

INSURANCE REGULATION - MORE TWEAKING OF THE RULES?

1. Background

1.1 Background to reform

The UK accounts for over 5% of premiums written globally, making it the third largest insurance market in the world¹, and its commercial insurance market is worth £95bn on an annual basis.² As a result, it should be no surprise that the FCA is looking in this direction as it seeks out areas to make the regulatory burden more proportionate with the purpose of driving growth and innovation.

In July 2024 the FCA published '*DP24/1: Regulation of commercial and bespoke insurance business*' (the **Discussion Paper**) where it set out its intention to revisit how it regulates the commercial insurance market, noting the importance of ensuring that it maintains the right balance between protecting less sophisticated commercial insurance customers whilst minimising the regulatory burden for insurers when dealing with more sophisticated customers.

1.2 Proposals for change

On 14 May the FCA published '*CP25/12: Simplifying the insurance rules*' (the **Consultation Paper**), which built upon the proposals set out in the Discussion Paper and the feedback received.

The most notable of the proposals is to lower the threshold at which a customer is deemed a commercial insurance customer, which will have the effect of increasing the number of customers that insurers are not required to apply ICOBs and PROD to in their entirety. The FCA has also proposed expanding the scope of and clarifying the bespoke contract exemption, so that it applies to insurers as well as intermediaries and to allow it to exclude all bespoke non-investment insurance contracts from the product oversight and governance rules contained in PROD 4.

The proposals, while by no means a major or significant change, should be welcomed. Larger commercial businesses should not be afforded the same level of protection as retail customers, and it is only by accepting

this principle that other meaningful proportionality driven change can be brought to the UK regulatory framework. Apart from anything else, aligning different elements of regulatory protections (as we explain below) is helpful to reduce uncertainty and compliance risk.

1.3 Next steps

Responses to the Consultation Paper are invited by 2 July 2025 and the FCA has not provided a timeline for when it will publish a policy statement. It has, however, stated that the final rules will come into force with immediate effect on publication of the policy statement.

2. Commercial insurance customer

Currently, a customer is excluded from some of the protections included in ICOBs and PROD if the contract they enter into qualifies as a 'Contract of Large Risk'. This is assessed on the basis of either:

- the policyholder exceeding the limits of at least two of the following three criteria: (i) a balance sheet total of €6.2m; (ii) net turnover of €12.8m; and (iii) average number of employees during the financial year of 250 employees; or
- the nature of the insured asset (for example, aviation and railway rolling stock insurance contracts).

This definition is, however, not aligned with, for example, the eligibility criteria for the Financial Ombudsman Service (**FOS**) or the Financial Services Compensation Scheme (**FSCS**) which gives rise to a peculiarity where businesses not deemed as requiring the protection of the FOS and FSCS are treated the same by insurers as sole traders and small businesses eligible to such protection. This creates unnecessary complexity as firms endeavoured to create systems that accurately categorised their customers across these overlapping regimes.

The FCA has proposed replacing the definition of 'Contract of Large Risk' with a definition of 'contracts of commercial or other risks'. This will retain the exclusion for contracts of insurance dealing with certain types of assets (such as aviation and shipping) whilst aligning the threshold at

¹ US Treasury - Annual Report on Insurance Industry (September 2024).

² FCA - CP25/12: Simplifying the insurance rules' (May 2025).

which a business is deemed to require protection with the FOS eligibility threshold (turnover of less than £6.5m and either a balance sheet total of less than £5m or fewer than 50 employees).

Such a change is welcome as it aligns the insurance customer categorisation more closely with the consumer protection regime. However, the previous definition already allowed insurers and intermediaries to disapply tracts of ICOBS and PROD for all large businesses, so whilst this proposed change expands that disapplication it does not fundamentally change the proposition for firms.

Given there will remain a variety of different categorisations of customers (including for the FSCS) that insurers and intermediaries will have to apply to customers, and that of the 5.5m businesses in the UK only 46,000 have more than 50 employees,³ there will remain a large number of commercial insurance customers who will continue to receive extensive regulatory protection. It remains to be seen, therefore, whether these pragmatic changes can markedly reduce the regulatory burden on firms.

3. Bespoke contracts exemption

PROD 4 requires insurers and insurance intermediaries to have systems and controls in place relating to the design, approval, marketing and ongoing management of insurance products throughout their lifecycle to ensure they meet legal and regulatory requirements. If an insurance contract is deemed to be bespoke, insurance intermediaries can currently disapply these rules with respect to the manufacturing requirements. The FCA believes that this exemption is rarely used or understood in its current form.

As a result, it has suggested extending its scope to include both insurers and intermediaries (irrespective of whether they are manufacturing or not) and to apply to all bespoke non-investment contracts of insurance (including pre protection products). The FCA has also proposed guidance on the meaning of a bespoke of contract, including that:

- it can be either an adaption of an existing insurance product or a new contract created in response to a customer request;
- pre-existing product wording can be used when creating a bespoke contract; and
- a bespoke contract can be sold to other customers in the future at their request, provided that the bespoke product has not been marketed for general distribution).

The FCA will assess whether a contract of insurance is bespoke on the basis of whether the changes were requested by the customer, it was made specifically to

meet their needs and it will not be marketed to other customers.

Such reforms are sensible, given the unnecessary compliance burden created by requiring products that have been specifically drafted for an individual customer to go through PROD governance processes aimed at products subject to broader marketing. It remains to be seen, however, whether the distinction between customisations which are and are not deemed to be within the confines of the pre-existing product's coverage could give rise to further uncertainty in determining whether a product is bespoke.

4. Other proposals

The Consultation Paper also includes proposals to simplify co-manufacturing arrangements pursuant to PROD by allowing one firm to take responsibility for PROD 4.2 compliance. It also suggests the removal of the 12 month minimum review period for non-investment insurance products with respect to the product itself and its distribution - instead, firms should determine the frequency of the reviews on the basis of the specific risks posed to customers by the insurance product.

It also includes reductions in the notification and disclosure requirements with respect to the employers' liability business and the removal of the prescriptive 15 hour training and development requirement and accompanying recording keeping and monitoring rules for employees of non-investment insurance and funeral plan distributors.

5. The wider context

Overall, these are sensible proposals and are clearly a step in the right direction as the FCA looks to support the growth agenda and develop a more proportionate regulatory regime. But we should not be under the illusion that these are fundamental changes - ultimately, these are tweaks that correct something of a pre-existing anomaly in the regime. The proposals should be welcomed and they are hopefully the first of a number of steps towards a reshaping of conduct standards in the commercial insurance market.

³ House of Commons Library 'Research Briefing - businesses statistics' (November 2024).

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