FINANCIAL CONDUCT AUTHORITY

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Dear CEO,

Insurance market priorities 2023-2025

We want to update you on the FCA's priorities for the life insurance market and broader insurance market 2023-2025, the specific risks of harm we are most concerned about, what we want firms to do about them and where we intend to focus the majority of our work in this area.

The broader insurance market is essential to the UK economy providing a vital service for millions of UK consumers and businesses. The market has 3 key sectors: personal and commercial lines insurance, wholesale insurance and life insurance. The wide variety of products and services within it includes personal and commercial lines products such as home and motor insurance that provide financial protection, wholesale products and services that price and underwrite risks from around the world, and life insurance products that provide income to millions of customers before and at retirement, as well as long-term protection products.

Life insurers manage c.£2.35trn of customer assets across c.90m policies (at end 2022), helping customers manage their risks and to save for their retirement as well as other long-term savings needs. In personal and commercial lines markets, our 2022 FCA Financial Lives survey, shows 84% of adults surveyed hold an insurance product with over two-thirds (68%) of them reporting they always or usually shop around for these products. Further, the wholesale insurance market is a fundamental enabler to the economy allowing risks to be pooled and covered with around £55bn of Gross Written Premiums (GWP) written in 2021 alone. The health of the UK insurance market remains significantly important to the UK economy.

As with all financial services, the insurance market has faced, and continues to face, significant challenges such as the aftereffects of COVID-19, supporting customers with cost of living pressures and adjusting to higher inflation and interest rates. Additionally, climate change, artificial intelligence, resourcing challenges and strains on profitability have the potential to materially increase the existing risks of harm about which we are concerned. Ensuring we have the right data to assess both current and emerging risks of harm is a key priority for us.

Our strategic objective under the Financial Services and Markets Act (FSMA) is to make financial services markets function well. A key aim for the UK insurance market is that it continues to be a successful industry that helps customers achieve their long-term financial goals and is there for consumers and companies when the worst happens. Where insurance works well, we see customers invested in good value pensions products with good quality and timely support when they need it, and claims being met quickly and fairly at the time of customers' greatest need.

However, when we take a closer look at specific areas, too often we find significant failings. For example, in the last year we have taken supervisory action against firms where we have seen:

- instances of very long waiting times/settlement delays
- weak identification of vulnerable customers
- the continued sale of products not providing fair value
- paying away substantial amounts of commission to third parties where it was not clear how those commission levels had been assessed as being fair value
- failure to implement general insurance pricing practices rules
- discriminatory pricing practices
- undervaluation of motor claims, and
- poor business interruption claims handling.

As a regulator, we are required to comply with our statutory obligations, we do this by focusing our resources on ensuring firms achieve good outcomes for consumers to meet their needs and to ensure the market is functioning well. We expect Boards to do the same and oversee firms and ensure their objectives are in line with our priorities. While we generally see good intent from Boards, we are concerned that not enough action is being taken to ensure good outcomes for customers. We therefore expect firms' Boards to ensure concrete, proactive action is taken throughout the firm in line with our rules and expectations and not to treat them as a compliance exercise or wait for us to force action.

Market-wide priorities

While the UK insurance market covers a broad and diverse range of firms, our focus is on 4 market-wide priorities alongside sector-specific priorities. These are consistent with our strategic outcomes and commitments:

Setting & Testing Higher Standards

Putting consumers' needs first: Embedding the Consumer Duty

We have a strong focus on Consumer Duty implementation, especially in the current tough macro-economic environment – for both consumers and firms. We expect firms to assess and address issues with Products & Services, Price & Value, Consumer Understanding and Consumer Support. We also expect firms to put the consumer at the centre of their business to ensure they are delivering good consumer outcomes. This is both for open products and services now and in readiness for the Duty applying to closed products and services from 31 July 2024. We set out our expectations on implementing the Consumer Duty for Life Insurance and Personal & Commercial Lines Insurance earlier this year. We will consider using our range of regulatory tools to assess the effectiveness of this implementation, which may include mystery shopping exercises across different sectors.

***Strategy for positive change - our ESG priorities:* Governance and Culture**

Poor governance and culture in the insurance market leads directly to poor outcomes for consumers, market participants and employees and these have been key root causes of recent major conduct failings.

Firms should be able to show how they are actively working towards having a diverse workforce at all levels in their organisation. This will help firms understand customers' diverse needs and make the market an attractive career proposition for future talent. These positive outcomes can be advanced through firms assessing and improving the drivers of culture in your firm, considering leadership, purpose, governance, and your approach to recruiting, managing and rewarding employees. We have seen encouraging market commitments in this area but remain disappointed on the general lack of progress within the market overall, especially in the wholesale market.

***Minimising the impact of operational disruption:* Operational resilience and the increasing reliance on third parties**

Operational resilience is the ability of firms, financial market infrastructures and the financial sector as a whole to prevent, adapt and respond to, recover and learn from operational disruption. We have recently seen incidences of a lack of operational resilience within firms to the detriment of customers and the wider market. We are particularly concerned with the level of governance, oversight and contingency planning on outsourced services where, if a problem occurs, customers suffer harm because adequate controls and contingency plans are not in place.

Our Operational Resilience Policy (PS21/3) accompanied rules and guidance. Firm had a year implementation period until the rules came into force on 31 March 2022. After that firms needed to as soon as reasonably practicable and no later than 3 years, show that they are which comes into effect in March 2025, requires in-scope firms to be able to remain within Impact Tolerance (ITol) in severe but plausible scenarios for their Important Business Services (IBSs). To meet this requirement firms must have scenario tested their IBSs to identify any vulnerability in their operational resilience and acted on any findings before March 2025, when the 3-year transitional period ends.

It is good practice for firms to have credible plans in place to manage and recover from operational problems, take remedial action where necessary and notify the regulators promptly as appropriate. In particular, we draw attention to the risks of cyber-attacks and the need to ensure you have adequate controls in place where information is held by third parties.

Improving oversight of Appointed Representatives

Many firms in the insurance market operate as principals with Appointed Representatives (ARs) to bring benefits such as supporting innovation as some firms use the model to trial new services and propositions, providing increased customer choice and driving competition by providing market access for smaller firms. However, we have seen a wide range of harms where firms operate with the AR model, as set out in our policy statement last year. Our strengthened rules, which came into force on 8 December 2022, give principals more responsibility for ensuring your ARs are fit and proper. We are using data and analytics to help us identify higher risk principals and taking appropriate action on outlier firms. We will be testing that firms are properly embedding the new rules across the AR regime and increasing and improving our engagement with principal firms and other stakeholders. We expect principal firms to ensure high standards both within their firm, and at their ARs. Principals need to take steps to ensure their ARs operate within those high standards and to take assertive action with those ARs that fall below the principal firm's standards.

In addition to the Market-wide priorities, we will also be focused on wider regulatory priorities over the next 2 years. These include the Future Regulatory Framework and its impact on the Insurance market, our new secondary competitiveness objective – with a focus on the wholesale market, and climate change risks. On climate change risk, we encourage firms to be systematically informed about the climate change risk impact across their organisation and continually challenge inputs and outputs of the climate change models they use.

Life insurance specific priorities

In August 2021, we wrote to firms within the life insurance sector to set out our view of the key risks of harm and our supervisory strategy. Our life insurance portfolio takes account of the risks within all life insurance firms, including mutuals. Within this portfolio we also include the main regulated Third-Party Administrators (TPAs) which perform various services on an outsourced basis for life insurers.

As well as the market-wide priorities, we will also be focusing on the following areas in your sector.

Setting & Testing Higher Standards

Putting consumers' needs first: **Price and value**

The Consumer Duty strengthens the need to deliver fair price and value for all retail products. This includes pensions and other long-term savings products, annuities and long-term protection.

Pensions and long-term savings products can have complex value chains. We expect there to be transparency in the charging process, including for closed book products invested in unit-linked or with-profits funds. We expect firms to ensure that consumers are not paying excessive fees and charges, that the overall value is fair, and that they are provided with the necessary information and support to understand the end-to-end fees breakdown to make informed choices and decisions.

As part of Consumer Duty requirements, we expect firms to make assessments of the fair value of open and closed book business to the customers that have them. We will be conducting work to fully understand the transparency of charges across the value chain and how firms assess overall product value. We will focus particularly on unit-linked investments which have not been subject to the same requirements as Authorised Fund Managers managing authorised investment funds. As part of this work, we want to understand what actions firms have taken where they have identified instances of unfair value and how they will be measuring this on an ongoing basis. We will use this data to evaluate whether remedies are needed.

Recently, annuity sales have increased significantly in response to increases in annuity rates. While consumers' response to improved annuity rates may be positive, the gap between the worst and best rates offered on standard (non-underwritten) annuities has widened. As we noted in our letter to life insurers in December 2022, given that consumers will be locking into an annuity rate for life, we expect firms to ensure that the prices offered are fair value to consumers. We also expect, in accordance with our rules on pension annuity comparison information (COBS 19.9), firms make it clear that consumers may achieve a higher rate by shopping around on the open market, including for impaired / enhanced annuities. This should be shown prominently, clearly and in an engaging way in the documentation a customer receives.

While the market for retail annuities might be price-competitive, pricing may be used as a way to manage a firm's capital budget. For example, firms may reduce annuity rates so they are less attractive, to avoid selling too many relative to the available capital budget or operational capacity. Insurers should ensure that, relative to market conditions / the yields on assets being used to back annuities, they are still providing fair value for customers buying their annuities.

Providing fair value includes individually underwritten annuities, where customers disclose particular health and lifestyle circumstances (enhanced annuities). There is a well-established, and rational, expectation across customers and financial advisers that where particular health and lifestyle factors are disclosed this should provide a higher (or at least the same) income, compared to an annuity without making disclosures. Given this, customers who qualify for these products may not seek quotes for annuities that do not allow for any health and lifestyle circumstances. Insurers (and intermediaries where appropriate) should ensure that customers who disclose information about their health and lifestyle circumstances when buying an annuity are not left worse off - due to any targeted pricing management, or disproportionately high distribution costs - than if they bought an annuity without these additional disclosures.

We will continue to monitor activity in the annuity market and will take action if we consider the actions of firms across the value chain, including the level and transparency of commission on non-advised annuities, could harm the delivery of good outcomes to annuity customers.

For the life protection market, through our thematic review of PROD 4 rules, we are testing whether protection products are delivering fair value to customers. We continue to engage with insurers to identify where there may be evidence of poor outcomes. We are also concerned that levels of commission may not always be consistent with fair value and may incentivise unnecessary product churn.

***Putting consumers' needs first / Dealing with problem firms:* Consumer support & service quality**

We have seen plenty of evidence in recent years of poor service being delivered to life insurance customers. This includes slow transfer and claim settlement times, as well as lengthy response times, and we expect firms to address this as a matter of urgency. We are also concerned about potentially poor service standard targets life insurers set themselves. Additionally, much of the poor service we have seen seems to be linked to migrations or transformation activity on legacy business. We expect to see firms raising the overall standard of their service to ensure good outcomes for their customers.

Transformation activities are a known risk to firms. This is both because of the technical elements involved and of the potential impact that key actions such as migrations can have on wider customer services. Insurers should have strong governance of transformation activities to ensure they are progressing in a way and on a timescale to-achieve the best overall outcomes and support for their customers.

There are also other developments which could continue to affect insurers' service levels unless firms actively manage these risks. For example, the economic environment continues to affect firms' ability to recruit staff. Firms should take a holistic view of their service levels to identify risks of potential service downturns and manage these before problems occur.

The Consumer Duty has further raised the standards expected of firms for the quality of service being delivered and how they factor this into assessing the fair value of what they deliver to customers. We expect firms to have a clear view of the standards they are trying to achieve, why these meet the needs of their customers in different product lines and plans for how they will achieve and maintain these standards. Given the wide range of products and older systems often involved, we expect closed book products to present different challenges to open book products in delivering the expected service standards. It is imperative that firms have a clear roadmap to comply with the Duty by the deadline for closed books.

We aim to understand the drivers of inadequate service where it arises. Where we identify firms that are not acting to deliver good customer outcomes or have inadequate processes in place to avoid causing foreseeable harms, we will intervene using our regulatory tools. More broadly, we will collect data in targeted areas to understand how life insurers' actual service standards compare with intended standards and how customer experience differs across a range of factors and between firms.

***Putting consumers' needs first:* Effective customer journeys**

Providing adequate support to customers involves more than providing baseline service levels. We expect firms to demonstrate that they provide effective support to customers throughout their journey and can evidence they have this support in place. The overall customer journeys around retirement will continue to be a key focus of our attention given that these can be highly complex, with customers taking significant life decisions at various stages. It is essential that firms understand their customer journeys, how current economic conditions may influence customer behaviour and needs, where poor support is likely to cause the most harm and, where weaknesses are identified, how best to improve customer outcomes.

A key way to support customers to make informed decisions may involve providing regulated advice or guidance. It remains important that, where regulated advice is not provided, firms consider the guidance they can provide to deliver good outcomes for their customers. We continue to work with the Treasury to review the Advice Guidance Boundary and have set out guidance for firms on how best to provide support within the current rules.

***Putting consumers' needs first:* Supporting customers in financial difficulty**

The behaviours and needs of customers are likely to continue changing and it is essential that firms appropriately understand these changes and mitigate any foreseeable risks of harm to customers arising from them. For example, the increasing cost of living may mean customers engage more frequently with their products than previously. We also expect that more customers will become financially vulnerable and will require those people they engage with at life insurers to be informed, well-trained and empowered to provide support. Such changes present a foreseeable risk of harm to customers, and we expect insurers to be taking proactive steps to understand what their changing customer needs are, or are likely to be, to avoid foreseeable customer harm. In December 2022, we set out our expectations of how life insurers should support their customers given the rising cost of living.

***Minimising the impact of operational disruptions:* Effectiveness of outsourcing oversight**

The extent of outsourcing of servicing, administration and systems functions to regulated Third-Party Administrators (TPAs) within the life insurance sector has continued to increase over recent years. This reliance on TPAs, and concentration within a small number of TPAs, presents risks to life insurers which we expect to form a key part of firms’ risk assessments.

In our February 2023 Consumer Duty letter to life insurers we highlighted that, where activities are dealt with by TPAs, the ultimate responsibility for customer outcomes lie with the insurer. While insurers have assured us they remain responsible, we have been disappointed by how some have responded to operational events. This suggests a disconnect of understanding and oversight of outsourced processes may have emerged. We will look for evidence that both insurers and TPAs understand and have implemented their respective responsibilities under the Duty into their three lines of defence model. We may intervene to restrict or delay additional outsourcing arrangements if firms cannot satisfactorily demonstrate they are meeting these responsibilities.

Cyber security and data loss risks are concerns across all sectors. We believe there to be particular concerns at life insurers given the high volume of sensitive personal information held and the interdependencies between TPAs and life insurers. Our expectation is that firms assess the risk of consumer harm which may arise from cyber-attacks and develop adequate responses to minimise potential impact. We will review whether firm-specific action is required to address resilience, particularly in relation to TPAs.

***Putting consumers’ needs first*: Suitability and value of life protection products**

We continue to see evidence of poor selling practices of protection products. While our data provided evidence of insurers taking appropriate actions in response to intelligence about poor broker conduct and remediating customers, we consider that insurers could often have acted sooner. We also want to see firms improve their due diligence on new brokers to avoid their products being sold to customers for whom they will not pay out as expected, and to avoid the unnecessary re-broking of policies. Where insurers identify the potential for customer loss in the policies they hold, we expect them to remediate customers appropriately and promptly. A potential driver of poor outcomes is the commission structures between insurers and brokers. We expect firms to perform thorough assessments of their products and distribution models to ensure they offer fair value, in line with PROD 4 and Consumer Duty expectations. Insurers should monitor brokers in their distribution channels to identify instances where either unsuitable products may be sold, or products do not offer fair value.

We engaged with product providers earlier this year to understand how effectively their controls manage the risks of poor selling practices within their distribution channels. We are also continuing with our thematic review of firms’ implementation of PROD 4 rules and assessments of fair value, which includes the level of commission structures under pure protection products. We will share feedback with the market once we have completed this work and continue to engage with providers.

We have seen evidence of reviewable whole of life policies not delivering good outcomes for customers. We have also seen premiums increasing substantially at review points, leaving customers to either pay the increased premium or reduce the level of pay-out their beneficiaries would receive on their death. Firms should already be able to demonstrate they are taking active steps to identify and rectify the causes of poor outcomes for customers. In guidance published in 2016 we set expectations for firms to periodically review their closed book products, to check they remain fit for purpose and continue to meet the general needs and reasonable expectations of the customers they were designed for, taking account of changing economic conditions.

Building on this with the PROD 4 rules and the Consumer Duty, insurers should make sure that products remain suitable for customers’ needs, offer fair value on an ongoing basis, and that clear and timely communications to customers detail the nature of the product and any changes.

***Strategy for positive change – our ESG priorities:* Sustainability-related investments and disclosures**

We know life insurers can have a role in driving the net-zero transition by aligning their underwriting and investment activities with net zero. We expect firms to align their actions with any ESG and sustainability-related public commitments that they may make. Firms should note that any sustainability-related claims must be communicated in a way that is clear, fair and not misleading. We have proposed a specific rule that reinforces this requirement and directly links it to sustainability claims in our consultation on Sustainability Disclosure Requirements and investment labels. The proposed policy will not cover unit-linked pension funds and we propose to consult on rules for pension funds in due course.

Life insurers may be in scope of our Taskforce for Climate Related Financial Disclosures (TCFD) rules. They may therefore be required to make entity-level disclosures on how they are managing climate-related risks and opportunities for assets managed or administered on behalf of clients and consumers. We encourage listed companies to supplement their existing reporting with reporting aligned with both the International Sustainability Standards Board (ISSB) standards and Transition Path Taskforce (TPT) Framework on a voluntary basis, ahead of potential future requirements.

In addition, firms have diverted investments to 'sustainable' default funds in recent months. However, because of the degree of members' inertia (in pensions in particular), there is a real risk of consumers landing in funds they may not understand or may not change if they don't want to be invested. We expect firms to ensure they have a good understanding of consumers' expectations and appetite for sustainable investments and communicate clearly to keep them appropriately informed about the funds they are invested in.

Smaller firms

As part of our risk-based approach to supervision, a substantial portion of our engagement with life insurers is with the largest firms. However, we recognise the importance of smaller firms, including a large number of small mutuals, to their policyholders and members. We will be specifically engaging with smaller firms to understand how they are meeting Consumer Duty requirements and delivering good customer outcomes in a sustainable way.

Action for firms

You are responsible for ensuring that your firm meets FCA requirements including the obligations and expectations set out above. You should take all necessary action to ensure these are met and that you are prepared for the additional requirements that the Consumer Duty brings to these priority areas. We will use the Senior Managers & Certification Regime to engage directly with accountable individuals on areas of concern.

A significant part of our activity over the next 2 years will be to test firms against our priorities and expectations. We will also continue to use data to identify outliers and, where firms are not meeting our rules and expectations, we will take action.

If you have any questions, please contact your 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. Our website has further details of how to contact us.

However, we know there may be occasions when your firm faces urgent issues of strategic importance. In such significant circumstances, please contact the Head of Department responsible for the life insurance portfolio, Andrew Kay, at Andrew.Kay@fca.org.uk.

Yours sincerely

Matt Brewis
Director of Insurance
Supervision, Policy & Competition – Consumers & Competition