

London and International Insurance Brokers' Association (LIIBA)-Written evidence-(CIR0016)

House of Lords Industry and Regulators Committee: Commercial insurance and reinsurance regulation inquiry – LIIBA response

About LIIBA

1. London and International Insurance Brokers' Association (LIIBA) is delighted to respond to House of Lords Industry and Regulators Committee inquiry into the regulation of the commercial insurance and reinsurance markets in UK. This response is provided in addition to the oral evidence provided by our Chief Executive, Christopher Croft, to the committee on 25th January 2022 and that which will be provided by our Chairman, Richard Dudley, on 22nd March 2022.
2. LIIBA is the trade body for Lloyd's brokers active in London's specialty (re)insurance markets. Our members are responsible for introducing in the region of \$110 billion in premium to the market on behalf of a global client base – with two thirds of that business placed on behalf of overseas clients. Our members act on behalf of sophisticated commercial businesses seeking insurance that is often only available in London given the depth of expertise concentrated here. As a whole, London insurance market contributes £39 billion annually to GDP, one quarter of the contribution of the City.
3. As these figures suggest, London insurance market is a vibrant export sector with a potential to grow significantly to further support government's trade policy objectives. Furthermore, insurance brokers with their advanced expertise in the modelling of climate risk; in the development of resilient and sustainable business models; and in their ability to design insurance products that will reward appropriately climate focussed behaviour by large corporations will pay a pivotal role in enabling the world to meet the net zero commitments made at COP26.
4. As intermediaries, LIIBA members are solo regulated by Financial Conduct Authority (FCA) and thus our comments are specific to that regulator unless otherwise stated.

Summary

5. LIIBA believes that a strong and internationally renowned regulatory system is a key advantage in attracting clients to place their insurance in London. However:

- FCA is not sufficiently disciplined in the way it establishes genuine evidence of market failure before it launches intervention action. This leads to it over regulating the commercial insurance and reinsurance sector.
- FCA is not sufficiently precise in targeting its action meaning the scope can creep to sectors where there is no evidence that the problem FCA is seeking to address actually exists.
- FCA fails to recognise the lower risk commercial insurance and reinsurance brokers dealing with sophisticated clients pose to the regulator's overall purpose. As a consequence its approach to regulating LIIBA members is indistinguishable to that for retail insurance brokers dealing with members of the general public.
- All these factors lead to FCA being disproportionate in its regulation of the commercial insurance and reinsurance sector.
- HM Treasury's proposal that FCA be given a new statutory objective to promote competitiveness and economic growth is welcome and could be the right approach to adjusting FCA's policy. However, it will only achieve this if there is significant culture change within FCA. So the objective must come with a suitable accountability framework to ensure this

Is the UK regulatory framework appropriate for the commercial insurance and reinsurance sectors?

6. LIIBA is adamant that a strong, internationally respected regulatory regime in UK is a key factor that attracts client business to London. But that system must be based on the core principles of regulation in competitive markets. Specifically, regulators must be able to demonstrate clear evidence of market failure or potential market failure before intervening. Their interventions should be precise in targeting the sectors where there are genuine issues. And they need to ensure their focus is on protecting vulnerable UK consumers and thus takes into account where sectors do not deal with such a client base – and where the client base is primarily based overseas outside UK regulatory responsibility.

7. The current UK regulatory framework has the potential to support such an approach. However, we believe that the culture within FCA means that it fails to meet these standards. For instance, the current general insurance fair value policy review originated from some investigation that FCA carried out in the domestic home and motor insurance markets that suggested unfair treatment of retail consumers on renewal. However, their lack of precision around the scope of the review – and the around what data it is that they expect insurers to collect to demonstrate the value of products – has led to many insurers believing that the review should extend a considerable way into the commercial markets. They have thus sought information from brokers that it is, in some cases, simply impossible to provide. For example, a LIIBA member may provide a whole range of risk management consultancy services to a client for which they are paid a fee. As a result of that the client may purchase a number of insurance contracts – as well as implement other risk mitigation strategies. It is not, therefore, possible to apportion any of the fee to any specific client outcome including the purchase of insurance contracts. To attempt to do so would be potentially misleading and would distort any judgement as to the value of any particular aspect of the overall service provided to the client. And this is in a sector of the insurance industry where there is not any evidence of the sorts of issues around renewal that FCA established in the motor and home markets. And the clients our members are dealing with are sophisticated corporate customers engaging LIIBA members as expert risk management consultants. The net result is a costly exercise for LIIBA members with no obvious benefit in terms of prospective improved outcomes for clients.

To what extent do the Bank of England and Financial Conduct Authority apply and interpret regulatory policy in these areas in a proportionate manner and strike the right balance between regulation and competitiveness?

8. We believe there is significant scope for FCA to be more precise in how it defines the scope of its policy to more accurately address risks to its objectives. The example set out above demonstrates how a lack of precision can lead to inappropriate regulatory intervention. We also believe FCA needs to be more proportionate in the way it addresses the services our members deliver to overseas clients that sit outside FCA's regulatory responsibilities.
9. For instance, FCA is equivocal around the perimeter of its powers when dealing with international clients. LIIBA believes that where a client is based in a well regulated domestic market then the UK broker in the distribution chain that brings that business to London should be able to rely on the initial client assessment – such as know your client and anti-money laundering controls – that will have been carried out by the overseas broker that first engages with the client. FCA has repeatedly failed to provide any clear expression of opinion on this issue with the result that understandably risk averse compliance departments in London insist on repeating such checks adding significant, unnecessary cost to the transactions.
10. A further example of this is in relation to the FCA's expectations in relation to the general insurance fair value product review pricing which we cited above. These rules have a geographical scope of -
 - (1) the United Kingdom, for all insurance products; and
 - (2) **overseas** in relation to an insurance product that is, or will be, marketed or distributed, or there are policies under the product that remain in force, in the United Kingdom.
11. It is unrealistic of the FCA to expect that overseas brokers and other entities within the distribution chain will complete value assessments given that they are not regulated by the FCA and the FCA has no jurisdiction to enforce it. This leaves UK brokers in a difficult position where overseas brokers do not respond to our value assessment requests.
12. We need a clear statement or opinion from the FCA on the areas (and/or markets) where they do not require additional compliance and are happy to rely upon the overseas regulator.

13. We would hope that the introduction of a new competitiveness and economic growth objective, as proposed by HM Treasury in its current consultation, would drive FCA to be more specific about its intentions and streamline a process that in its current form often adds cost to no benefit
14. However, we are concerned that it is proposed to make this only a secondary objective. This could allow FCA to focus less on the new objective and not deliver the necessary change in its approach.
15. We also believe that the new objective will not succeed unless it is also supported by culture change. LIIBA believes that, for the regulator to function appropriately in relation to our sector, there needs to be a fundamental change in the approach at FCA. As set out above, currently it has an inability to distinguish between retail financial services sectors, where regulated firms deal directly with members of the general public, and wholesale sectors such as ours, where regulated firms deal with sophisticated corporate clients. The difference is stark.
16. In retail markets, consumers utilise the services of intermediaries to seek to manage information asymmetries between them and the product provider so as to make their eventual purchase more appropriate.
17. In wholesale markets such as the London insurance market, as seen in the example we provided in response to the first question, corporate clients seek the services of LIIBA members as specialist risk management consultants because they recognise that their broker possesses deep expertise in their own line of business. The LIIBA member is therefore deeply engaged in their clients' analysis of the full scope of risk faced by their businesses and then works with those clients to develop the most appropriate method of mitigating those risks – only some of which will involve the purchase of insurance. And yet the approach of FCA to regulating these two very different relationships between regulated firms and their clients in very different sectors is fundamentally indistinguishable. The scope for streamlining the requirements of firms dealing with sophisticated corporate clients for complex business is considerable. But it will need a significant change in approach at FCA – and one that is implemented in its day to day supervisory process and not just suggested by high level management commitments.

18. For instance, a number of our members have established subsidiary entities in European Union to allow them to continue to service EU clients following UK withdrawal. These entities typically have a branch in London to allow them to be dual regulated in EU and by FCA. FCA authorisation has been granted by entry into the Temporary Permissions Regime but these firms are now being assessed for full authorisation. These are firms that have no UK clients and those clients that they do deal with are sophisticated EU corporations. The firms thus pose no threat to FCA's overall purpose and should be subject to very minimal supervision in UK. However, those firms now going through the authorisation process are discovering that FCA is insisting on very significant governance mechanisms for the UK branch adding entirely unnecessary cost to international export businesses. This is but one example of an excessively bureaucratic culture at FCA hindering the operation of efficient and effective services for clients.

How do the activities of the UK's financial regulators affect the ease of carrying out commercial insurance and reinsurance business in the UK? What impact does this have on the availability and cost of insurance cover in the UK?

19. The impact that this has on firms that might otherwise seek to place more of their clients' business in London is best illustrated in the research FCA itself commissioned as part of its Wholesale Insurance Broker Market Study¹. This FCA research cites numerous examples of brokers, Managing General Agents (MGAs) or insurers based in North America and other parts of the world who face increased UK compliance requirements, on top of their own domestic compliance, impacting their appetite to do business with the London market. To quote one overseas client in this report "The most extraordinary level of regulation! The level of regulation has reached a point where, if there is anything more, it might not be worth the time and money it takes to place on London Insurance Market."

What is the status of the London Market's global competitiveness, and how is this impacted by different regulatory approaches in other territories?

20. In a highly competitive and mobile global trading environment, London must keep pace with the regional hubs which are vying for our business if we are to retain our position as a global centre. Singapore, Bermuda, Hong Kong, Switzerland, Miami, Australia all have regulators

¹ [FWD Research: Client research into the Wholesale Insurance market \(fca.org.uk\)](https://www.fca.org.uk/publications/research/FWD-Client-research-into-the-wholesale-insurance-market) pages 16-19

who are seeking to promote their markets and enhance their competitive position.

21. The competitiveness and growth duties that exist internationally come in different forms and involve a number of different obligations and we can learn from these different objectives. The majority include a requirement to report on the impact of their regulatory decision making upon the competitiveness of their financial services sectors.
- In Switzerland, the Swiss Financial Market Supervisory Authority (FINMA) is required to take particular account of "the effect that regulation has on competition, innovative ability and the international competitiveness of Switzerland's financial centre".
 - The Monetary Authority of Singapore (MAS) works to ensure that Singapore's financial services industry remains competitive by engaging with governmental agencies and financial institutions to promote Singapore as both a regional and international financial centre. To facilitate this the MAS may draw upon a Financial Sector Development Fund to develop regulatory and infrastructure systems.
 - In Bermuda, part of the mission of the Bermuda Monetary Authority (BMA) is, "to protect and enhance Bermuda's reputation and position as a leading international financial centre."
 - One of the key functions of the Hong Kong Monetary Authority (HKMA) is to promote Hong Kong as an international financial centre through market development initiatives that strengthen the international competitiveness of Hong Kong's financial services.
 - The Australian Prudential Regulation Authority's (ARPA) statutory objectives require it to "have regard to, and avoid unduly hindering, desired objectives for the financial system: efficiency, competition, contestability and competitive neutrality. Balancing these additional objectives in undertaking its prudential role is important, as they support Australia's long-term growth and productivity."
22. For example, Singapore copied the UK Insurance Linked Securities (ILS) regime in recognition of the quality of the framework. Since 2018 it has encouraged new entrants and has approved 18 ILS vehicles in a shorter period of time than the equivalent framework has been in place in UK. During that time 4 ILS solutions have been placed in London.
23. Whilst ILS are insurance vehicles regulated by Prudential Regulatory Authority (PRA) in UK, LIIBA members, due to their expertise, are instrumental in setting up these entities on behalf of, mainly,

reinsurance clients. Our members contrast the regulatory approach in Singapore, and other centres such as Bermuda with that of PRA. In other centres the regulator will sit alongside applicants as they are designing and putting in place the vehicle. This makes the approval process when the time comes very straightforward. In contrast, PRA will tend not to engage with applicants prior to the formal submission for approval – at which point any number of issues that could have been resolved through a more proactive approach arise. This is a clear example of how a disproportionate regulatory approach in the UK is resulting in the UK losing investment to overseas competitor jurisdictions.

24. To change this culture we need active regulator and government support for not only new businesses wanting to invest in the UK, but for established players who are looking to increase their footprints.

What improvements could be made to the regulation of commercial insurance and reinsurance in a post-Brexit context?

25. The focus must increasingly be on what the UK can do to cement its global position through domestic reform - particularly through HM Treasury's Future Regulatory Framework - now that we are no longer part of the EU regulatory process. This is a once in a lifetime opportunity to develop a system which ensures we remain competitive against new and growing financials centres.
26. We support HM Treasury's proposals to introduce new growth and international competitiveness objectives for the PRA and FCA. However, the objectives alone are insufficient. There now needs to be further emphasis on how the regulators will implement the duty and how they will be held to account in meeting its requirements. The focus should now be on the annual reporting requirement for the duty and what issues or criteria this should cover. The Treasury should set out in statute the parameters and reporting requirements in some detail, to ensure that it is not reduced to a 'tick box' exercise.
27. Furthermore, LIIBA would propose that FCA should be required to regularly (perhaps every 3 – 5 years) commission an independent benchmarking review of its regime against those in appropriate other international financial centres. At a minimum we would suggest that this list includes Singapore, Switzerland and Bermuda. The report should be published and laid before Parliament for scrutiny by Treasury Select Committee. FCA should be expected to have delivered

improvements to the international competitiveness of its regime between successive iterations of this benchmarking exercise.

28. The forthcoming financial services legislation should implement a system which allows us to move away from the 'one size fits all' approach, which recognises the differences of the London Market. We need a framework which recognises the distinct characteristics of low risk entities that deal with sophisticated clients. The legislation needs to develop a more stratified regulatory framework to set a clear direction for the regulators.
29. The Government should also look further at strengthening the accountability and scrutiny mechanisms around the regulators. We would like to see requirements set out in the legislation to engage with industry more closely before regulation is implemented, there needs to be far more transparency around data and impact assessments and we believe parliament should have a much bigger scrutiny role, which is properly resourced, in holding the regulators to account.
30. As examples for where there is the potential to develop a more focussed, precise and proportionate approach to regulation we would refer back to the case studies around the FCA general insurance fair value product review cited earlier. We would also point to the lack of clarity around the regulatory perimeter demonstrated in dealing with overseas clients and with our members new EU subsidiary firms.
31. We would also point to the issue of duplicative rule making that FCA pursues, particularly in the area of operational resilience. FCA began by publishing a consultation paper in December 2019. No firm has any issue in principle with the concept that firms should be resilient. However, a point that LIIBA raised in our response (and which FCA ignored and did not even address in its subsequent policy statement) was that, via Systems and Controls Handbook and Senior Managers and Certification Regime (SMCR), FCA already had sufficient powers to achieve the outcomes it was proposing and did not need a third level of rules. The issue was further exacerbated by the fact that SMCR only came into force for insurance intermediaries on 9th December 2019. So, for our sector, FCA was already drafting a consultation paper suggesting that a set of rules were insufficient and not working before those same rules had actually come into effect. Furthermore, none of the examples of market failure provided involved insurance distribution. And, between the publication of the consultation paper and the subsequent policy statement, our market had undergone the most comprehensive test of its operational resilience due to the lockdowns

necessitated by the COVID-19 pandemic and the market had continued to function on behalf of its clients. So the need for further rules – and the cost that it requires to ensure compliance with them as well as the cost of responding to sizeable consultation papers – is hard to establish. Another FCA intervention, we would suggest, that has added considerable cost to know obvious client benefit.

32. Another area where the regulatory approach will need to evolve is around climate change. The role of insurance, and, in particular, the services of insurance brokers dealing with corporate clients, will be pivotal to the world achieving its net zero ambitions. But this will only be possible with a suitably flexible regulatory regime to support it. Much of the change needed to reach net zero will be delivered by new, as yet to be invented technology. There will be a need to move this technology rapidly into commercial production and that will require innovative insurance products to underpin the development. These products will not be able to rely on the availability of historic performance data to support underwriting decisions. Regulators will need to adapt their culture so that acceptable, flexible approaches can be found that allows the rapid development of suitable products and thus the continued progress towards net zero. This will need to include the realisation that the development of new, innovative products is likely to require a level of cross-sector collaboration.

33. This the outcome will only be achieved through necessary, and fundamental, cultural change at the regulators. As part of this approach, we would encourage a requirement for regulators to review the impact of their regulatory regime upon achievement of net zero climate change targets. Specifically FCA should be asked to identify any regulatory barriers to the economic, industrial and capital market transformation needed to achieve net zero, including those regulations that might slow progress and hinder the timely achievement of 2030 and 2050 targets; and to implement changes to remove such barriers.

11 February 2022