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In this Insurance Bulletin:

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REGULATORY

FCA reviews firms' implementation of the Consumer Duty

The FCA has recently published its findings from its review of firms' implementation of the Consumer Duty. It found that there have been some improvements to deliver better outcomes for customers, but that some firms "could do better". Alongside this, Sheldon Mills (FCA Executive Director, Consumers and Competition) has, in a speech delivered in February, looked ahead to the implementation of the Duty for closed products on 31 July 2024.

Review of implementation

As set out above the underlying message in the FCA's findings from its implementation review is that firms 'could do better'. Although recognising that there is some good practice, the FCA states that some firms are lagging behind.

Aside from the examples of good practice, of interest in the findings is the FCA's commentary on areas that require improvement, including:

- Culture, governance and monitoring – some firms are not having sufficient discussions on the Duty at a board level. Firms need to ensure that there is focus on the Duty's outcomes at all levels.
- Consumers in vulnerable circumstances – the FCA has found firms putting the onus on customers to identify themselves as vulnerable and, in some circumstances, requesting evidence of vulnerability. This can create barriers to customers getting the support they need.[1]
- Products and services – the review discovered instances of information not being shared effectively across distribution chains or firms not paying close enough attention to distribution strategies; and
- Price and value – some firms are failing to show that their products and services offer fair value or are making statements about fair value without any qualitative reasoning as to how fair value has been achieved.

These findings are likely to be useful for firms currently working on the changes they need to make to meet the 31 July 2024 implementation deadline for the introduction of the Duty for closed products and services.

Closed products and services

In his speech, Mr Mills referenced the FCA's review of firms' implementation and noted that, in particular, fair value assessments are not relying on solid data or credible evidence when justifying a product's value to customers. Acknowledging that the fair value outcome is perhaps the most challenging outcome of the Duty, Mr Mills stated that firms should be considering all aspects of fair value at a product level and the impact on different customers. He added that the firms' board reports would be coming under scrutiny as the FCA reviews the steps firms are taking to drive good outcomes.

Looking ahead to the implementation of the Duty for closed products from 31 July 2024, Mr Mills identified the following as areas that required particular attention from firms:

- Gaps in monitoring data – some firms will face challenges in obtaining relevant data on closed products, particularly where legacy systems are involved. Firms that identify gaps need to take additional steps, where they cannot address those gaps, to mitigate the risk of harm to consumers, such as through enhanced outcomes testing.
- Fair value – firms will not be judged with the benefit of hindsight but must still be able to demonstrate that closed products offer fair value. For products that are not providing fair value, the FCA will consider whether a firm complied with the rules in place at the time the product was sold, where it identifies that a firm could reasonably have known that its assumptions in respect of the product were significantly wrong.

- Customer connections – closed products raise issues around firms not having up to date information on some customers, including those that do not actively engage with a firm. The FCA expects that firms will take action to engage customers of closed products, including seeking out customers that a firm has lost contact with.
- Vested rights – vested rights, such as annual fees or exit charges, can lead to poor outcomes for consumers. There is an expectation that firms will offer extra support in respect of vested rights where there is a crossover between the vulnerability of a customer and the complexity of a product.

Looking ahead

The findings from the review and Mr Mills' speech echo the "not once and done" mindset that the FCA has adopted in relation to the Duty from the get-go. Firms can expect ongoing scrutiny from the FCA, particularly with the first round of board reporting since the Duty was introduced rapidly approaching. Particularly for those firms that are looking at the Duty's implementation for closed products and services, there are new challenges to face.

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Footnotes:

1. The FCA has since announced, on 15 March, a review of firms' treatment of customers in vulnerable circumstances – see **here**

Insurers pause the sale of GAP products due to fair value concerns

Last month, the FCA announced that several insurers offering 'Guaranteed Asset Protection' (GAP) insurance have agreed to halt sales of these products temporarily due to concerns about the products' value for money. This measure is considered to be part of a wider trend of FCA action aimed at ensuring that firms uphold the Consumer Duty.

GAP insurance is often sold alongside car finance, and the object is essentially to provide protection against a vehicle's loss of value. Many consumers take out loans to finance their car purchases at an amount to match the car's original value, but if the car is stolen or written off before the loan is repaid, the consumer's loss will be calculated on the basis of the car's then current, lower market value. GAP insurance bridges the gap between these values.

The FCA has previously undertaken significant work in this area, and wrote to firms manufacturing GAP products in September 2023 to ask them to take action to prove consumers were getting fair deal. The FCA has indicated that it was not satisfied with the responses. Latest fair value measures data shows that only 6% of the amount paid in premiums for GAP products is paid out in claims, with some firms paying 70% of the value of insurance premiums in commission to third parties.

The pause in sales is therefore to enable the regulator to engage further with sector participants with a view to improving the value of the product so as to ensure consumers get a fair deal.

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FCA focus on non-financial misconduct in the insurance industry

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"The FCA made clear a number of years ago that it considers non-financial misconduct to fall within its remit, stating *"non-financial misconduct is misconduct, plain and simple"*."

Non-financial misconduct continues to be a key focus for the FCA, and the report[1], "Sexism in the City", released by the Treasury Committee on 8 March, lays out very starkly some of the problems that exist within the financial services industry. At the end of February, the FCA launched a survey of Lloyd's Managing Agents, London Market Insurers, and intermediaries, as part of an information gathering exercise on non-financial misconduct. In this article we recap developments and place the survey in the context of current FCA thinking in this area.

FCA action

The FCA made clear a number of years ago that it considers non-financial misconduct to fall within its remit, stating "*non-financial misconduct is misconduct, plain and simple*"[2]. This area is a priority for the FCA, across all the financial services industry generally, but it has flagged that the wholesale insurance market in particular has a long way to go.

The FCA wrote[3] to wholesale insurance firms in 2020 to flag that non-financial misconduct, such as discrimination, harassment, victimisation, and bullying, presents a risk. The FCA stated that non-financial misconduct indicates a firm's approach to cultural issues and makes the environment one where the best business choices and risk decisions are not made, and the best people are not retained. This was flagged again in September 2023, when the FCA indicated[4] its concern that, although a sizeable proportion of firms had taken steps to tackle issues, this had not gone far enough and a concerning increase in incidents had occurred. We have also seen some high-profile reports of behaviour in the insurance market highlighted in the press in the last couple of years.

In October 2023, the FCA and PRA published a joint consultation[5] on Diversity and Inclusion in the Financial Sector. As part of its paper, the FCA included proposed amendments in relation to certain aspects of non-financial misconduct. These were:

- Firms must be satisfied that individuals performing a Senior Management Function (SMF) or a certification function are "fit and proper" to carry out the role. Guidance in the FCA FIT chapter of the Handbook already sets out that firms should assess honesty, integrity and reputation. The FCA will explain that bullying or similar misconduct in the workplace is relevant, as is similarly serious behaviour in a person's private life (such as domestic abuse) and will give examples such as sexual or racially-motivated misconduct. The PRA will also take into account established patterns of an individual's behaviour that would be likely to affect a firm's safety and soundness when considering if the individual meets the PRA's standards of fitness and propriety.
- The FCA will expand the scope of the Code of Conduct Sourcebook (COCON) to make clear that serious instances of bullying, harassment and similar behaviour towards fellow employees will be a breach of the rules.
- The FCA proposes to add guidance to the Handbook on how non-financial misconduct in relation to other members of the firm's workforce or in relation to someone outside the work context should be incorporated into regulatory references. This is in line with the FCA's position, as set out above, that non-financial misconduct is misconduct and not its own separate, lesser category.

These proposals in part aim to deal with issues arising from a decision of the Upper Tribunal in *Frensham*.[6] This found that the FCA was entitled to take into account non-financial misconduct outside the work setting, but that the conviction of an individual IFA for a serious non-financial crime of attempted grooming did not alone justify enforcement action. This was because it had not been linked by the

FCA to a relevant regulatory provision, such as the integrity objective.

The "Sexism in the City" report noted the role of the regulators in combatting sexual harassment and considered the proposals in the October consultation paper. The FCA gave evidence to the Treasury inquiry indicating that the proposals would give the FCA a stronger ability to take action in this area. Some at the inquiry questioned whether the proposals went far enough, but it was noted by the FCA CEO Nikhil Rathi that the FCA was already at the limit of its legal powers and that the new proposals will likely at some point be tested in court.

We have seen the courts grapple with issues relating to the application of professional regulation to private life. *Frensham* referred to *Beckwith v SRA*, in which the Divisional Court found that the misconduct in question must be qualitatively relevant to the practice and reputation of the profession. The Court noted that regulators must recognise that a popular outcry is not enough to establish that a matter falls within a regulator's remit.

FCA request for information from the insurance market

In February, the FCA sent out a request for data from the insurance market relating to non-financial misconduct that had taken place at the office, working from home, offsite or in work-related social situations or events. The aim is to gain a baseline assessment of when and where incidents occur, the methods of detection (such as whistleblowing or surveillance), the outcomes (such as written warning, dismissal or complaint not upheld) and the number of certain other outcomes, such as non-disclosure agreements and employment tribunals. The FCA has said that it will use the data from this exercise, and from similar exercises it intends to carry out in other areas of financial services, to inform supervisory work.

Conclusion

We wait to see the outcome of the FCA's D&I consultation on all of the areas it addressed, including non-financial misconduct. In its response[7] to the Treasury Report, the FCA indicated that it will consider carefully the Committee's comments on that Consultation and its recommendations. However, the FCA has made clear that it will be using its full range of regulatory tools, including enforcement action, to address non-financial misconduct going forward.

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Footnotes:

1. https://committees.parliament.uk/publications/43731/documents/217019/default/
2. Speech of Christopher Woolard, Executive Director of Strategy and Competition, 19/12/18 Opening up and speaking out: diversity in financial services and the challenge to be met | FCA
3. https://www.fca.org.uk/publication/correspondence/dear-ceo-letter-non-financial-misconduct-wholesale-general-insurance-firms.pdf
4. https://www.fca.org.uk/publication/correspondence/wholesale-insurance-market-priorities-2023.pdf
5. Covered in a previous bulletin here
6. Jon Frensham v The Financial Conduct Authority [2021] UKUT 0222 (TCC)
7. https://www.fca.org.uk/news/statements/house-commons-treasury-committees-sexism-city-report

DISPUTES

Court gives judgment on the Insurance Act 2015

Since the Insurance Act 2015 came into force in August 2016, there have been only a few judgments considering its provisions.

Therefore, *Scotbeef v D&S Storage (in liquidation)*[1] will be of some interest to insurers and brokers. The court has given some consideration to the application of section 9 (basis clauses) in particular. It has also considered the application of the transparency requirements under the Act. More information is available here.[2]

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Footnotes:

1. [2024] EWHC 341 (TCC)
2. https://www.hfw.com/Court-gives-judgment-on-the-Insurance-Act-2015

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