Browne Jacobson

Good insurance business: has Covid changed the insurance market for the better?

FCA publications last month gave general insurance ("GI") and in particular London Market ("LM") firms a sharp reminder of where their culture stands in regulators' eyes compared with other financial services ("FS") industries.

16 December 2020

FCA publications last month gave general insurance ("GI") and in particular London Market ("LM") firms a sharp reminder of where their culture stands in regulators' eyes compared with other financial services ("FS") industries.

On a general basis, the FCA seems to be encouraging FS firms that their cultural change is 'on the right track'. A speech by Jonathan Davidson, Executive Director of Supervision - Retail and Authorisations at The 6th Annual Culture and Conduct Forum for the FS Industry stated that coronavirus had, for "many" FS firms, "[swept] away many of the big barriers to healthy cultures."

For the FCA, healthy cultures are:

- "purposeful,
- diverse and inclusive … [and]
- deliver[ing] healthy returns to shareholders"

Interestingly, the speech did not identify any specific firm that had married healthy returns and healthy culture, although it did say "there was a solid business case for firms being purposeful".

The speech did however provide more detail on the "barriers" to healthy cultures, being "fear of …

- "the short-term focus on profits, elevated in importance by financial key performance indicators (KPIs) and short-term horizons for reporting" and
- "taking the initiative to do the right thing and being blamed if it goes wrong – especially by the regulator",

which resulted in firms often having:

- "a purpose which is a thin veneer for the outside world which doesn't resonate internally
- bureaucracy (including dense and thorny barriers of compliance)
- slow, legalistic, command and control approaches
- lack of empowerment and engagement especially of [a] mid-management … often constrained by bureaucracy and fear of blame, and unfairly and unkindly referred to as the permafrost layer
- the domination of a compliance box-ticking mindset at the expense of a systems thinking outcome and learning mindset."

But dealing with Covid had resulted in "early and thoughtful engagement of firm leadership in problem-solving at the outset – leaders have de-layered the organisation for these issues and role-modelled system based thinking on how to deliver outcomes."

This revised approach had in turn engendered a "purpose" within firms of "supporting customers and colleagues". The effects on culture have been to:

- "empower … staff to make decisions quickly and consistently [with] … ingenuity and judgement in adapting to ensure continuation of customer service especially to the vulnerable … [and]
- create … the trust for colleagues to do the right thing at speed without paralysing fear of the consequences … [and thereby]

- “melt” the “permafrost” by the reciprocation of trust between employees and senior management, thus enabling the “empowerment of middle management.”

For the FCA,

- the “role” of FS is to “channel … and guide ... the investment and funding with which our economy is built, diversif[y] risks and provide … affordable financial support to those in need by advancing credit [and] … facilitate … every single economic transaction through the payments system”, and
- a healthy culture in FS is sustained by the “purpose” of “… providing support to consumers and small businesses and keeping the economy going.”

But insurance firms should think carefully about ‘basking in any reflected glory’, as is shown by a letter to the CEOs of “[LM] Intermediaries and Managing General Agents” from Charlotte Cross, Head of Wholesale General Insurance at the FCA. This letter was originally sent 03.11.20 but not published until 23.11.20, and has a less optimistic, perhaps even minatory, and certainly sterner, tone.

In contrast to Mr Davidson’s points about the FS industry’s effective use of “technology”, Ms Cross “recognises that the [London] market requires modernisation and careful monitoring to ensure that the interaction between brokers and underwriting capacity does not become dysfunctional” which would prevent the LM from “creat[ing] and maintain[ing] healthy competition, efficient distribution chains, good claims services and better use of data.” [emphasis added].

Ms Cross’ point is based on regulatory work (eg the FCA’s Wholesale Insurance Broker Market Study) that pre-dates the dominant economic factors now in play of Covid and the “hardening market” of rising premiums and reducing cover. Among the “areas warranting further action”, Ms Cross identified “conflicts of interest emanating from [intermediaries’] remuneration practices”. It is possible to infer exasperation from a lack of progress by her comments:

“We want firms to behave ethically and responsibly in the way they treat their customers, their employees and their counterparties. We believe that we have provided sufficient information to help them do so.” [emphasis added] Instead of Mr Davidson’s praise for overcoming “barriers”, Ms Cross identifies four “drivers of harm”, as to which LM firms must promptly “identify and address any shortcomings”:

1. “Financial Resilience and Orderly Wind down
2. Ineffective Governance and Oversight of businesses
3. Culture and Non-Financial Misconduct
4. Business Models which provide poor oversight of distribution chains”

In relation to financial resilience, it seems that the FCA regards a number of LM firms as being close to needing, or being forced, to exit the market. In particular, the FCA once again highlights the importance of firms’ having appropriate professional indemnity insurance (“PII”), previously highlighted as a problem in Thematic Review 16/9. The fact the FCA has issued a reminder on PII indicates its awareness that LM firms have been, or are at serious risk of, failing to obtain suitable cover. Again, an undertone of exasperation can be discerned.

Effective governance is of course inextricably linked to culture, and on these there is significantly less optimism in Ms Cross’ letter than Mr Davidson’s suggestion that the FS industry just needs to “tip the balance” in order to advance its “journey to healthy, purposeful, safe, diverse and inclusive cultures.” By contrast, Ms Cross states that the FCA -

- “recognise[s] that some [LM] firms have been taking steps to tackle [“major conduct failings”]” and
- “[has] been encouraged by some of the commitment we have seen in this area.” [emphasis added]

However, the FCA describes conduct failings in the London market as “often widespread and embedded cultural issues which will require considerable and consistent commitment to address at all levels of the organisation.” Linked to the issue of healthy culture “at all levels” (and the implication of the possibility of an unhealthy culture at one or more levels) in firms is Ms Cross’ admonition, on the topic of the new Certification Regime from 31 March 2021, that:

- “Certification connects to almost every stage of the people management process [such as:]
  - recruitment,

    - performance management,
    - training and development,
    - exit and disciplinary processes …"
- "Firms that do not integrate certification into these processes are unlikely to be able to operate certification effectively"
- "We anticipate that … some individuals will not meet … fit and proper standards … and firms mustn't assume someone is fit and proper just because the individual had been [an] approved [person] … in the past"
- "Firms should [not certify but] remove staff who are not fit and proper".

The FCA is clearly expressing significant dissatisfaction with LM distribution arrangements. Despite longstanding expectations that firms "deliver clear, fair outcomes for consumers [who will be] better informed [about] products which meet their needs" the FCA has "seen evidence [that] business models employ elongated distribution chains, with poor product oversight both in design and purpose."

It would be prudent for LM and GI firms to focus on Ms Cross' letter rather than Mr Davidson's speech, and quickly work out what they might need to do. First published by Thomson Reuters.

Contact

Jeremy Irving

Partner

jeremy.irving@brownejacobson.com

+44 (0)20 7337 1010

Related expertise