Conduct of Business Supervisory Update

Insurance Regulatory Seminar - 2016

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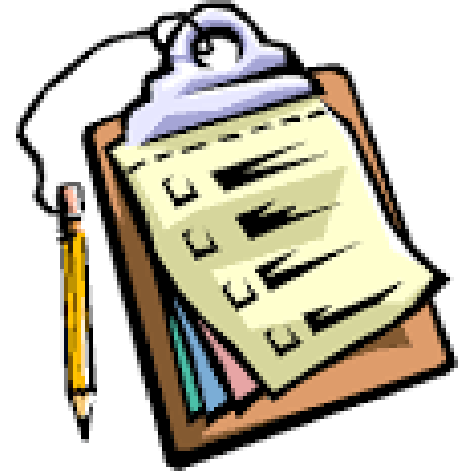
AGENDA



1. LOOKING BACK

- *From TCF to Conduct Risk*
- *Sources of Conduct Risk*
- *One Year Ago: The State of Binder Data*

2. WHERE ARE WE TODAY?

- *Conduct Risk & Culture*
- *The Year in Review: A few key findings*
- *Some Case Studies*

3. WHERE ARE WE HEADING?

- *Upcoming Focus Areas*
- *The Future of Outsourcing*
- *Asking The Right Questions*

LOOKING BACK

Where were we a year ago – from TCF to Conduct Risk?

THE EVOLUTION OF CONDUCT RISK

- **OLD NEWS**
  - ✓ Just remembering the 6 TCF Outcomes?
- **THE EVOLUTION**
  - ✓ Move from talking about TCF outcomes to proactive management of market conduct / conduct of business risks
- **BUT WHAT IS CONDUCT RISK MANAGEMENT?**
  - ✓ Identifying potential risks to fair customer outcomes across the business
  - ✓ Operationalising TCF across all aspects of the business
  - ✓ Embedding fair customer outcomes in all areas of the product lifecycle
  - ✓ Including areas of the business that are outsourced
- **HOW?**
  - ✓ Through incremental implementation

INCREMENTAL IMPLEMENTATION

- **WHAT DOES "*incremental implementation*" MEAN?**

CURRENTLY

✓ Challenging TCF commitment when investigating concerns

✓ Identifying conduct risk indicators

✓ Specific thematic supervisory initiatives testing risks to fair customer outcomes

✓ Reviewing existing regulatory frameworks to test whether they support fair customer outcomes

✓ Testing of TCF commitment and culture through intrusive supervision – focus on effectiveness of operational embedment – "joining the dots" across the business

COMING (very) SOON

✓ Structured reporting on conduct risk indicators

✓ Introducing TCF principles into existing regulation

✓ Reflecting TCF principles in overarching Twin Peaks regulatory framework

RECAP: SOURCES OF CONDUCT RISK

- Product value
- Unfair contract terms
- Misleading advertising/marketing
- Ineffective disclosure
- Conflicted advice
- Poor claims handling
- Poor complaints handling
- Empowered customers

Testing outcomes, rather than compliance 'tick-box'

Rebalancing of responsibilities: Increased scrutiny of the way firms develop products;

Product provider oversight of chosen distribution channel

Fair outcomes can be achieved in different ways, through emphasising different TCF elements

RECAP: THE VALUE OF DATA

- Meaningful regulatory and management reporting requires consolidation of accurate, quality and usable data from various distribution touch points
- Investing in more reliable, dependable, quality data helps to articulate conduct risks more precisely and makes compliance much easier to **demonstrate**
- Having consistent access to the right data, in the desired format and at the right moment helps to generate new insights for better customer solutions and improved business efficiencies

Reference:

Data Points: HOW FINANCIAL SERVICES FIRMS USE TECHNOLOGY TO TURN DATA INTO ACTIONABLE INSIGHT
Bloomberg for Enterprise

BINDER THEMATIC REVIEW KEY FINDINGS (DECEMBER 2015)

3.3 Reporting systems and access to information[3]

The following specific concerns were identified:

- The thematic review revealed that many insurers follow the “letter” of the Binder Regulations but not its underlying intention (“spirit”) when it comes to data exchange and access to information. The Binder Regulations prescribe the intervals[4] in which data should be submitted to insurers. Certain insurers followed a “tick-box” approach to demonstrate to this Office that they *receive* data as per the regulated intervals. In many cases, little or no evidence could be demonstrated relating to the integration of data into the insurer’s in-house system and/or the subsequent verification and analysis of data;

  Insurers indicated that binder holders are generally not willing to share information on request, and that binder holders, in general, still believe that they are the owners of all policyholder data. This was a concern as this means that, in the event of specific policyholder concerns or risks materialising outside of the regular data reporting intervals, insurers would likely not be able to access relevant data required in order to timeously address such concerns or risks;

- The quality of data received differed vastly across insurers and in many instances data was inaccurate or incomplete, making it difficult for insurers to consistently identify or contact policyholders or to readily ascertain liability or access historical policy data;

- Most insurers require the bare minimum of data from binder holders, which in most cases is limited to financial information. The absence of quality reporting from binder holders on, amongst other things, claims and complaints processes, pointed to the lack of demonstrable and robust oversight of the market conduct of binder holders as described elsewhere in this document;

- Various methods are used to collect data even within individual insurers, ranging from rudimentary methods like the use of memory sticks and data “dumps”, to Excel spread sheets sent via e-mail or through FTP/SFTP protocols; and

- The data being transferred does not generally meet the ACORD standard. According to many of the insurers sampled, the various systems currently being used by them and by their binder holders do not have the capability to meet this standard. Insurers indicated that it is very costly to change and/or enhance systems especially when binder holders do not seem to understand the benefits of having quality, usable data. Many insurers further stated they do not want to be the first insurer to “push too hard” on system changes, as the binder holder will “simply move their business to another insurer with lesser (data) requirements”.

EXTRACT FROM REPORT

HOLDING UP A MIRROR

Where are we today – can you demonstrate positive conduct culture without data?

DEFINING CULTURE

- **THE MYTH OF CULTURE**
  - ✓ *"Culture can't be defined!"*
  - ✓ *"Culture? Hmm … that is such a soft, airy fairy concept!"*
  - ✓ *"You cannot measure culture!"*
  - ✓ *"Yes, we have a great culture. Here is our written policy to prove it!"*

Culture is the way you think, act, and interact.

- **THE REALITY OF CULTURE AND CONDUCT**

*Our approach is joining the dots rather than assessing culture directly. This can be done through how a firm responds to regulatory issues; what customers are actually experiencing when they buy a product or service; how a firm designs products; the manner in which decisions are made or escalated; and even the remuneration structures.**

*Culture remains a key driver of significant risks in every sector and the root cause of high-profile and significant failings. It impacts on individual behaviours which in turn affect day-to-day decisions and practices in the firms we regulate. Culture is therefore both a driver, and a potential mitigator, of conduct risk.***

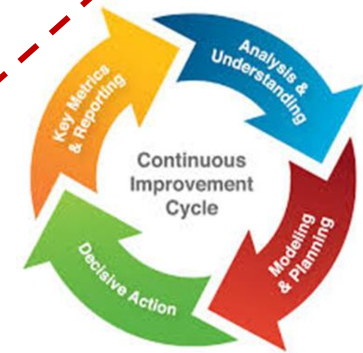
Clive Adamson, Director of Supervision, UK Financial Conduct Authority (FCA), November 2013

****UK Financial Conduct Authority (FCA), Business Plan 2016/12017*

CULTURE = JOINING THE DOTS

- **ONGOING, PROACTIVE, <u>DEMONSTRABLE</u> MANAGEMENT OF CONDUCT RISK INDICATORS MANIFESTING IN:**
  - ✓ Continuous improvement in product design, service delivery, customer experience (e.g. link between claims and complaints data and product/process/service improvements
  - ✓ Fair pricing and appropriate products
  - ✓ Improved clarity and ease of understanding of disclosures
  - ✓ Improved claims handling practices
  - ✓ Reduction in persistent complaints
  - ✓ Meaningful management information and reporting
  - ✓ Enhanced governance and oversight of distribution channels
  - ✓ Customer centric strategic and operational decision making
  - ✓ Co-ordination of assurance and risk identification activities
  - ✓ Ongoing review and validation of conduct risk indicators
  - ✓ Better alignment between prudential and conduct areas of the business

IS IT POSSIBLE TO "JOIN THE DOTS" WITHOUT ACCESS TO PROPER DATA?



MARKET CONDUCT ON-SITES – 2016

- General market conduct on-site visits – 8 insurers visited
- Key common findings:

- ✓ Highest risk – insurers with outsourced models
- ✓ Data not being received from third parties – policy data, claims data, complaints data
- ✓ Unable to demonstrate adequate, ongoing oversight of third parties
- ✓ Absence of credible data resulting in:
  - Poor/inconsistent management information relating to policyholder risks inherent in business operating model
  - Lack of root cause/trend analysis on claims and complaints
  - Absence of substantive TCF embedment plans across distribution channels
- ✓ Conduct risks not adequately incorporated as part of business wide assurance activities, evidenced by:
  - Insufficient capacity and level of skill of compliance function – largely FAIS focused, poor insight on strategic and operational impact of regulatory developments, lack of integration into wider enterprise risk management framework
  - Inadequate focus on conduct issues by internal audit – largely financial and process focused, lack of understanding of conduct risk issues

CLAIMS THEMATIC ON-SITES – 2016

- Phase 1 (2015) – 14 insurers visited
- Phase 2 (2016) – 7 additional insurers visited
- Key findings:
  - ✓ Inconsistent understanding of "claims", "claims ratio", "repudiations"– leading to inconsistent and inaccurate reporting
  - ✓ Absence of centralised repository for claims reporting – not all claims information being captured, including data from binder holders
  - ✓ Lack of root cause analysis on common repudiation reasons – absence of evidence to demonstrate updates/improvements to policy wording, product design and customer processes
  - ✓ Historical policy wording and claims forms not being consistently reviewed to ensure alignment with fairness principles
  - ✓ Unnecessary documentation still being requested prior to processing of claims, based on "standardised" checklists that do not consider the nature of individual claims
  - ✓ Increase in "voluntary" excess structures to drive down premiums and retain customers – leads to excessive out of pocket costs to policyholders
  - ✓ Increased reliance on technology for fraud detection and repudiation of claims – without policyholder consent and absence of corroborative evidence
  - ✓ "Hands-off" approach to claims that are dealt with by binder holders

BUSINESS AS USUAL - 2016

- **CASE 1**
  - ✓ Movement of policies by binder holder without policyholder consent
  - ✓ Claims rejected by Insurer 2 – different terms and conditions
  - ✓ Policyholders unaware of Insurer 2
  - ✓ Insurer 1 could not contact policyholders – no data

- **CASE 2**
  - ✓ Insurer not receiving data from binder holders despite numerous requests
  - ✓ Terminate binder agreement - binder holder wants to “move” policies – hostile relationship
  - ✓ Run off claims to remain with insurer
  - ✓ Insurer could not confirm policy details or value of outstanding claims – no data
- **CASE 3**
  - ✓ Insurer wants to terminate binder, cancel policies – poor performance/ solvency
  - ✓ Binder holder creates confusion – denies cancellation – refuses insurer access to data to contact policyholders directly

CASE 4: INTRODUCING INSURER "X" (1)

- **THE INSURER**
  - ✓ *"TCF is part of who we are, we always put our customers first"*
  - ✓ *"We have access to all data in-house"*
  - ✓ *"We do ongoing monitoring of all our binder holders"*
  - ✓ *"We do proper annual audits of our third parties"*

- **THE "AGENT" OF THE INSURER**
  - ✓ *"The policyholder is my client"*
  - ✓ *"Why do you want the data, it belongs to me?"*
  - ✓ *"I am too busy – I don't have time to keep giving the insurer updates on outstanding claims"*
  - ✓ *"If the insurer wants access to <u>my</u> data on my system, they must pay me a fee"*
  - ✓ *"I am taking <u>my</u> clients and moving them to another insurer"*
  - ✓ *"Don't talk directly to <u>my</u> clients"*

CASE 4: INTRODUCING INSURER "X" (2)

- **THE POLICYHOLDER**
  - ✓ *"What is happening with my claim?"*
  - ✓ *"Why is nobody getting back to me?"*
  - ✓ *"But, my insurer is* [UMA ABC]*!!"*

- **THE EVIDENCE**
  - ✓ Solvency and liquidity challenges
  - ✓ No TCF embedment plan
  - ✓ No data from third parties
  - ✓ No monitoring and oversight
  - ✓ Inadequate insight into claims and complaints
  - ✓ Inability to provide timeous, accurate and complete picture of outstanding claims
- **THE IMPACT**
  - ✓ Rapid burn through of capital due to acceptance of "bad" books without proper due diligence
  - ✓ Potential for significant policyholder losses due to insolvent position
  - ✓ Complexity of resolution due to lack of credible and consistent data

THE FUTURE

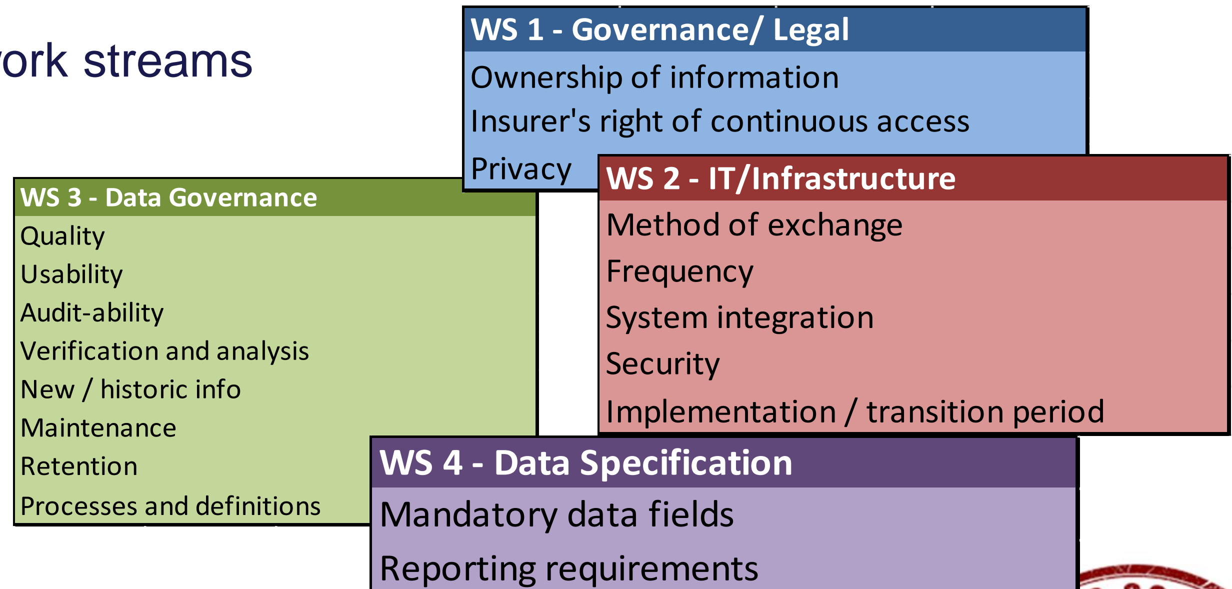
Where are we heading - are you prepared?

UPCOMING FOCUS AREAS

- **CONDUCT OF BUSINESS RETURNS**
  - ✓ First reporting due – H1 2017
  - ✓ Two year transitional plan to full reporting – H1 2019
  - ✓ Insurers required to report on implementation progress
- **THIRD PARTY CELL CAPTIVE THEMATIC REVIEW**
  - ✓ Information Request 5 of 2016
  - ✓ Thematic Review – H1 2017
- **VALUE ADDED PRODUCTS (VAPS)**
  - ✓ Enhanced supervisory focus
  - ✓ Insurers required to demonstrate value to policyholders
- **CAPPING OF BINDER FEES**
  - ✓ Information Request 4 of 2016
  - ✓ Activity segmentation technical work

LEVELLING THE DATA PLAYING FIELD

- Short-term Insurance Industry Data Task Team – established March 2016
- Objective:
  - ✓ To develop a standardised framework for the consistent and meaningful exchange of data between insurers and their outsourced partners
- Four (4) collaborative work streams
- Representation:
  - ✓ SAIA
  - ✓ FIA
  - ✓ SAUMA
  - ✓ ACORD
  - ✓ ASTUTE
  - ✓ TRANSUNION
  - ✓ INDEPENDENT TECHNICAL CONSULTANTS
  - ✓ FSB



THE FUTURE OF OUTSOURCING

- **NO** outsourcing/binders unless it can be demonstrated that it:
  - ✓ Enhances operational efficiencies
  - ✓ Eliminates duplication of effort and costs
  - ✓ Allows for proactive management of conduct of business risks and improved reporting (CBRs & Internal MI)
  - ✓ Ensures improved customer outcomes

- Efficiency is demonstrated by the capability of outsourced partners to integrate with the insurer's system to enable continuous access to, and maintenance of, up to date, accurate, quality, usable, verifiable, secure and complete information

- If **NO** integration ⇒ Inefficiencies ⇒ Inability to proactively manage conduct risks ⇒ Poor customer outcomes **=**

ASKING THE RIGHT QUESTIONS

- **IS YOUR COMPANY ABLE TO JOIN THE DOTS:**

- ✓ What do “fair customer outcomes” mean in the context of the strategy, operating model and target market of the business?
- ✓ Does the chosen distribution model pose potential risks to fair customer outcomes? What are these risks? How is the business addressing these risks?
- ✓ Are customers obtaining fair value from the chosen strategy and operating model? How do you know?
- ✓ Is the ability to deliver fair customer outcomes a consideration during the development of products and the take-on of new business partners?
- ✓ What is the level of oversight over the product development, product launch, sales fulfilment, claims handling and complaints management processes?
- ✓ How do post-sales processes support the delivery of fair customer outcomes? (e.g. servicing, claims, complaints)?
- ✓ Do senior management and Board structures receive appropriate and accurate management information (MI) relating to the delivery of fair customer outcomes?

CLOSING THOUGHTS

In life, change is inevitable. In business, change is vital.

— *Warren G. Bennis* —

Remember that the six most expensive words in business are: 'We've always done it that way'

— *Catherine DeVrye* —

THANK YOU