We have taken that into account in preparing this letter and will continue to do so in future pieces of work and correspondence. We are open to hearing more of your views on these challenges both directly and through your trade bodies' regular engagement with us. As stated in our recently published strategy, we aim to have open markets that support the domestic economy and growth; and we believe that by listening to the challenges that firms face will strengthen our ability to achieve this.

The key areas of harm identified for LLMI firms are:

- Product suitability and price transparency;
- Uncertainty of insurance cover;
- Culture; and
- Resilience.

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 the guidance in our pandemic related work. We also recognise the industry's commitment and the actions by some, to date, on driving change and reducing the impact of climate change.

However, our view in terms of the treatment of customers, is that firms in the portfolio have not fully embraced our key messages (for example around product oversight or firm culture and purpose) or kept up with the pace of regulatory change. We are also disappointed on the progress made on diversity and inclusion, where firms still require substantial changes, both as employers and in serving the diverse needs of customers.

We are aware of several initiatives within the London Market to simplify and clarify contract wordings – we welcome these types of initiatives where they will lead to positive customer outcomes. We also reiterate our view that such improvements must be underpinned by a healthy culture in the market, especially targeting the elimination of non-financial misconduct, and actively encouraging diversity, inclusion and openness.

Where we see new risks of harms emerging, 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.

To maintain the integrity and reputation of the market, the Senior Managers & Certification Regime (SM&CR) will underpin our interactions with firms, and we will hold Senior Management Function (SMF) holders accountable where they fail to take reasonable steps to prevent breaches of our requirements.

**Product Suitability and Price Transparency**

*All customers should be able to make informed choices about general insurance products to ensure that they meet their needs at a suitable quality and price. Customers should not be exploited or targeted with poor value products.*

We continue to see customers buying products which may not be suitable, do not offer fair value and provide insufficient cover at the point of claim. Our work on pricing practices found that pricing governance and control frameworks do not allow firms and senior managers to effectively oversee pricing practices and activities, such that they are able to reliably assess and evidence whether they are treating customers fairly.

We also continue to see instances of customer harm occurring due to firms' ineffective oversight of the value chain. In our November 2020 Portfolio letter, we explained the importance of firms having adequate systems and controls in place to meet all relevant conduct requirements. Following our letter, we have continued to see distribution strategies, including the associated remuneration arrangements, that do not consider nor adequately evaluate customer outcomes; this includes the use of high commission and administration fees, which can significantly inflate an insurance premium and lead to customers receiving poor value.

As part of the Pricing Practices Policy Statement PS21/5 published in May 2021, we have introduced new product governance rules to ensure that firms deliver fair value on all insurance products. The rules emphasise that all manufacturers, regardless of the distribution chain, are responsible for ensuring that products are appropriate for the intended target market and will provide fair value. We expect firms to have implemented these rules which became effective 1 January 2022.

Our proposed Consumer Duty also provides additional obligations for firms to ensure that products and services are fit for purpose and offer fair value. CP 21/36 proposes draft handbook rules to underpin a new Consumer Principle that provides an overarching standard of conduct for all retail focused firms that we regulate.

We expect firms to consider the value products deliver for consumers during the product development and review process and to take appropriate action when products that do not provide fair value are identified.

Manufacturers should carefully identify their target market for products and ensure that distribution methods are appropriate and that products reach the intended target market. Product distributors need to understand the intended value of products and ensure that their distribution arrangements (including remuneration) are consistent with providing fair value to the customer.

Our new pricing practices and product governance rules represent a step change for the insurance industry. We expect Senior Managers and Boards (where applicable) to have delivered these regulatory changes effectively and to be fully engaged on issues related to value and pricing. Firms should have embedded these changes so that they can evidence that customers receive value from the products they hold.

**Uncertainty over insurance cover due to ambiguous contract terms**

*Customers should buy insurance products that are well designed, with clear contract terms that detail the scope of cover and that deliver as expected at point of claim.*

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 and that a wide-reaching incident, for example a cyber attack, could expose uncertainty of insurance coverage for a large number of customers. In such an example, uncertainty could arise on a standalone cyber insurance product – or under another type of policy where cover for losses relating to a cyber attack was not originally intended.

The issue arises or is exacerbated if disclosure and communication does not align with the policy or does not clearly explain the cover. This could lead to customers taking out insurance that does not provide the level of cover they thought they held.

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 receive the level of protection they require and are not inhibited from making a claim.

We expect firms to have robust product governance arrangements in place which meet our rules to ensure that irrespective of a firms position within the distribution chain, customers receive insurance products that deliver when they are needed.

**Culture: Diversity and Inclusion (D&I) & Non-Financial Misconduct**

*A firm's culture, governance and remuneration structures should drive good behaviours and produce fair outcomes for customers. This includes firms having a workforce that is diverse and inclusive at all levels, which drives innovation in the best interest of customers and helps firms understand the demands and needs of customers.*

Although we have seen positive evidence from the market of seeking to improve both culture and products to better serve changing needs of customers, there remains a significant risk that poor underlying cultures may lead to poor customer outcomes and impact the integrity of the market.

It is encouraging to see that D&I is increasingly on firms' agendas. However, there is still a long way to go before the London market becomes a truly diverse and inclusive sector; representative of the society it serves.

In our Approach to Supervision, we outline the focus we place on business models and culture as the key causes of harm in firms. We define culture as the habitual behaviours and mindsets that characterise an organisation and we view a healthy culture as critical both to consumer protection and to well-functioning markets. In almost every instance of poor conduct, we have found that deep-set cultural issues have been present. We believe firms with healthy cultures are less prone to misconduct.

We view both lack of 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.

There is growing evidence that diversity of thought, when part of an inclusive culture, supports better decision making by firms. We consider that more diverse and truly inclusive firms will benefit from better risk management. Inclusion includes psychological safety, meaning that individuals will feel more empowered to have open discussions and debates, without fear of having their views ignored.

In July 2021, we published DP21/2 which engaged in a wide conversation on D&I. This year, we will be consulting on proposed new rules and guidance.

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.

We expect high standards of character, probity and fitness and properness from those who operate in the financial services industry. We believe that the steps a firm takes to address non-financial misconduct throughout the organisation, including discrimination, harassment, victimisation and bullying, is indicative of a firm's culture.

**Financial and Operational resilience**

*Customers should have confidence doing business with insurance firms and be protected from harms relating to firms' financial and operational resilience.*

We recognise the significant challenges that many firms have faced because of the disruption from Covid-19. As a result of the pandemic, we saw that many firms had not adequately planned an orderly wind down or taken appropriate steps to conserve capital; or considered how to meet future demands on liquidity.

We also identified, through the FCA's financial resilience surveys, that a substantial number of firms had insufficient controls and oversight arrangements in place for client asset arrangements.

We will continue to proactively contact firms where we consider that there is an enhanced risk of failure, and we thank firms for their continued submissions and efforts in completing our financial resilience surveys. We expect firms to have adopted a prudent approach to the management of financial resources, overseen by senior management, and to ensure that they maintain an up-to-date wind-down plan.

We also expect firms that hold client money to have rectified the issues identified in our earlier letter of July 2021, Maintaining adequate client money arrangements.

Given the current heightened international tensions, firms should pay particular attention to cyber security as well as management of data and must ensure that they proactively manage any operational resilience exposure and take appropriate steps, including the necessary investment, to implement any remedies and address any gaps that may exist within their current arrangements.

In addition, reliance on third parties and technology outsourcers presents the potential for systemic and concentration risk, if a large number of firms rely on the same service provider.

For reference, 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. These rules will be applicable to some firms in this portfolio.

**Next steps**

We will continue to engage with LLMI firms over the next two years through our planned programme of work. We also invite you to read our business plan that was published on 7 April 2022. 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 2024 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, email us at firm.queries@fca.org.uk 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 circumstances, if I am not available, please contact the Head of Department responsible for the LLMI Portfolio, Charlotte Cross at Charlotte.Cross@fca.org.uk.

Yours sincerely

Matt Brewis
Director