# Insurance Advisory Predictions 2024

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## 1. The FCA and PRA will drive greater diversity and inclusion in the workplace

Consultation proposals by both regulators are more far-reaching than expected. They include controversial elements, such as a requirement to set targets to address underrepresentation at all levels of the work force. The proposals are set out in the FCA's consultation paper entitled "Diversity and inclusion in the financial sector – working together to drive change" and the PRA's counterpart consultation paper entitled "Diversity and inclusion in PRA regulated firms", both published on 25 September 2023. Insurers will be required to publish diversity and inclusion (D&I) strategies (including a plan for meeting the goals set out); monitor diversity and inclusion internally; collect and report data across a range of demographic characteristics to the regulators; and make public disclosures of D&I data. It will be challenging to set targets based on characteristics such as sexual orientation or religion, given the heightened sensitivity around the processing of this information on an identifiable basis. Though many larger firms will already have D&I policies and some level of diversity monitoring in place, careful consideration will be needed to ensure compliance with the prescriptive requirements proposed.

## 2. Plan now for the changing role of the insurance professional in the face of AI…

The sector will need to grapple with the changing role of the insurance professional in the face of AI. One aspect of this is the looming skills gap. The industry will need experts in both insurance and AI and it should be looking to get ahead of this now, with extensive education and upskilling and, where required, recruitment. This should also involve developing a strategy for ongoing education and training to ensure that organisations keep up with the pace of technological and regulatory change. Another aspect is the issue of job displacement. As the technology evolves, automation may lead to changes for the workforce, with roles reimagined or replaced and a need for retraining. The industry should be planning now for the ethical and economic issues that flow from this.

## 3. …And consider too the impact of AI on insurance products

While there is plenty of commentary on the risks and rewards of AI to the insurance sector, what is considered less is the impact that AI may have on insurance products themselves. One issue will be the insurance of AI-related risks. This will require an assessment of the fitness for purpose of traditional policies to manage and mitigate enhanced AI risks and consideration of whether new types of products are required. There is also the threat of "silent AI". The industry will need to be mindful of potential exposures contained within more traditional policies which may not specifically deal with AI risks. Another issue will be the challenges around policy wordings and coverage more broadly. A specific issue, similar to what we saw with cyber, will be establishing an adequate definition of AI. There will also be the related challenge of how to establish effective and credible exclusions and endorsements. The sector will also need to consider the impact of AI, and the additional data it gives access to, on the duty of fair presentation, which is somewhere we see that AI could really shift the balance.

## 4. The Consumer Duty will continue to challenge the market in 2024

The Consumer Duty, which came into force on 31 July 2023, has been described by the FCA's CEO as its "most significant reform for decades". The FCA will assess the impact of the Consumer Duty closely, with a particular focus on the value of insurance products and the effectiveness of the measures taken by insurers to address the needs of vulnerable customers. The Consumer Duty will be an increasing feature of regulatory enforcement action against firms. Insurers and intermediaries will need to show they have taken all reasonable steps to ensure good customer outcomes. It will no longer be enough to show that the relevant rules were complied with; firms will have to demonstrate the additional measures they identified as necessary to meet the four cross-cutting obligations that make up the Consumer Duty, and the steps they took to ensure those measures were carried out.

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## 5. The Consumer Duty will affect price and value, and may require products to be withdrawn

The Financial Conduct Authority (FCA) will continue its work on fair value for insurance products, but with added impetus under the Consumer Duty. The FCA has expressed surprise at the small number of insurance products withdrawn following firms' fair value assessments. It is also clear where the FCA will be directing its sights; it has highlighted GAP insurance as being a product it thinks often fails to provide fair value, with claims costs representing as little as 4% of premiums. The FCA has also seen examples of firms paying up to 70% of the value of insurance premiums in commission to distributors of GAP insurance. Products previously highlighted by the FCA as often representing poor value include policies sold as add-ons to non-insurance goods and services, and policies where the distributor's remuneration represents a high proportion of the premium paid by the customer, particularly where the distributor's role is limited to non-advised sales. Insurers and distributors with products which may represent poor value should ensure that their value assessments are robust and up-to-date.

## 6. Consultation on new framework for captives in Spring 2024 will require bold stance by government and regulators

The UK government, along with the Prudential Regulation Authority and Financial Conduct Authority, will continue to reshape the UK rulebook, taking advantage of the greater flexibility resulting from the UK's departure from the European Union. Progress continues to be slow and cautious, although there are encouraging signs (for example, the abolition of the cap on bonuses) of a willingness to make changes which make regulatory sense even at the risk of unfavourable headlines.  In this light, the announcement in the Autumn Statement on 22 November of a consultation in the Spring of 2024 on the design of "a new framework for encouraging the establishment and growth of captive insurance companies in the UK" is welcome. However, the measures will be successful only if the government and regulators are sufficiently bold to put the UK's regime at least on a par with those of established captive centres.

## 7. Expect greater scrutiny around third party service providers in the name of operational resilience

Financial regulators are becoming increasingly alive to the need for operational resilience around services obtained by regulated firms from third party service providers (TPSPs). TPSPs can pose unique systemic risks where firms are dependent on a limited number of providers; the Bank of England has identified a significant concentration of cloud-based service providers for banks and insurance companies. The Financial Services and Markets Act 2023 establishes a new Critical Third Party (CTP) regime, giving the UK regulators new powers to directly regulate CTPs, rather than rely on firms to manage the risks themselves. This regime will apply where HM Treasury identifies a CTP as 'critical' – this is likely to apply to just a small number of TPSPs. In the EU, the Digital Operational Resilience Act will apply broadly similar requirements to EU firms and TPSPs. Firms and potential CTPs alike will need to prepare for much closer regulatory scrutiny than previously. Even where a TPSP is unlikely to be found to be providing 'critical' services, more intensive regulatory scrutiny of such arrangements is on its way.



## 8. International ESG initiatives will continue to drive sustainable finance regulation in the UK

On 19 September 2023 the Taskforce on Nature-Related Financial Disclosures (TNFD) released its final recommendations. It provides a framework enabling companies to assess, disclose and manage nature-related risks and impacts with the aim of consistent and comparable reporting by businesses and financial institutions worldwide. This has been described as a "game changer" for corporates and financial institutions. The output of the TNFD complements that of the Task Force on Climate-Related Financial Disclosures (TCFD), enabling financial institutions that are already acting on climate risks to use TNFD's integrated approach to address nature-related financial risks at the same time. Though the framework is currently a voluntary one, as happened with the TCFD we can expect governments and regulators around the world, including the Financial Conduct Authority in the UK, to move to introduce compulsory nature-related financial disclosures in line with TNFD alongside the current compulsory climate-related financial disclosures for in-scope firms.

## 9. Insurers need to focus on the supervision of appointed representatives

The Financial Conduct Authority (FCA) will continue to focus on firms' supervision of appointed representatives (ARs), including testing whether firms have fully implemented the FCA's recently enhanced supervisory requirements. We can expect enforcement action where firms have failed to do so, and in the longer term where failings on the part of the AR are the result of poor oversight or due diligence on the part of the principal. Insurers and intermediaries with ARs should review both the terms of their current arrangements and their policies and procedures for overseeing new and renewed appointments. It is likely that the willingness of insurers and intermediaries to take on such responsibilities will reduce given the greater regulatory scrutiny, particularly where the appointment of an AR is not key to the firm's strategy.

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