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Dear Board of Directors,

FCA Supervisory strategy for Personal and Commercial line insurers

We wrote to you in January 2020 setting out our view of the key risks of harm Personal and Commercial line (PL&CL) 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 significant 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 PL&CL insurers pose.

2. Outline our expectations of PL&CL insurers.

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. In circumstances where we have contact with your firm, we will expect you and your senior managers to be able to demonstrate that you are taking reasonable steps to mitigate these risks.

Our view of the portfolio

The insurance sector, alongside the financial services industry, has faced significant challenges in the past year as a result of the Covid-19 pandemic (CV-19). The sector's response has highlighted the need for firms to maintain and embed healthy cultures, focused on more proactive consideration of conduct and good customer outcomes. We remain focused on ensuring firms understand and manage their customer-centric cultures effectively, treating it as equally important and integral to their business model and strategy.

While firms in the portfolio are diverse, both in terms of their size and business models, we have previously observed weaknesses in governance and operational controls resulting in a failure to proactively engage with, plan for and implement, all relevant regulatory changes. We continue to see firms' effective implementation of regulatory changes, such as those introduced by the UK implementation of the Insurance Distribution Directive (IDD), as fundamental to ensuring the General Insurance (GI) market treats consumers fairly and that consumers purchase products that meet their needs. This is particularly relevant in the coming period where firms will need to comply with regulatory changes and respond to any remedies coming out of our Pricing Practices market study, our Operational Resilience Policy Statement, and the Business Interruption (BI) test case judgment. Further detail on how we will supervise each of these areas is outlined below.

Business models have evolved as a result of CV-19 and are likely to continue to do so. We expect firms to ensure any such changes are delivered in a controlled and managed way, minimising the risk of harm to consumers and the market.

Notwithstanding the above, the portfolio has responded resiliently to the challenges posed by CV-19, adapting to the operational demands of home working, onshoring services at pace and some responding to consumers' changing needs. CV-19 has however, caused material issues due to the lack of clarity and certainty for some customers making BI claims, and the basis on which some firms were making decisions in relation to these claims. This led to our intervention to resolve certain key elements of contractual uncertainty around the validity of many BI claims through the Courts with the BI test case. The industry has engaged positively with this process overall, it is now imperative that firms take appropriate steps to ensure that policyholders' claims are handled swiftly and, in respect of valid claims, interim and full claim payments are made as soon as possible.

Our view of the key drivers of harm

Our view of the risks of harm to consumers remain broadly consistent with those identified in our January 2020 letter. In this assessment we have considered the impact of CV-19. Recognising that CV-19, and the restrictions to control it, has brought significant challenges for firms and consumers that would not have been anticipated. Given the unprecedented impact of CV-19, we expect firms to be aware of the circumstances that customers find themselves in and to consider very carefully the needs of their customers and show flexibility in their treatment of them.

Below we outline what we consider to be the key harms for consumers. In the next section we outline our expectations of PL&CL insurers alongside our planned supervisory strategy to ensure that firms are meeting these expectations, and harms are being appropriately remedied.

Poor pricing practices pose significant risk of harm and poor outcomes for consumers

Our work on pricing practices has highlighted that differential pricing leads to significant risks of harm to consumers, whereby some identifiable groups of consumers pay significantly higher prices than other identifiable groups of consumers with similar risk characteristics and cost to serve. We also found that firms pricing governance and control frameworks do not allow firms and senior managers to effectively oversee their pricing practices and activities, such that they are able to reliably assess and evidence whether they are treating their consumers fairly.

Consumers purchase products which are not fair value

We continue to see consumers buying products which do not always offer fair value, for example, due to limited utility demonstrated through low loss ratios. This also results in some consumer groups paying excessive amounts for products with low claims success.

Consumers experience poor service due to ineffective oversight of the value chain

We continue to see instances of consumer harm occurring due to firms' ineffective oversight of the value chain. For example, through consumers paying high prices due to remuneration paid to firms in the distribution chain.

Business interruption claims payments are not made in a timely manner and in line with the BI Insurance test case judgment

The judgments from the Supreme Court and High Court provide policyholders and insurers with clarity about how and to what extent the policies in the representative sample may respond to BI losses arising from UK Government action taken primarily in March 2020 in response to CV-19. The judgments also provide authoritative guidance for the interpretation of similar policy wordings. Nevertheless, there remains a risk that policyholders do not receive BI claims payments in a timely manner, in line with the BI Insurance test case judgment and relevant regulatory requirements, and that communications and settlement offers provided to policyholders do not align with our guidance and expectations.

Where elements of BI policies that weren't covered by the test case, we expect firms to respond in line with their regulatory obligations and the expectations around claims handling set out in our June guidance and January Dear CEO letter. We particularly note firms' obligations to 'provide reasonable guidance to help a policyholder make a claim' (ICOBS8.1.1) and to act fairly, honestly and professionally in the best interests of their customers. In this context, where there are further disputes over BI policies that are the subject of legal proceedings firms should consider the significant costs faced by policyholders and seek to narrow the issues in dispute to ensure that the litigation can proceed in the cheapest and quickest way possible.

Firms' operational resilience does not prevent the loss or misuse of consumer data or results in consumers not having access to key services

Insurers manage large volumes of sensitive consumer data, ranging from financial data to medical data. There is a risk that insufficient controls to protect this data may result in data breaches and irreparable consumer harm. Additionally, complex and legacy systems may result in firms being unable to prevent, adapt, respond to, recover and learn from operational disruptions resulting in consumers not having access to key services.

All firms should consider the degree to which they present these risks of harm to consumers and markets and ensure they have implemented effective strategies to mitigate these. Where we identify firms that have not taken sufficient steps to do so, we will intervene and consider all our regulatory tools to take appropriate action.

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. Our strategy is focused on ensuring firms; prioritise conduct and consumer outcomes throughout the consumer journey; effectively implement all relevant regulatory changes in a timely manner;

and manage the risk of evolving business models in the wake of the CV-19 pandemic in a controlled and managed way.

Pricing practices that lead to consumers paying excessive prices for products

We published the final report on our pricing practices market study in September 2020. In this we outlined our proposed package of remedies to tackle the harms identified. This was accompanied by a consultation paper setting out our proposed remedies. We will publish the policy statement, and any rules we make, at the end of May.

Following any Policy Statement, we will expect firms to implement any rules on or before the timeframes set out in our March statement on the implementation period.

We are planning a broad supervisory programme of work to ensure firms comply with the rules we implement. This will include engagement with firms during the implementation period on their readiness for the new rules, and multi-firm work to verify firms' compliance with the rules and guidance. Alongside this, we will regularly review pricing data submitted as part of the new rules to inform our programme of work and engage directly with firms where they are falling short of our expectations.

Our market engagement and interventions will also assess whether there is appropriate pricing governance, ownership and accountability within firms, if firms are actively considering the value they provide to their customers and consistently treating them fairly.

Consumers purchase products which are not fair value

We have seen evidence of firms selling products which are not of fair value to consumers.

Our supervisory approach will include work focused on firms' oversight and governance of product manufacturing, and how firms are ensuring products represent fair value to their customers. Where we see shortcomings in firms' product governance and oversight or examples of lower value products which do not provide fair value to customers, we will intervene as appropriate.

Additionally, firms are required to report on value measures. We will use this data to monitor how firms are ensuring the product offers fair value to the target market and engage with firms directly where we identify products of potential concern.

Furthermore, CV-19 has created exceptional circumstances affecting the value of a number of insurance products. We expect firms to have considered whether and how CV-19 may have materially affected the value of their products and take appropriate action where they find this is the case. We also expect firms to continue to monitor the impact of CV-19 on product value as part of their product governance processes and take appropriate action to mitigate customer harm where necessary.

We will continue our existing engagement with firms on product value. This includes work to ensure product manufacturers sufficiently consider whether products are delivering value to consumers and work to assess how firms are meeting the expectations set out in our CV19 product value guidance and General Insurance Distribution Chain finalised guidance.

Consumers experience poor service due to ineffective oversight of the value chain

Our 2019 GI distribution chain (GIDC) report identified significant potential harm from the product oversight and distribution approaches of some sectors of the GI market and by some GI firms. Alongside the report we issued a Dear CEO letter and published guidance making our expectations clear. In our January 2020 Portfolio letter we stated our intention to consider this when undertaking our firm facing work.

Since our letter, we have continued to see examples of ineffective oversight causing harm to consumers. As a result, we intend to undertake a review to assess the action taken by firms to improve their oversight, governance and control of the distribution chain following our GIDC report, published guidance and associated Dear CEO letter. Where we identify firms that have not taken sufficient steps since these reports, we will intervene and consider all our regulatory tools to take appropriate action.

Business interruption claims payments are not made in a timely manner and in line with the BI Insurance test case judgment

Our expectation is that all businesses with valid BI claims receive the payments due to them as soon as possible.

We made clear our expectations of insurers in our subsequent January 2021 Dear CEO letter. You should read that letter carefully alongside this and ensure you make interim and full payments on valid claims as soon as possible to support customers during the current situation. You should also refer regularly to our BI webpage, as any further guidance or statements regarding our expectations will be published there.

We will engage regularly with firms to understand how claims are progressing and the outcomes that are being delivered for customers. We have requested and published data from all affected insurers on the progress of their non-damage BI claims. The collection and publication of this data will be regular, will support our engagement with firms and policyholders, and assist us to efficiently supervise firms' activities in this area. Where we see that insurers are not meeting our expectations, we will use the full range of our regulatory tools and powers to ensure they do so.

Firms' operational resilience does not prevent the loss or misuse of consumer data or results in consumers not having access to key services

The risk of harm to consumers and risk 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; by the transfer of data between firms and; from the accelerated mobilisation of remote working arrangements implemented in response to CV-19. Third-party failures or weak controls can also lead to operational disruption, unauthorised losses or disclosure of consumer data.

We expect firms to have sufficiently robust systems and controls to continue to operate effectively in a stressed situation with business continuity plans to manage this. We also expect firms to have implemented, to the extent necessary, our Building operational resilience Policy Statement, by 31 March 2022.

Our supervisory approach will include engagement with firms during the implementation period on their readiness for the new rules. This will be coupled with continued engagement through our specialists in the sector specific Cyber Coordination Groups, alongside the continued use of ethical-hacking (CBEST) to assess firms' ability to detect and respond to cyber-attacks.

Brexit

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.

Next steps

We will continue to engage with PL&CL insurers in 2021 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 plans as a result.

We expect firms to keep up to date with regulatory development 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 PL&CL Portfolio, Roma Pearson at Roma.Pearson@fca.org.uk.

Yours sincerely

Matt Brewis

Director