INSURANCE NEWSLETTER

The Consumer Duty in practice

The new Consumer Duty came into effect for in force business on 31 July. Although the concept of treating customers fairly is not new, the FCA sees the introduction of the duty as a significant step change in its expectations of firms' behaviour. Since July we have already started to see the ways in which the FCA intends to use the new duty in its supervision of firms. Increasingly, firms can expect to see their responsibilities under the Consumer Duty referenced as part of wider thematic and supervisory activities of the FCA.

A clear example of this is in the FCA's statements published alongside its general insurance values measures data in September. This data in particular identified concerns regarding fair value in the GAP insurance market, and led to the FCA writing to relevant firms requiring them to take immediate action to prove customers are getting a fair deal. The FCA called this an early signal of the work it would be doing under the Consumer Duty - although the requirement for firms to provide fair value in the context of motor insurance were actually introduced through changes to the Product Intervention and Product Governance Sourcebook in 2021.

> *"it's really important that this isn't just seen as a compliance exercise but creates a shift in culture throughout firms"*
>
> (Nisha Arora, FCA)

Similarly, the FCA's findings from its review of the sale of lifetime (equity release) mortgages sets out the FCA's expectations arising from both the Consumer Duty and its detailed rules, although the review of the associated financial promotions was based on "clear and long-standing rules".

Where existing work is ongoing, therefore, the Consumer Duty will often provide an overlay to existing FCA Handbook requirements. Future supervisory work by the FCA is likely increasingly to focus on the Consumer Duty requirements even where these do not operate alongside existing rules.

The FCA also continues to emphasize the work which firms with closed product business will need to do between now and the end of July 2024 to ensure compliance when the rules are extended to apply to those products. Firms will need to ensure that closed products continue to offer fair value. Given the length of time since some of these products were written there are a number of challenges, which include quality of customer records, disengagement of long-standing customers, use of legacy IT systems and, at a fundamental level, the possibility of higher charges applying than is the case with more recently issued products. The FCA has stated that firms will not be required to waive vested rights under existing contracts but its non-exhaustive list of such rights is quite narrow, covering only payments already due under a contract, remuneration for services wholly or partly provided, and contractual charges payable on early termination. Alternative appropriate action might include changing non-vested fees or charges or offering forbearance from policyholders' obligations.

Given the uncertainty about how firms should approach closed products, it is possible that we will see some more indication of the FCA's expectations in the coming months.

FCA insurance market priorities

On 20 September the FCA published three portfolio letters setting out its insurance market priorities for 2023-25 for Personal and commercial lines insurance, Life insurance and Wholesale insurance. The FCA's market-wide priorities are: embedding the Consumer Duty; governance and culture, in particular workforce diversity; operational resilience; and improving oversight of appointed representatives. These priorities are supplemented by sector-specific priorities.

Personal and commercial lines

For personal and commercial lines, the emphasis continues to be on price and value. The letter outlines areas of ongoing concern with implementation of Consumer Duty requirements, including high commissions, higher margins for longer tenure customers and question marks over some fair value assessments. Other Consumer Duty-related areas are also highlighted, however, including consumer support, dealing with claims, access to insurance and sales practices. Firms will need to look at the overall experience of their customers to ensure they are meeting their regulatory obligations, in particular those who are vulnerable or who may need more support in view of cost of living pressures.

Life

The FCA is also prioritising elements of the Consumer Duty, including price and value and customer support, for life firms. Areas of particular focus are annuity rates, supporting customers in financial difficulty and use of third party administrators (in particular in relation to cyber security and data loss risks).

An additional area of focus is sustainability-related investments and disclosures. The FCA comments that "any sustainability-related claims must be communicated in a way which is clear, fair and not misleading". Life firms will be subject to the new anti-greenwashing rule which the FCA proposed in CP22/20 and which is expected to come into force in Q4 2023. Separately, the FCA notes that many firms have diverted investments to "sustainable" default funds and reminds firms of the need to understand customers' expectations and appetites for sustainable investments and to communicate clearly with them about the funds in which they are invested.

Wholesale

The FCA identifies a range of sector-specific priorities in the wholesale market, including: competitiveness; operational resilience; and financial crime. Some particular areas of interest are:

- Governance and culture, including non-financial misconduct: New rules on diversity and inclusion are expected to come into force in 2024, following publication of the PRA and FCA's joint consultation on this topic in September. The FCA comments that "the wholesale insurance market in particular has a long way to go in having an inclusive culture", including in preventing and handling non-financial misconduct such as discrimination, harassment, victimisation and bullying. Despite a previous Dear CEO letter to wholesale insurance firms sent in 2020, the FCA reports that firms are not prioritising this issue and the FCA is ready to use its full range of tools where instances of non-financial misconduct arise.

- Cyber insurance: The rise in cyber attacks and developing market in cyber insurance raises a number of issues for firms. The FCA's principal concern is that uncertain cyber policy wordings may result in firms not meeting their customer needs. The FCA plans to continue to monitor the market to ensure policy wordings are clear and cyber claims are handled in a fair and timely way.

- The Consumer Duty: The duty applies to all firms in the wholesale insurance market who can determine or have a material influence over retail customer outcomes, even if they do not have a direct relationship with retail customers. The FCA comments that it has seen evidence of high commission rates and poor practices in the wholesale market which are inconsistent with good outcomes for retail customers. Wholesale firms will need to ensure they have embedded the Consumer Duty into their business practices where the design or distribution of their products may affect end retail customers.

Themes from our best friends seminar

Earlier in November we hosted a client seminar in London jointly with our network of best friends firms. We discussed approaches to restructurings and redomiciliations, developments in the insurance sector, and technology and use of data. Some insights from the seminar are outlined below.

To request access to the full seminar recording please contact our **Events** team.

Cross-border conversions

A&L Goodbody (Steven Quinlaven) spoke about the new cross-border conversion procedure in the EU. This was established by the Cross-border Conversions, Mergers and Divisions Directive, which came into force on 1 January 2020 but with an implementation date of 31 January 2023.

The process allows a legal entity to convert to a new legal form in another Member State, transferring the registered office whilst retaining legal personality. We heard from Steven about the advantages of this process, including speed, the avoidance of the need to transfer assets, policies or employees and the absence of direct policyholder notification requirements. Regulatory approval of the new legal entity is still needed and lack of familiarity with the new regime may in the short term lead to regulatory nervousness.

Artificial intelligence and the insurance sector

The use of artificial intelligence in general, and in financial services in particular, is an ongoing regulatory theme, as illustrated by the recent publication in the UK of the PRA and FCA's joint feedback statement on Artificial Intelligence and Machine Learning. In the seminar, Bredin Prat (Béna Mara) discussed the EU's current approach to artificial intelligence in the form of the draft Artificial Intelligence Act. The Act, which is currently in trialogue negotiations between the EU legislative bodies, will classify AI systems according to the risk they pose to users and regulate them accordingly. This will include the banning of AI systems which pose an unacceptable level of risk and introducing a series of requirements applying to the use of "high-risk" AI systems. The original draft legislation did not include insurance activities within the list of high risk systems but discussions are ongoing. The European Council's general approach on the legislation, adopted in December 2022, proposed including "AI systems intended to be used for risk assessment and pricing in relation to natural persons in the case of life and health insurance" as a high risk system.

The UK intends to follow a more sector-specific approach, using a principle-based framework for regulators to interpret and apply to AI within their remits. In its white paper published in March, the Government commented that "new rigid and onerous legislative requirements on businesses could hold back AI innovation and reduce [their] ability to respond quickly… to technological advances". In the client seminar, Charles Randell (Senior Consultant at Slaughter and May and former Chair of the FCA) highlighted that the FCA Handbook already contains many provisions which enable supervisors to hold firms to account for the use of AI. Co-ordination and coherence between different regulators (e.g. the Information Commissioner's Office and the FCA) is, however, essential.

Looking further ahead, the hyper-personalisation of insurance using "big data" and AI (or even less sophisticated algorithms) may lead to regulatory policy interventions aimed at reducing financial exclusion or new categories of discrimination.

Further information

For more information on our Insurance practice, including our latest insights, please visit our website.

Our recent briefing note on the PRA's consultation on funded reinsurance can be found here.

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