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REGULATORY

FCA business plan for 2023/24 – points of interest

> "The FCA's three-year strategy is underpinned by three core focusses: reducing and preventing serious harm; setting and testing higher standards; and promoting competition and positive change."

On 5 April, the FCA published its business plan for 2023/24 (the Business Plan) setting out how the FCA intends to deliver on the second year of its three-year strategy to improve outcomes for consumers and the UK markets, which it launched in April 2022. The FCA's three-year strategy is underpinned by three core focusses: reducing and preventing serious harm; setting and testing higher standards; and promoting competition and positive change.

With the key uncertainties that will impact the UK economy in 2023/24 noted as including interest rates and inflation, rising unemployment, and declines in household disposable income, the Business Plan contains thirteen commitments that build upon the core focusses of the three-year strategy. The FCA also states that, where it has additional resources available, it will focus on the following four "most critical" commitments:

- preparing financial services for the future;
- putting consumers' needs first;
- reducing and preventing financial crime; and
- strengthening the UK's position in global wholesale markets.

Key Activities

The Business Plan sets out the activities that the FCA will undertake over the next year in connection with its commitments, including:

Reducing and preventing serious harm

- enhancing proactive and data-led detection of problem firms and increasing the number of firms that action is taken against;
- consulting on redress exercises, developing proposals to improve complaints reporting and reviewing rules on access to the Financial Ombudsman Service for SMEs;
- assessing whether the new rules for the Appointed Representatives regime are being embedded properly, and the need for further policy interventions;
- introducing a new regulatory return for solo-regulated firms to provide information about their financial resilience;

Setting and testing higher standards

- undertaking sector-specific supervisory work in connection with the Consumer Duty and creating an additional interventions team to take action where consumer harm is detected;
- publishing a net-zero transition plan and monitoring how effectively firms are implementing climate-related financial disclosures;
- assessing how operationally resilient firms are and publishing a consultation paper on an oversight regime for critical third parties (e.g., cloud service providers);

Promoting competition and positive change

- preparing for an orderly replacement of firm-facing provisions in retained EU law with new rules in the FCA Handbook; and
- publishing feedback statements to discussion papers on AI in financial services and Big Tech.

Other takeaways

The FCA highlights in the Business Plan that it will soon have a new secondary objective to facilitate the international competitiveness of the UK economy and its growth in the medium to long term (introduced as part of the Financial Services and Markets Bill). The FCA states that it sees this secondary objective as being in line with its current approach and that it will increase its focus on international competitiveness and growth in delivering its primary objectives.

It is also noted that the Consumer Duty[1] underpins a number of the activities that the FCA sets out in the Business Plan, in particular the introduction of an interventions team that will take action where consumer harm is detected and sector-specific supervisory work.

The Business Plan also places emphasis on the FCA becoming a 'data-led

regulator', with the FCA noting that it is aiming to complete a major upgrade of its core regulatory systems and improve its capabilities through the automation of analytics tooling. The FCA also states that it will reduce firm burden by improving data collection. Several of the activities detailed in the Business Plan draw upon this data-led approach. For example, the new regulatory return mentioned above is seen as a key step in embedding a data-led approach that will help the FCA identify more effectively financial and other stresses which may cause firm failure. There is also an emphasis on developing new data-led analytical tools, including in relation to anti-money laundering supervisory work.

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1. Please refer to our September 2022 and February 2023 Insurance Bulletin articles on the Consumer Duty.

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"The FCA's focus post 31 July will be on tackling the greatest harms, and it will act swiftly where there is harm or a risk of harm to consumers."

Consumer Duty: lessons from the FCA review of fair value frameworks

The FCA has reviewed 14 firms' fair value assessment frameworks, and has published a report setting out good and poor practice identified. Particular issues found by the review include: ensuring that firms properly consider outcomes for different types of consumers, such as those on low incomes, rather than using broad averages; and the importance of firms challenging themselves on questions such as whether high profit margins signify a lack of fair value.

Firms will need to use the remaining time to address these issues before the Duty comes into force on 31 July[1].

Background

The Consumer Duty is intended to set higher standards of consumer protection and require firms to deliver good outcomes for consumers[2]. The price and value outcome is one of the four key outcomes firms need to deliver for customers.

The findings of the FCA review

Whilst the FCA's review was quite limited, as it reviewed 14 fair value assessment frameworks, mainly from a range of large firms in four portfolios (retail banking, consumer investments, payments and digital assets) nonetheless the findings are still important to take on board. The FCA has noted that many firms are making substantial efforts to implement the Duty and overall, the frameworks indicated that firms had carefully considered the requirements and shift in focus to consumer outcomes. However, in some cases there were questions as to how effective certain frameworks would prove to be in practice. A summary of the FCA's findings follows:

Understanding fair value

Firms need to have a strong understanding of what fair value is and the requirements of a fair value outcome. Some frameworks planned to rely on high-level or unevidenced arguments that their business models inherently offer fair value, perhaps due to their perception of how competitive their product or service is. Firms need to evidence this view and allow for their own critical analysis of the position.

Assessing value

Most frameworks set out a reasonable view of how to assess the benefits consumers can expect to receive and provided a sufficiently broad view of overall costs to the consumer. However, a few firms active across several markets had a single generalised template, and it was not always clear how it would apply to very different products for different target markets. Some did not make reference to the firm's profit margins on different products and services, and whilst it can be difficult to make this allocation on an individual product basis it is likely to be a relevant factor in assessing fair value.

Considering contextual factors

Many firms did consider the interaction between fair value and other elements of the Duty such as consumer support and consumer understanding outcomes. There was some good analysis around consumer choice and how it affects value, and especially how "sludge practices"[3] could lead to poor value. However, some firms did not give much consideration to broader contextual factors and only considered whether the financial value was positive. Some firms did not give much thought to whether they needed information from other firms in the distribution chain or third parties.

Assessing differential outcomes

A number of firms set out how they plan to look at differential outcomes and demonstrated a range of ways to segment customers. Some included tailored analysis of fair value for customers with characteristics of vulnerability, such as how the needs and objectives of such customers might differ and thus how costs and benefits would vary. On the other hand, some information presented in frameworks tended to rely on average outcomes rather than analysis to understand the distribution of customers. The FCA considers that, even if firms are analysing segmented groups, group averages could disguise outliers or pockets of poor value.

Data and governance

Most of the frameworks had appropriate data-led plans to monitor and review customer outcomes and allow challenge and discussion in decision-making with clear timelines for value assessments. However, some firms did not identify what data they might use, and others did not make their remediation steps clear. A points-based or red/amber/green style approach in the frameworks appeared appropriate in many cases, but the FCA expects firms to consider whether they are giving sufficient weight to critical analysis around the ratings, how thresholds between them are drawn and whether decision-makers have enough information to review and challenge the assessment of fair value.

Conclusion

In a recent **speech**, Sheldon Mills of the FCA emphasised that the issues identified in the report needed renewed focus, and that firms should use the run-up to 31 July to ensure that their fees are fair and transparent and that particular groups of consumers are not disproportionately disadvantaged. The FCA's focus post 31 July will be on tackling the greatest harms, and it will act swiftly where there is harm or a risk of harm to consumers. However, the FCA also recognises that this is new territory and some firms will need to improve continually. The FCA says it will be pragmatic and open in working with firms on how they use data and analytics to demonstrate compliance.

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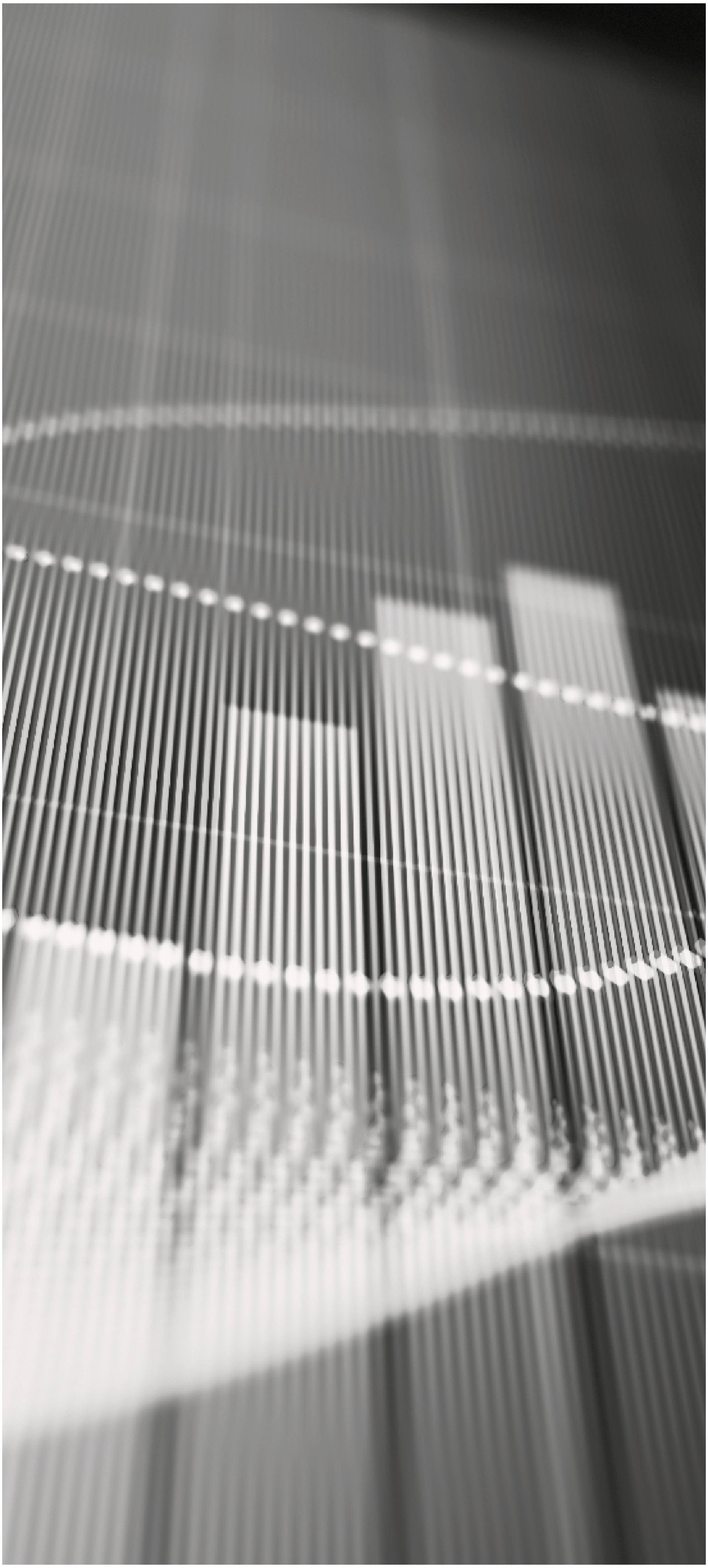
1. The Duty comes into force on 31 July 2023 for all new products and services and from 31 July 2024 for closed products and services.
2. See our previous articles on the Duty **here** and **here**
3. The FCA defines these as practices that create excessive friction that hinder consumers from making decisions in their interests, such as not clearly signposting the process for product cancellation on a website.



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"The mere fact two parties are insured under the same policy does not mean that they are covered for the same loss and cannot make claims against one another."

DISPUTES

Construction all risks insurance: Contractors beware the risk of subrogation

In *FM Conway v The Rugby Football Union and others*[1], the Court of Appeal has confirmed that, in the context of a composite insurance policy, a co-insured contractor could not rely on the insurance policy as a defence for subrogated claims against it for defective work.

Background

As part of the major refurbishment works to upgrade Twickenham Stadium ahead of the 2015 Rugby World Cup, the Rugby Football Union (RFU) engaged FM Conway Limited (Conway) to install ductwork at the stadium. This ductwork was designed by Clark Smith Partnership Limited (CSP) to accommodate high voltage power cables.

The RFU and Conway entered into a letter of intent and building contract that incorporated the JCT Standard Form Building Contract 2011. The parties chose "Option C" for the insurance, which required the RFU to take out and maintain insurance in respect of the existing structures and contents, and all risks insurance for the works. It was common ground that Option C did not expressly require the RFU to effect insurance on behalf of Conway to insure it against the cost of rectifying its own defective work.

The RFU alleged defects in both the design and installation of the ductwork as the cables were damaged when they were pulled through the ducts. The RFU was indemnified £3.3 million for the cost of replacement cables by its insurer pursuant to the terms of the insurance policy. The insurer subsequently commenced subrogated proceedings against Conway and CSP for the negligent design and install.

In response, Conway commenced proceedings seeking declarations that:

a) it had the benefit of the policy on the same terms as the RFU;

b) the RFU could not commence a claim against Conway under the policy; and

c) the insurer could not exercise any rights of subrogation against Conway because the loss and damage was covered under the terms of the policy.

The first instance decision

Mr Justice Eyre decided that Conway could not rely on the policy to defend the claim. Utilising agency principles, the critical issue was whether and to what extent the party effecting the insurance had both the authority to obtain cover for the other party and an intention to do so. That analysis begins with the relevant contractual documents. Accordingly, based on the letter of intent and building contract, Conway's cover was limited to the extent required to fulfil the contractual obligations between the parties (i.e., Option C), nothing more.

Eyre J did consider contextual evidence alongside the documents and recognised that, during the initial negotiations, there had been a general understanding between the representatives for the RFU and Conway that the policy would be comprehensive and cover the contractors. However, Eyre J found that this had been overtaken by subsequent negotiations and, fatally, was not the final position reflected in the contractual documents.

The appeal

The Court of Appeal noted that the leading case on this issue is *Gard Marine Energy Ltd v China National Chartering Co Ltd*[2], which provides that the critical question is whether the contractual scheme precludes a claim between the parties for any insured loss. The issue then is whether the parties intended to create an insurance fund as the sole avenue for pursuing damages, or whether there is an independent right of action for breach of contract alongside that fund. This is a matter of construction.

Lord Justice Coulson set out the following five broad principles based on the authorities considered:

1. The mere fact that two parties are insured under the same policy does not mean that they are covered for the same loss and cannot make claims against one another.
2. Where one party has procured insurance for the other, it will usually be necessary to consider issues such as authority and intention (and the related issue of scope of cover) by reference to the law of agency.
3. An underlying contract between the two parties is not a pre-requisite for a proper investigation into these issues, although one may well be implied by the court.
4. If there is an underlying contract then, in most cases, that will be the best place to find evidence of these issues. The court will begin its analysis here.
5. In circumstances where the underlying contract does not provide the complete answer, the court will look to other evidence for these issues (e.g., any negotiations).

Applying these principles, the Court of Appeal unanimously upheld Eyre J's decision and confirmed that authority and intention was the correct test in the circumstances.

Conclusion

This case provides helpful guidance in an often complex area of insurance law. The key takeaway for insureds and insurers should be to ensure that any contractual documents, including the insurance policy, reflect the allocation of risk and scope of insurance cover agreed for each of the parties involved.

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1. [2023] EWCA Civ 418 (Court of Appeal)
2. [2017] UKSC 35

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"The Judge also provided an endnote to the judgment which stated that it might surprise law firm clients and the public that professional indemnity insurance will not protect them from dishonesty where a second law firm partner condoned the dishonesty of the first."

What does it mean to condone?

In *Discovery Land v Axis*[1] the court gave some guidance as to the meaning of the word "condone" within the context of a fraud or dishonesty exclusion in a solicitors' professional indemnity policy.

Introduction

The background to this matter was that a number of fraudulent and dishonest acts were committed by the Jirehouse entities (an LLP and several companies) by the acts of a partner and solicitor, Mr Jones. He removed very large sums from the client accounts held on behalf of the claimants, taking them for his own benefit. The claimants obtained judgment against the Jirehouse entities, which had become insolvent.

In this claim, the claimants sought to obtain payment of the judgment amount from the defendant, which was the professional indemnity insurer of the Jirehouse entities.

The policy was written in accordance with the SRA minimum terms and conditions (MTC). There was no dispute that the claim fell within the insuring clause of the policy, but the issue was whether it was excluded under the fraud or dishonesty exclusion. The policy excluded:

"Any claims directly or indirectly arising out of or in any way involving dishonest or fraudulent acts, errors or omissions committed or condoned by the insured, provided that:

(a) the policy shall nonetheless cover the civil liability of any innocent insured; and

(b) no dishonest or fraudulent act, error or omission shall be imputed to a body corporate unless it was committed or condoned by, in the case of a company, all directors of that company or, in the case of a Limited Liability Partnership, all members of that Limited Liability Partnership."

Issues

The key issues were whether Mr Jones was the sole director and member of the Jirehouse entities, or whether a Mr Prentice was also a director/member and if so, whether Mr Prentice had condoned the behaviour of Mr Jones – so that the exclusion from cover would be engaged.

Judgment

The Judge, Mr Justice Robin Knowles, gave some guidance on the meaning of "condone" in this context, finding that it should be given its ordinary meaning which is to convey acceptance or approval, and in some situations not requiring an overt act. The Judge also held that to condone an act, it is not necessary that a person must know of a particular fraudulent act before or at the time they are taken to have condoned it. It is enough for them to have known and condoned a pattern of dishonest behaviour of which the particular fraudulent act formed a part.

Applying this to the facts the Court found that Mr Prentice did realise that Mr Jones was prepared to do things he should not and Mr Prenctice turned a blind eye to that. However, Mr Prentice did not realise, and should not, have realised, that Mr Jones stole client monies. Mr Prentice did not make enquiries or follow up issues because he did not want to confirm what he believed or strongly suspected, the misuse of client money by Mr Jones in order to deal with the financial problems of the Jirehouse entities, and in this regard Mr Prentice had lacked the necessary professional responsibility and appreciation of the regulatory requirements of the SRA. Further, he had been willing to be untruthful in the current proceedings and to downplay his role in events.

However, it was held that what Mr Prentice suspected was that the client monies were being used to meet the Jirehouse Entities' own temporary financial problems, and that he did not suspect a fraud of the nature and multi-million pound scale that Mr Jones was actually carrying out. Mr Prentice was shocked when he discovered the nature of the misuse.

Therefore, the Court found that Mr Prentice had not condoned Mr Jones' behaviour with regard to these claims within the meaning of the policy, or if he had condoned anything then it was the use of the money to meet temporary exigencies and pressures.

The case was distinguished from previous authorities in this area, *Zurich v Karim*[2], as in that case the Court accepted that the two condoning partners knew that flows of money from the firm to them could not have come legitimately from its income; and *Goldsmith v Williams*[3] as the condoning partner engaged in mortgage fraud in her own right and knew that her partner did.

The insurer also argued that the partnership between the two solicitors was a sham partnership. However, the Court found that the evidence indicated that it was genuine. Even if Mr Jones was intended to be the far more powerful partner, with the power to cause Mr Prentice's removal at a future date, that did not make the partnership a sham. It was not, for example, a preparatory step in a fraudulent plan. It was also noted that there would be serious consequences in terms of legal uncertainty if the duly documented and registered appointments as partner/director were too readily treated as a sham.

Conclusion

The case gives some guidance on the meaning of condone within a solicitors' professional indemnity policy, and provides an illustration of circumstances where, despite some arguably dishonest behaviour on the part of a second partner, this will not be enough to satisfy the dishonesty or fraud exclusion.

The Judge also provided an endnote to the judgment which stated that it might surprise law firm clients and the public that professional indemnity insurance will not protect them from dishonesty where a second law firm partner condoned the dishonesty of the first, especially where the firm is a separate legal entity. It was suggested that this point may be reviewed by the SRA and Law Society.

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Additional research conducted by Trainee Solicitor Alexia Karamitsou.

1. [2023] EWHC 779 (Comm)
2. [2006] EWHC 3355 (QB)
3. [2010] EWHC 26 (QB)

Lloyd's Rugby 7s

We enjoyed catching up with clients and colleagues in the sunshine at the recent Lloyd's Rugby 7s and netball event on 18 May in Richmond.

Members of our Shipping, (Re) Insurance and Aerospace teams were very pleased to host a marquee, and to field a team for the rugby from across the firm together with some of our friends from the market. This was, as always, an excellent event and we are already looking forward to next year.

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