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

5 August 2021

Dear Board of Directors,

FCA Supervisory Strategy for Life Insurers

We wrote to you in December 2018 setting out our view of the key risks of harm Life Insurance firms (Insurers) pose to their customers and the markets in which they operate. We also set out our 2-year strategy for mitigating those risks. In response to Coronavirus (Covid-19) we extended the strategy period to Q1 2021, so we could focus our supervisory resources on responding to the challenges posed by the pandemic and lockdown measures.

In this letter, we:

1. Give an update on the progress of our 2018 strategy.
2. Give an updated view of the key risks of harm to customers Insurers pose.
3. Outline our expectations of Insurers.
4. Give an overview of our supervisory strategy and programme of work to make sure firms are meeting our expectations, and the risks of harm are being appropriately mitigated.

We have extended the scope of our strategy to include the main regulated Third-Party Administrators (TPAs) performing servicing, administration and systems functions on an outsourced basis on behalf of Insurers. We expect you to consider the degree to which your firm presents such risks and review your strategies for mitigating them. For firms with a named FCA supervisory contact, we expect you and your senior managers to be able to demonstrate through our engagement with you that you are taking reasonable steps to mitigate these risks.

Update on progress of our 2018 strategy

Our 2018 strategy sought to address 3 key risks of consumer harm:

- Customers have reduced savings and lower income in retirement due to poor management of their funds.

- Customers are not provided with the investment, pension or protection product or service they expect because of changes to or unclear terms and conditions.

- Customers do not receive the service or payments they expect because of operational failures.

To mitigate these risks of harm we focused our supervisory activity in specific areas, some of which were cross-sector FCA priorities:

Portfolio activities	FCA Priorities
Culture and governance	EU Withdrawal
Resilience and Outsourcing	Senior Managers and Certification Regime (SM&CR)
Fair treatment of long-standing customers	LIBOR transition
Fair treatment of with-profits customers	
Operation of unit-linked funds	

We set out the outcome of this activity in Annex 1. Broadly, we did not identify widespread weaknesses within the portfolio in how firms manage and mitigate these risks of harm; however, we have observed some poor practice and there is still a risk of poor outcomes for customers arising from these harms. Our updated view of the key risks of harm in the portfolio capture these residual risks.

Below we outline our view of the sector and what we consider to be the key harms for customers. In the section that follows we outline our expectations of Insurers alongside our planned supervisory strategy to ensure that firms are meeting these expectations, and harms are being appropriately remedied.

<u>Our view of the portfolio</u>

The characteristics of the sector described in our 2018 letter remain largely the same; in particular, the long-term nature of the products means outcomes for customers emerge after long periods of time, leaving them with limited or no time to take corrective action where outcomes are unexpected and financial benefits fall short of expectations. Product complexity and low levels of customer engagement and understanding of financial products remain factors that amplify the risk of consumer harms crystallising. During the life of a long-term product it is likely a significant number of policyholders will experience life events that could adversely affect their ability to make informed decisions, especially in later life when product benefits are more likely to be accessed. Therefore, customer vulnerability is a key consideration in how firms deliver fair treatment to all their customers consistently.

We have seen firms reassessing their strategic focus within the portfolio, with Insurers re-entering the advice market, commencing new lines of business (e.g. equity release) and disposing of non-core business lines (e.g. legacy business, annuity books and general insurance business). In response to the pandemic, some Insurers are refocussing their purpose to support UK consumers in their financial recovery from its effects.

There are a significant number of policyholder migration programmes arising from closed-book, fund and IT system consolidations across the sector. Poorly executed migration programmes by Insurers and TPAs can result in customers experiencing inadequate levels of service and potentially suffering loss. It is essential for policies and key business processes to be administered on robust and sustainable platforms. We appreciate the longer-term policyholder benefits these programmes can deliver; but, given their complexity, this can place undue strain on available capacity within firms to manage the programmes effectively, especially where firms are focused on ambitious cost-driven targets.

Insurers and TPAs have responded resiliently to the challenges posed by the pandemic, adapting promptly to the operational demands of home working, onshoring functions where necessary and responding to policyholders' changing needs. Firms responded positively to support vulnerable customers and those that may experience financial difficulty by offering forbearance on certain product obligations. Key business processes were largely maintained; but, it was disappointing to see common functions experiencing backlogs and servicing issues (e.g. telephony, complaints handling, bereavement services).

The longer-term economic impacts of the pandemic and Brexit are yet to become clear, but we anticipate challenges for the portfolio going forward. This may result in further strategic shifts in the products and services on offer, that will increasingly be delivered through digital channels, the adoption of which has likely accelerated as an outcome of the pandemic. Digitisation offers benefits in improving customer engagement and access, reducing customer acquisition and servicing costs and supports timely communications. It also increases the risk of poor customer outcomes, where customers potentially purchase unsuitable products, where they are denied access to products and services given their limited digital capability and increases the risk of data loss and customers falling prey to scam activity.

Our view of the key drivers of harm

Our view of the risks of harm to customers have evolved from those identified in our 2018 letter, with the residual risks of harm from that letter being consistent with those for the current period. We consider the following to be the key risks of harm for customers:

Weaknesses in pricing and product governance practices leading to customers experiencing excessive fees and charges, resulting in poor customer outcomes

There is a risk that customers pay significantly higher fees for their funds and product wrappers, particularly in relation to legacy products, resulting in customers having reduced levels of savings and income in retirement. Also, distribution strategies that allow high upfront commissions on protection policies could drive poor outcomes for customers. These harms can arise where firms fail to effectively manage conflicts of interest (both internally and throughout the distribution chain), where they have inadequate product governance arrangements and where customers do not receive timely and clear information to enable informed decision making.

Weaknesses in product governance arrangements and the management and execution of migration programmes resulting in customers receiving poor quality services and products

In response to the economic impact of the pandemic, firms may evolve products and services that do not deliver the quality and value that customers expect. There is the possibility that firms could make unilateral changes to Terms & Conditions that could be challenged on the grounds of fairness. Poor governance and oversight arrangements may give rise to substandard claims handling processes, customer communications and management of unit-linked funds. We have seen examples of firms facing challenges to stop customers' scheduled payments buying additional units in unit-linked property funds when those funds became suspended during the pandemic, due to a lack of system functionality and the structure of multi-asset products.

There is also a risk that customers do not receive the same quality of services during the lifetime of a policy. This could arise from firms failing to treat legacy product policyholders fairly and where policy migrations are not well executed.

Weaknesses in the management of operational risks:

a) result in the interruption of services to customers, causing inconvenience and potential consumer loss

There is a risk that services are not delivered consistently to customers due to operational weaknesses. These weaknesses could be caused by substandard operational resilience and cyber security controls, along with poor general systems and controls. Additionally, complex and legacy systems may result in firms being unable to prevent, adapt, respond to, recover and learn from operational disruptions resulting in customers not having access to key services. Weaknesses could be present within Insurers and their controls for overseeing the activities of TPAs, as well as weaknesses that may be present in the TPA's themselves. Policyholder migrations pose risks of interruptions in service if they are not managed and executed effectively.

b) relating to IT and cyber security results in the loss or misuse of customer data

Insurers and TPAs hold significant volumes of sensitive data and there is a risk that weak operational resilience and cyber security arrangements and inadequate oversight of TPAs could result in the loss and misuse of customer data leading to irreparable customer harm. With an increased number of staff working from home and Insurers increasingly digitising their products and services, there is heightened risk that data security could be compromised, increasing the risk of a cyber-attacks, data theft and misuse of data.

The risk of poor customer outcomes arising from a disorderly exit from outsourcing arrangements between an insurer and a TPA

The total number of policies administered by TPAs in the portfolio continues to increase and the reliance of Insurers on a small number of TPAs is a characteristic of the portfolio. The unlikely event of an insurer or TPA exiting from outsourcing arrangements in an unplanned manner could impact many market participants (directly or indirectly) and their customers, who could suffer disruption to the services they receive.

Weaknesses in product governance arrangements resulting in customers buying or being sold unsuitable products

There is a risk that customers purchasing accumulation, decumulation or protection products, buy products, or invest in funds, that are not suitable for their needs. This could arise from poor product development or product journeys not delivering appropriate outcomes, as well as customers not receiving, clear and fair information in a timely manner. Customers approaching retirement may not receive clear signposting to the guidance available from Pension Wise.

Firms should ensure that they are considering the diverse needs of their customers in the development and delivery of products and services.

Over time products may become unsuitable and firms may fail to take the necessary steps to ensure they continue to deliver fair outcomes to customers or communicate with them in a timely and clear manner to prompt them to take action to avoid unintended outcomes.

Markets develop in a way that results in customers not having access to products that suit their needs

The number of active participants in the annuity market has declined post pension freedoms and with the impact of Solvency II. If this continues, there is a risk that supply will not match demand from those customers seeking a secure income in later life, leading customers to suffer from reduced choice and competition in the market. There is also a concern that the supply of sustainable products will not be sufficient to meet customer demand. This could be a driver in products being developed that overstate their Environmental, Social and governance (ESG) credentials ('greenwashing'), resulting in customer expectations not being met and undermining the integrity of the market.

Weaknesses in control and oversight arrangements and awareness raising of scams with customers, increases the risks of them suffering financial loss as a result of scams

We have seen an increasing number of sophisticated scams where fraudsters, posing as authorised firms online, promote non-existent investment products with enticing (but seemingly realistic) guaranteed returns on investments. Whilst scams are not unique to the insurance sector, the vulnerability of customers and the values invested, mean the impact can be significant.

Our expectations and supervisory strategy

We are prioritising our supervisory strategy and programme of work to ensure that firms are meeting our expectations, and the key drivers of harm are remedied appropriately. This will form part of our ongoing supervisory engagement with the larger firms in the portfolio and further risk-targeted work focussing on a broader base of firms. Below we set out our supervisory activities in response to the identified key harms, however firms should be mindful of our broader expectations.

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. We expect firms' arrangements to 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. We note the PRA's findings in its recent Evaluation of the SM&CR report and highlight the Financial Stability Board (FSB) Peer Review of the UK's remuneration regime and the FCA and PRA's joint statement. We encourage Insurers to consider the steps outlined in the FSB report to further strengthen the financial sector compensation framework; including a review of the interaction between the SM&CR and remuneration regimes and take appropriate action.

Senior Managers play a vital role in shaping the cultural environment of their firms. We expect them to lead the development of healthy cultures, giving consideration of the drivers of culture, which includes policies that incentivise behaviours which create diversity and an inclusive environment, including psychological safety.

Although some progress has been made on diversity and inclusion, the industry, including the regulators, still have a long way to go, both as employers and in serving the diverse needs of customers. Firms should take stock of where they are and the effectiveness of initiatives that they have in place to drive change, including the speed of change. We would expect these issues to be discussed by the Board and for change to be delivered by senior management.

On 7 July, we published a Discussion Paper on diversity and inclusion, jointly with the PRA and the Bank of England. We encourage firms to engage with this paper and to respond to it before the closing date of 30 September. We want to work with the industry to deliver real change.

Accountable SMF holders and Boards should ensure that the Certification Regime and the Conduct Rules are embedded effectively, including consideration of whether adequate arrangements are in place for 'business as usual'. Insurers should review the positive and negative indicators on our website to assure themselves that they are meeting our expectations. (These apply to insurers as well as solo regulated firms.)

We expect firms to engage with future FCA policy initiatives. These include our work to evaluate the impact of the investment pathways for non-advised customers entering drawdown and our joint pensions strategy with The Pensions Regulator to further improve outcomes for pension customers. This also includes our ongoing programme of work to deliver our sustainable finance strategy. This focusses on good disclosures along the investment chain, ensuring the market delivers sustainable finance instruments that meet investors' sustainability preferences and developing the tools, guidance and industry support across the financial services and markets industry to address the challenge of climate change.

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 the steps they need to take to make sure they treat vulnerable customers fairly.

In March 2021 we published our Building Operational Resilience Policy Statement, that introduces final rules and guidance on requirements to strengthen operational resilience within firms. We expect firms to take the necessary steps, including investment, to implement these requirements and address any gaps that may exist between their current arrangements and these new standards.

The Pension Schemes Act 2021 requires the FCA to consult on rules that will apply to pension providers, requiring them to:

- connect to the pensions dashboards ecosystem that is being developed by the Pension Dashboard Programme (PDP).

- make pensions information available to individual consumers who request it via a pensions dashboard.

Government must also consult on regulations to place corresponding requirements on occupational pension scheme trustees. The PDP's recent Call for Input on staging, outlined initial thinking on when these obligations will apply to specific industry participants. Information about the provider data requirements and the provider ecosystem requirements is available via the PDP's data provider hub.

The staging profile will be determined from the feedback to the Call for Input, but it is clear there are steps firms could take now to prepare for dashboards. We encourage firms to engage with the material the PDP has made available at the earliest opportunity.

The EU withdrawal transition period came to an end on 31 December 2020. We expect you to have considered how this affects you and your customers and taken any required actions. We also expect you 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.

Weaknesses in pricing and product governance practices leading to customers experiencing excessive fees and charges, resulting in poor customer outcomes

Uncertainty over the future economic environment and changing customer needs may place financial pressure on firms to shift strategic direction and evolve their products. We expect firms to meet these challenges with the best interest of customers at the centre of their strategic planning, objectives and product and proposition development. We expect firms to be able to demonstrate this along-side good customer outcomes.

We expect firms to demonstrate robust product governance arrangements to ensure existing products continue to meet customer needs and to take action to mitigate adverse customer outcomes arising from changing circumstances relating to the product. We also expect firms to demonstrate that distribution strategies, including remuneration arrangements, are appropriate when considering and evaluating customer outcomes.

We recently published our General Insurance Pricing Practices Market Study Policy Statement, which details our rule changes and guidance, some of which apply to pure protection products. We may undertake targeted engagement with firms to understand how they implement the remedies that apply to pure protection policies (including guaranteed over fifties plans). We will monitor firms' compliance with implementing the investment pathways and will support further work to evaluate the impact of these measures.

We will also consider whether our regulatory returns need updating to target our key risks, including the risk relating to excessive fees and charges.

Weaknesses in product governance arrangements and the management and execution of migration programmes resulting in customers receiving poor quality services and products

Firms must have robust product governance arrangements to ensure products and propositions meet the needs of the identified target market and are distributed in accordance with our requirements during the life cycle of the product. We expect these servicing standards to be maintained when a book of business is transferred between Insurers. Firms should disclose to us the details of material events that could potentially cause customer loss or disrupt services. We will continue to engage with firms to ensure that transfers of business, fund consolidations and policyholder migrations meet our requirements including that customers are treated fairly. We are consulting on possible changes to our 2018 Finalised Guidance on Part VII transfer, to incorporate key developments and lessons learnt since 2018 to improve the process.

Weaknesses in the management of operational risks:

a) resulting in interruption of services to customers, causing inconvenience and potential consumer loss

We expect Insurers and TPAs to demonstrate robust management of operational risks, including those relating to operational resilience and cyber security. Our Technology, Resilience and Cyber (TRC) specialist supervisory department will continue with its targeted supervisory programme with larger firms and we will adapt our level of engagement with larger firms on Covid-19 pandemic related operational challenges to address issues as they emerge. We expect firms to consider what lessons can be learned from the servicing issues experienced during the pandemic to strengthen plans, and where necessary, to deal with peaks in demand.

We will seek to understand the steps larger firms will take to implement the rules and guidance published in our March 2021 Building Operational Resilience Policy Statement and we will draw on the expertise of TRC colleagues to support this work and when responding to operational events notified to us by firms.

b) relating to IT and cyber security results in the loss or misuse of customer data

Further to our expectations stated above and TRC continuing its targeted supervisory programme in relation to IT and cyber security, firms are expected to notify us of incidents involving the loss or misuse of customer data. We will continue to respond to understand the impact of incidents and the action necessary to rectify weaknesses and remediate customer harm.

The risk of poor customer outcomes arising from a disorderly exit from outsourcing arrangements between an insurer and a TPA

As the prudential regulator for the solo-regulated TPAs we will continue to monitor the capital and liquidity positions to satisfy ourselves they remain adequate relative to their liabilities and risk exposures. We also expect Insurers to keep under review the effectiveness of any outsourced activities and their plans to exit such arrangements in all circumstances, including in an unplanned scenario.

Weaknesses in product governance arrangements resulting in customers buying / being sold unsuitable products

As stated above we expect firms to have robust product governance arrangements to ensure products and propositions are suitable for customers. We will continue to engage with firms, and our supervisory activities will focus on how they have implemented the investment pathways and how they respond to any future policy changes to pension retirement journeys and the remedies from our General Insurance Pricing Practices work.

Markets develop in a way that results in customers not having access to products that suit their needs

We are progressing our proposals to introduce a disclosure regime that is aligned with the Task Force on Climate-related Financial Disclosures (TCFD) and we recently published our consultation paper on enhancing climate-related disclosures by asset managers, life insurers and FCA regulated pension providers. We may undertake targeted work on firms' ESG offerings to ensure they fit consumer demand. We will also monitor developments in the annuity market and any further issues that may impact UK Insurers and their overseas customers arising from the UK's departure from the EU.

Weaknesses in control and oversight arrangements and awareness raising of scams with customers, increase the risks of customers suffering financial loss as a result of scams

We have observed good practice in the sector, with firms taking steps to raise awareness of the risks of scams to customers, both online and through social media. Firms have acted promptly to make us aware of incidents, kept us informed of developments, and permitted us to share details of the nature of scams with other firms to increase awareness and prompt protective responses. We want to see these practices continue and develop in response to evolving risks. We will continue to support firms in understanding the impact of scam activity and cooperate where we can in taking actions to remove threats on a case-by-case basis and achieve fair outcomes for customers.

Next steps

We will continue to engage with Insurers and TPAs through our planned programme of work.

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 plan.

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

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, if I am not available, please contact the Head of Department responsible for the Life Insurer Portfolio, Mark Wilson at mark.wilson@fca.org.uk.

Yours sincerely

Matt Brewis

Director

Annex 1

Our 2018 two-year strategy sought to target three key risks of consumer harm:

- Customers have reduced savings and lower income in retirement due to poor management of their funds;
- Customers are not provided with the investment, pension or protection product or service they expect because of changes to or unclear terms and conditions;
- Customers do not receive the service or payments they expect because of operational failures.

Here are details of the progress we have made since our 2018 letter to mitigate these risks of harm:

Fair treatment of with-profits customers

We published the findings of our thematic review into the Fair Treatment of With-Profit Customers in July 2019 and issued a Dear CEO Letter. The review concluded that, in most cases, firms were carrying out appropriate governance to ensure fair treatment of with-profits customers. We identified areas for improvement, these being the oversight and challenge by senior individuals and Boards on with-profits governance and firms ensuring run-off plans are kept up-to-date and used. We said we would consider carrying out further work on With-Profit Advisory Arrangements. We have not started this work and do not plan to do so in the immediate future; but may re-consider this if we see the risk of harm to with-profit policyholders increasing from these arrangements. We expect with-profit operators to have used the findings of the review to improve outcomes for with-profit policyholders and to have considered the examples of good and poor practice, assessing whether they need to make any changes to their management arrangements.

We intend to carry on holding With-Profit Forums and will continue to assess the effectiveness of governance and oversight arrangements through our supervisory engagement with firms, relying on SMF function holders to discharge their responsibilities appropriately.

Resilience and Outsourcers

We published the findings of our review into Outsourcing in the life insurance sector in March 2020. We did not find evidence of widespread failures to manage the risks to customers arising from outsourcing. We found evidence of good and poor practices and identified improvements to be made in the areas of exit planning and in identifying and managing operational risks throughout the lifespan of outsourcing arrangements. We fed back our findings to firms involved in the review and followed up with remedial action where it was required. We encouraged firms to review their systems and controls in-light of the findings and good and poor practice examples and to take prompt remedial action appropriate for their business.

Our broader work focussing on operational resilience has continued, resulting in the recent publication of our March 2021 Building Operational Resilience Policy Statement.

Operation of unit-linked funds

We published the findings of our Unit-linked funds' governance review in September 2019. As we found with management of authorised funds in our Asset Management Market Study (AMMS), insurance firms' fund governance for unit-linked funds often didn't include considerations we believe important when assessing whether they provide good value for their investors. Specifically, we found limited consideration of unit holders' interests in decision-making around levels of fees and charges. We are continuing to progress our joint pensions strategy with The Pensions Regulator to further improve outcomes for pension customers and will decide whether any further remedies are needed as part of that work.

Fair treatment of long-standing customers

We said we would undertake evaluation work to assess the impact of the Finalised Guidance 16/8 we published to address our findings from our 2016 Thematic Report. We have not undertaken any cross-firm evaluation work, nor do we intend to at this time. We have engaged with some firms on their work remediation programmes in response to our guidance and individual firm findings. These have largely concluded with changes being embedded into day-to-day operational practices. The experience of long-standing customers remains central to the potential customer harms we perceive in the portfolio and fair outcomes for long-standing customers remains central to our portfolio strategy.

Culture and governance

We said we would assess individual firms on their culture and governance arrangements. We will test the effectiveness of firms and their senior managers in demonstrating that governance and oversight arrangements are effective in identifying and mitigating risk of harm to customers. In April 2019 we published our Approach to Supervision that provided details of our Firm Assessment Model, which is the framework against which we have and will continue to assess larger firms in the portfolio against our expectations on the standards of culture and governance. This is a continuous assessment that takes account of performance during both the firm specific and cross-firm work set out in this Annex. Feedback on our areas of concern and supervisory focus are provided to individual firms following our periodic Firm Evaluations. This letter is our feedback to the wider Life Insurer portfolio following our Portfolio Evaluation, that uses a similar approach to the Firm Assessment Model.

Senior Managers and Certification Regime (SM&CR)

We said we would undertake work to assess how firms are implementing the SM&CR. We have focussed on Senior Management Function (SMF) holders demonstrating they are fulfilling their responsibilities during our supervisory engagement. For larger firms this has involved focussing on SMF holders with responsibility for managing and mitigating the risk of harm to customers we are seeking to mitigate in our supervision strategy for the firm. For all firms in the portfolio this has involved us focussing on SMF holders demonstrating that they are discharging their responsibilities in response to incidents that arise.

EU Withdrawal

In preparation for the UK's withdrawal and transition away from EU membership we undertook a significant amount of work with firms to ensure they were operationally prepared to deal with the challenges of contract continuity for EU-based customers and the loss of passporting rights (which resulted in a number of firms undertaking Part VII transfers of books of business to EU-based entities), communicating with EU-based customers and managing the impact of market volatility.

LIBOR transition

We have undertaken work with firms along with the PRA to assess conduct risks associated with the transition away from LIBOR for Insurers. We assessed the overall conduct risks across Insurers to be low, with minimal number of customer-facing products being exposed to LIBOR. Further engagement will be taken forward on a case-by-case basis to discuss progress in assessing and mitigating risks.