Consumer Protection

Examples of sound practices to manage conduct risk

July 2014

CRO FORUM

Table of contents

Foreword

Insurance provides a valuable contribution to society by enabling customers to protect themselves from the consequences of risks that may otherwise be unaffordable, or to plan to meet current or future financial needs.

The delivery of fair and appropriate products and services should be a common aim of all insurance industry stakeholders - insurers, distributors, customers, regulators and legislators - with respective and shared responsibilities clearly identified and understood.

For example, insurers and distributors are responsible for designing and delivering suitable products and services capable of meeting customers' needs, promoting those products and services in an appropriate way, and delivering value for customers.

Customers must ensure that they provide insurers with relevant, complete and accurate information in good faith. One of the challenges for customers is that insurance products are complex, meaning they face difficult financial decision taking. Insurers can help by taking account of customers' financial experience and understanding when designing financial promotions and product disclosure material. However, the financial literacy of customers' needs to be improved.

Regulators have a responsibility to all industry stakeholders to deliver clear, effective and proportionate supervision, which promotes a well-functioning insurance market, encourages sound management practices, and maintains appropriate levels of consumer protection.

Legislators are ultimately responsible for putting in place the necessary legal framework within which firms and regulators operate. They are also responsible for a variety of other factors affecting the insurance industry and its customers, ranging from general social, political and economic policy, to specific issues such as improving consumers' financial literacy.

Working together effectively, we can ensure stakeholders' respective responsibilities are addressed, that products and services can meet the reasonable expectations of stakeholders, and that customers can plan confidently for their immediate and future financial needs and objectives.

It was in this spirit of effective collaboration that the CRO Forum decided to prepare this paper on managing conduct risks, providing an opportunity for our members to identify and discuss specific areas of conduct risk and to consider, by use of examples of sound risk management practices, potential means for insurers to mitigate those risks for the future.

Of course, conduct risk is only one of a number of relevant factors to consider, but nevertheless effective management of conduct risk can make a significant contribution to helping deliver fair and appropriate outcomes for our customers.

Marco Vet, Chairman CRO Forum

1 Executive summary

Introduction

The purpose of this paper is to identify and consider areas of conduct risk, to provide examples of sound risk management practices that can assist insurers in managing those risks, and thus help insurers to provide products and services capable of delivering good outcomes for customers and other stakeholders.

The paper specifically considers the product life cycle, i.e., product development, distribution process, services, and complaints handling, as well as means by which firms can effectively manage conduct risks related to P&C or Health contracts and life and pensions insurance. The development of consumer protection regulation places an increasing focus on the conduct of insurance companies.

An ongoing challenge for customers is that some of the products needed might be perceived as complex, meaning they face difficult financial decisions with possibly very long term impact involving measuring risk and applying a cost/benefit analysis. While insurers can help by taking account of customers' financial experience and understanding when designing financial promotions and product disclosure material, it seems desirable to improve customers' financial literacy. In this regard, all industry stakeholders, including regulators and legislators, have a vested interest in improving the financial literacy of customers.

The paper reflects the industry's ambition and identifies examples of good practice. However a 'one size fits all approach' would not be appropriate, nor would it be appropriate to apply these ambitions and examples of good practice retrospectively, since certain aspects such as (but not limited to) the present legal framework, technology, or distribution may differ from what was applicable and/or possible in the past, or what was considered to be good or standard practice at that time.

Product Life Cycle

Whether products deliver tangible benefits for customers can depend on a number of factors, for example whether they are being purchased for the purpose they were in fact designed, and whether they are performing in line with initial expectations.

Given the long term nature of some insurance products, insurers should aim to review the performance of products at appropriate intervals. An important element in this review process is the availability of fully embedded feedback loops from distribution, services and complaint handling processes.

Product development

There are a number of factors in product development, including research, design, pricing and condition setting that are crucial in ensuring that products address the needs of, and provide value to, customers.

Regarding product development, the following are identified as examples of sound risk management practices:

1. Product development considers current customers' needs as well as how these needs may involve in the longer term (where appropriate);
2. Product propositions appropriately and demonstrably consider customer factors;
3. Product propositions are appropriately tested and evaluated;
4. Product approval and review processes operate within a clearly defined internal governance framework;
5. After launch, products are subject to appropriate ongoing oversight and periodic review.

Distribution process

Distribution is a crucial component in matching the needs of customers with appropriate products. The following are identified as examples of sound risk management practices that should enable customers to make informed decisions based on their circumstances:

1. Insurers provide up to date information about their products and related services to their distribution channels;
2. Where customers receive advice and information on the purchase of insurance policies, the adviser should provide information on their relationship with the product provider;
3. Advice provided is appropriate for the customer circumstances and needs;
4. Staff dealing with customers should be properly qualified and trained for the service they provide.

Services

"Services" is defined as all the activities the insurer performs for the customer after the insurance contract is set up. This could include, for example, execution of the terms of the contract, execution of policy changes, informing customers about the financial development of their policy as well as general developments, answering customer queries, updating customer details and claim management. Insurers should ensure that these services when promised can be delivered and aim to improve these services taking into account feedback from customers.

The following are identified as examples of sound risk management practices:

1. Customers are informed about the level of service and more particularly the scope of cover that will be provided;
2. The level of service is reviewed to anticipate evolving customer needs;
3. Insurers have appropriate procedures and processes in place to ensure that service related processes are executed by trained staff in a reasonable timely fashion;
4. Insurers should be accessible by an appropriate range of communication channels;
5. Insurers or their distributors provide customers (on request) with appropriate information reflecting the status of their policies;
6. Internal control systems are structured in such a way that service related processes meet reasonable customer expectations.

Complaints handling

Customer complaints handling is a valuable source of information and learning for insurers. Recognising that effective complaints handling and settling processes are important tools in promoting trust in the industry and delivering outcomes that are appropriate for customers, the following are identified as examples of sound risk management practices:

1. Well-documented complaints handling procedure with easy access for customers to this procedure;
2. The complainant is kept informed about the status of the complaint;
3. Complaints are registered and there is an open culture about complaints received;
4. Complaints are investigated competently and diligently, resulting in an appropriate root cause analysis where necessary, so that relevant corrective action plans are put into place;
5. Complainants are informed about recourse possibilities if the complaint is not resolved satisfactorily;
6. Complaints are assessed and used as feedback to improve processes/services/tools/products to better meet customer expectations.

Risk-based monitoring and Key Risk Indicators

The ability to identify emerging conduct risks, and monitor the development and mitigation of existing conduct risks, is fundamental to effective risk management. A robust risk-based monitoring framework, incorporating relevant Key Risk Indicators (KRIs), can facilitate an insurer's understanding of risk and performance, and initiate and inform management actions and decision-making. Some examples of possible conduct KRIs are set out in Annex I of this paper.

2 Introduction

Customers need information and guidance on the risks they face in life (e.g. death, disability, retirement, legal liability, loss of a home by natural catastrophe, etc) and need protection from the consequences of those risks (loss of income, financial obligations, etc). Insurance can enable customers to protect themselves from the consequences of risks that may otherwise be unaffordable, or to plan to meet current or future financial needs.

However, a customer's experience with insurance, and their ability to make informed decisions regarding the products available to meet their needs, can be impacted by many factors. Critical factors in this respect are:

- The complexity of the product;
- The clarity of product information;
- The quality of advice they may receive;
- Their existing knowledge and prior experience of financial services;
- The number of interactions with the distributors and manufacturers of that product.

An ongoing challenge for customers is that many of the products needed are, by their very nature, complex, meaning they face difficult financial decisions with possibly very long term impact involving measuring risk and applying a cost/benefit analysis. While insurers can help by taking account of customers' financial experience and understanding when designing financial promotions and product disclosure material, it seems desirable to improve customers' financial literacy. In this regard, all industry stakeholders, including regulators and legislators, have a vested interest in improving the financial literacy of customers.

Product features can also impact the customer's opportunity to learn from the experience of purchasing financial products. For example, many P&C or health contracts are one year in duration and the renewal process creates an opportunity for the customer to refresh their understanding of the product and increase their knowledge. Life insurance, annuities and pensions, on the other hand, are long-term decisions and customers may not review these products on a regular basis. Therefore, there are less interactions with the insurer, and the opportunity to re-fresh or increase knowledge is limited.

Insurance companies need to be aware of, and actively managing, their conduct risks. In this context, conduct risk can be defined as the risk that processes, systems and controls that support the company's products and services are inadequate, or fail to deliver the reasonable expectations of customers, bearing in mind the view of other stakeholders.

This requires insurers to exhibit conduct that meets high standards in the areas of product development, distribution and customer communication, servicing and complaints handling. Consequently the culture within a firm, its products, its systems, processes and controls should aim to deliver appropriate products and services for customers and meet expectations of all relevant stakeholders.

Conduct risk can be defined as the risk that processes, systems and controls that support the company's products and services are inadequate, or fail to deliver the reasonable expectations of customers, bearing in mind the view of other stakeholders.

The purpose of this paper is to provide examples of sound risk management practices that can help insurers manage their conduct risks and explain how insurers can provide products and services that are capable of delivering good outcomes for customers and other stakeholders.

In the following chapters we distinguish 4 focus areas which are based on the main processes of an insurance company. The focus areas are:

- Product development (and the product life cycle);
- Distribution process;
- Services;
- Complaints handling.

3 Product development and the product life cycle

3.1.1 Introduction

Whether products deliver good customer outcomes can depend on a number of factors, for example whether they are being purchased to meet the needs for which they were designed, and whether they are performing in line with initial expectations.

Given the long term nature of some insurance products, insurers should aim to review the performance of products at appropriate intervals, and determine whether they are still capable of meeting the original aims they were designed to meet. An important element in this review process is the availability of fully embedded feedback loops from distribution, services and complaint processes.

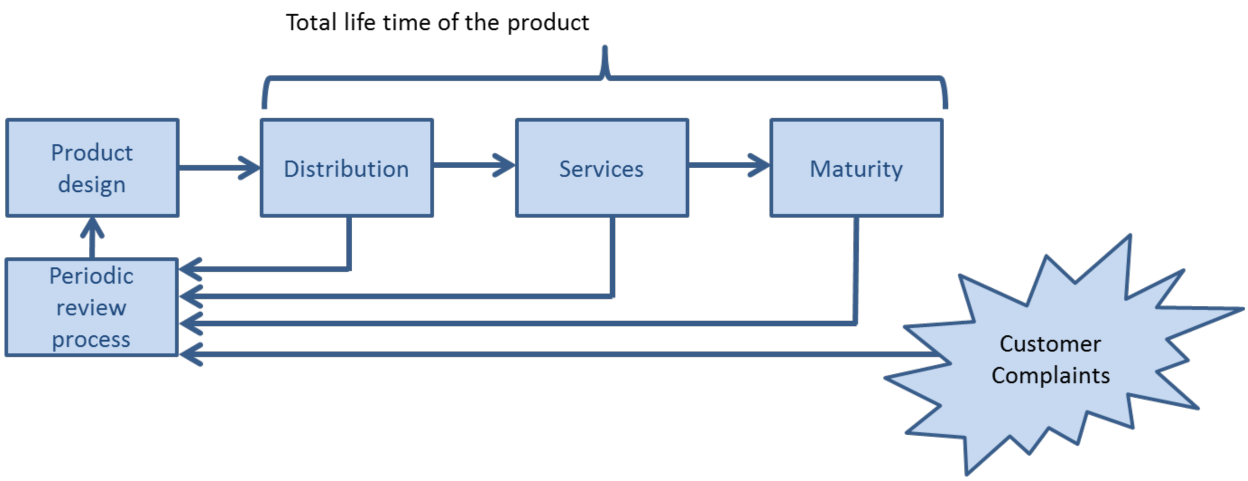
Given the long term nature of some insurance products, insurers should aim to review the performance of products at appropriate intervals, and determine whether they are still capable of meeting the original aims they were designed to meet.

3.1.2 Product Life Cycle and Review Process

The below diagram illustrates the product review process. One of the underlying requirements is the availability of fully embedded feedback loops from the distribution, services and complaints processes into the periodic review process. This feedback should assist the insurer to perform the periodic review in an effective way.

Fully embedded feedback loops from the distribution, services and complaints handling processes should assist the insurer to perform a periodic product review in an effective way.

In the chapters on products, distribution, services and complaints, examples of sound practice have been identified to support an adequate feedback cycle.



3.1.3 **Product Development: Examples of Sound Risk Management Practices**

From an insurance company perspective, the process of meeting the customer need begins with the product development process. The examples of risk management practices identified below suggest how the processes for development of products can be shown to meet customer needs, be transparent, and be reviewed on an ongoing basis to assess their on-going appropriateness.

The annex to this paper lists examples of the literature in this area that provides indications of expectations in respect to product development. The following are identified as examples of risk management practices for focus on customer considerations:

1. *Product development considers current customers' needs as well as how these needs may evolve in the longer term (where appropriate):*
   - Product terms and conditions are clear and transparent;
   - The appropriateness of any conditions to cancellation/exit;
   - Alignment of product design with the identified objectives and interests of the target market;
   - The information needs of the target customers, with emphasis on providing clear appropriate information;
   - Use of plain language, and avoidance of terms that are unlikely to be familiar to the target market;
   - Clear, transparent and balanced explanation of the products aims, risks and customer commitment, including key terms, conditions and exclusions. Clear signposting is provided to where additional information can be found where relevant;
   - The value to the customer should be demonstrated;
2. *Product propositions appropriately and demonstrably consider customer factors:*

– Consideration may be given to a number of customer factors before propositions are approved to proceed to development, including for example:
   - Identification of the target market for the product, analysis of its characteristics and how the proposed product will match the objectives and needs of that market, and provide customer value;
   - Whether the product risks are likely to be suitable to the target market;
   - The methods of distribution that will be most suited to ensure good outcomes for the target market;
   - The information requirements, taking into account the respective responsibilities of the product provider (manufacturer), distributor and customer;

3. *Product propositions are appropriately tested and evaluated:*

– The feasibility of product propositions should be evaluated prior to approval for development;

– Proposition testing may be considered where required, for example new types of products where past experiences may not provide a suitable guide to customer insights. The aim of proposition testing may, for example, be to establish whether:

  - Customers are likely to be able to understand and articulate the purpose of the product and its features, and how these may match their needs;

  - Target customers are likely to understand the risks of the product and the circumstances in which those risks might crystallise;

– Marketing materials, scripts and customer documentation should be reviewed by management as well as the legal department;

4. *Product approval and review processes operate within a clearly defined internal governance framework:*

– Insurers have in place documented product oversight and governance processes. This may include a product approval and review framework that identifies clear stages, and the authorisation and information requirements needed for progression in each stage of the development and review process;

– The product oversight and governance processes should be endorsed by the senior management of the product manufacturer. Senior management is responsible for compliance with the processes, and ensure records are kept;

– The framework may be organised such that customer, commercial and operational factors are subject to regular review for suitability and delivery of intended outcomes;

.

5. *After launch, products are subject to appropriate ongoing oversight and periodic review:*

– Consideration may also be given to the systems and controls, and management information required to monitor/manage the product risks on an ongoing basis including whether:
  - Management information is sufficient to indicate whether the product is being purchased by the intended target market, and to address the customer needs for which it was designed;
  - Customers experience of the product is consistent with what they have been led to expect;

– Issues with the product performance or customer experience are identified and escalated to an appropriate level to ensure root causes are investigated, and mitigating actions considered where necessary;

– Prior to the launch of a product the preparedness of the chosen distribution channel may be assessed to ensure that, for example:
  - It has accurate and up to date relevant product information;
  - Advisers/distributors are appropriately trained/qualified to advise on/sell the product;
  - The target market for the product, and what the product is intended to provide/deliver for customers, is clear;
  - The product can be presented in a clear and understandable way;
  - Sales incentives are not solely based on volume of sales;

– A documented post launch review may be undertaken to assess for example whether:
  - The product is being purchased by the intended target market;
  - The product is being purchased to address the customer needs for which it was designed;
  - The product is performing as intended;
  - Any risks or issues have emerged following launch which had not been identified/anticipated previously (and if so, determine how these can be best disclosed/addressed);

– Products are periodically reviewed to consider whether they are capable of continuing to meet the needs for which they were designed;

– Where a product review identifies material issues with a long term product appropriate action is taken.

4 Distribution Process

4.1.1 Introduction

Distribution is a crucial component in matching the needs of customers with appropriate products. From a risk management perspective, the process of distribution should enable customers to make an informed decision based on their circumstances.

Distribution is a crucial component in matching the needs of customers with appropriate products. From a risk management perspective, the process of distribution should enable customers to make an informed decision based on their circumstances.

Distribution processes should provide that:

- Customers who purchase products without advice (whether direct from a product provider, from an intermediary, or a platform provider) have access to appropriate information to enable them to make an informed decision;
- Where customers require advice in addressing their financial needs, advice provided (whether direct from a product provider, or from an intermediary) should be appropriate for the customer's circumstances;
- Where a product is complex, consideration is given to accompany the customer with the appropriate levels of advice and to document its decision.

The above stated comments do not apply in countries where advice is legally compulsory (e.g. France).

4.1.2 Examples of Sound Risk Management Practices

With regard to the distribution process the following are identified as examples of sound risk management practices:

1. *Insurers provide up to date information about their products and related services to their distribution channels*

– Direct writers provide customers with key information about their insurance products. Information should be provided on the material aspects and risks of the product, including the target market/type of customer the product has been developed for;

2. *Where customers receive advice and information on the purchase of insurance policies, the adviser should provide information on their relationship with the product provider*

– Such information includes any influence the relationship may exert on the provision of advice, and any other conflicts that may arise;

3. *Advice provided is appropriate for the customer circumstances and needs*

– The advice process should be designed to enable the customer to purchase a product that meets his/her financial needs, risk appetite and circumstances. Communications with the customer should be made in a timely and accurate manner, and in clear and comprehensible language;

4. *Staff dealing with customers should be properly qualified and trained for the service they provide*

– Staff keep up to date and enhance their professional knowledge through programmes of continuing professional development.

5 Services

5.1.1 Introduction

To meet customer expectations, insurers should aim to be clear on the services they are providing, ensure that these services can be delivered, and consider customer feedback in reviewing whether improvements are required. Since customers tend to complain when problems arise, it is important to also collect customers' feedback on satisfaction and have a system in place to capture such feedback at various touchpoints (e.g. sales, inquiry, claims). This feedback should be analysed, reported to management and acted upon.

To meet customer expectations insurers aim to be clear on the services they are providing, ensure that these services can be delivered and consider customer feedback in reviewing whether improvements are required.

5.1.2 Examples of Sound Risk Management Practices

To maintain appropriate service levels and manage the risk that services fail to meet reasonable customer expectations, the following are identified as example of sound risk management practices:

1. *Customers are informed about the level of service and more particularly the scope of cover that will be provided;*
2. *The level of service is reviewed to anticipate evolving customer needs;*
3. *Appropriate procedures and processes in place to ensure that service related processes are executed by trained staff in a reasonable timely fashion;*
4. *Insurers being accessible by an appropriate range of communication channels;*
5. *Insurers or their distributors provide customers (on request) with appropriate information reflecting the status of their policies;*
6. *Internal control systems are structured in such a way that service related processes meet reasonable customer expectations:*

- Service related processes are regularly reported to, and monitored, by management. The objectives regarding customer expectations and other key processes can be translated into Key Performance Indicators (KPIs)/metrics to provide management with steering information. Service models evolve over time and if there is an impact for the customer they need to be informed if there is a change of service. This may be due to ongoing technology development or other circumstances;
- When services are outsourced to third parties, service level agreements should encourage the service providers to meet the abovementioned objectives. Service providers should regularly report to insurers on the KPIs/metrics;
- Regular evaluation of the processes, policies and procedures to decide if adjustments are necessary. This evaluation may take into account the outcomes of customer surveys, customer panels, opinions/feedback from customers, customer research, and public perceptions. KPIs/metrics and analytical information on root causes for complaints is also considered (see next chapter).

6 Complaints handling

6.1.1 Introduction

Effective complaints handling and settling processes are important tools in promoting trust within the industry and delivering outcomes that are appropriate for customers. The analysis of the root causes of customer complaints is a source of valuable risk management information. A pro-active and transparent approach to handling complaints is in this respect crucial.

The analysis of the root causes of customer complaints is a source of valuable risk management information.

In establishing appropriate complaint handling arrangements, it is important to not only consider the current environment (including the product features, existing processes, the target market etc.), but to also consider changes and developments to that environment, for example the internet and social media. Social media can present both threats and opportunities when an insurer is being confronted with complaints. In no time, large groups of customers can be made aware of issues regarding certain products. At the same time, social media can be of help in communicating clearly about what customers can expect from the insurer.

6.1.2 Examples of Sound Risk Management Practices

Complaints can inform the review of products and processes, in addition to inputs from other research the company may carry out. This can be done in such a way that confidence in insurers meets the levels needed for an industry that basically sells trust. The following are identified as examples of sound risk management practices:

1. *Well-documented complaints handling procedure with easy access for customers to this procedure;*

2. *The complainant is kept informed about the status of the complaint;*

3. *Complaints are registered and there is an open culture about complaints received:*

   – The complaints received by any department of the company are registered in a manner that allows for easy aggregation of complaints at appropriate levels within the company;

   – The company registers the main characteristics of the complaint. This is done in such a way that it allows for root cause analysis. It is important to detect the underlying reasons of the complaint;

   – Insurers create an environment that is open to receiving and communicating about complaints;

   – Complaints that involve the regulators or litigation must be brought into the attention of senior management and the legal department;

4. *Complaints are investigated competently and diligently, resulting in an appropriate root cause analysis where necessary:*

   – The investigation considers whether the matters giving rise to the complaint have a broader impact. For example, relate to similar product products that are sold via other distribution channels, other products that are sold via the same distribution method, or products that are processed in a similar way;

   – Based on broader impact analysis, an assessment is made as to whether the company should pro-actively make changes in product development, distribution methods and/or processes involved;

   – The staff handling complaints should be well trained and competent to undertake their duties. If the complaint is justified, the complaint should be resolved in the customers favour. If the complaint is found not to be justified, the complainant should be informed about the reason in an empathetic and understandable way;

5. *Complainants are informed about recourse possibilities if the complaint is not resolved satisfactory:*

   – Decisions by endorsed Alternative Dispute Resolution (ADR) bodies are settled promptly, unless the company has good reasons to appeal against the decision. In that case, both the complainant and the ADR bodies are informed in a timely manner;

6. *Complaints are assessed and used as feedback to improve processes/services/tools/products to better meet customer expectations.*

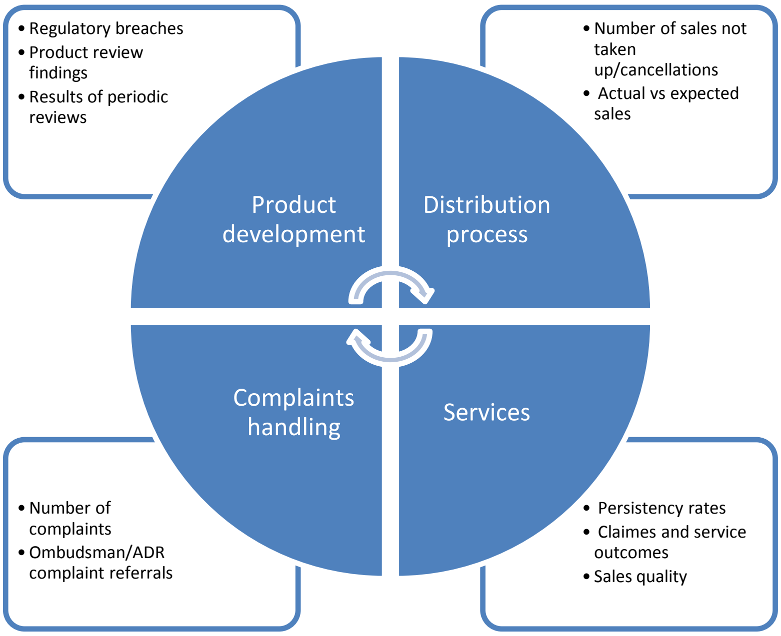
7 Risk-based monitoring and Key Risk Indicators

7.1 Risk Based Management Reporting

The ability to identify and measure new conduct risks, monitor their development and mitigate existing conduct risks, is fundamental to effective risk management. Risk management reporting, incorporating relevant risk-based information, such as Key Risk Indicators (KRIs), will facilitate an insurer's understanding of risk and performance and will trigger management actions and the corresponding decision-making:

- Risk-based management reporting should ideally be developed for all relevant products, services and processes, and be aligned to appropriate customer outcomes and the insurer's conduct risk appetite. Regular reporting can enable risks to be closely monitored, and facilitate timely action. Reports should easily and readily identify areas of current or emerging concern, allowing senior management to focus on priority issues. This reporting can be complemented by trend analysis, allowing longer term risks and issues to be identified and considered;
- Risk-based management reporting may also be used to inform an insurer's product and/or sales governance processes, including process development and subsequent reviews;
- Insurers should periodically review their management and reporting framework, including the range of KRIs, to ensure it remains appropriate and suitably robust. Maintaining an optimum number of KRIs should provide insurers with sufficient granularity of information, without creating excessive and/or unmanageable levels of data;
- Ultimately, an insurer's approach to risk management and reporting market conduct risks, including the number, type and form of KRIs, will depend on, among other things, its business model, strategy, risk appetite, the products and services it provides, and its target market. Examples of possible KRIs are set out below as well as in Annex I.

7.2 Some practical considerations to establish effective Key Risk Indicators



Key Risk Indicators (KRIs) should be able to signal issues developing internally or externally. They are necessarily embedded in the company's risk appetite framework, and need to be reviewed regularly for their significance.

To effectively manage conduct risks, each company will select their own set of relevant KRIs. In order to keep the reports and the management of the indicators meaningful, the number of indicators should kept small. Related e.g. to a traffic light system, they will serve as early warning indicators or signal acute issues.

Key Risk Indicators can be set top-down or bottom-up depending on the focus; the latter is generally reasonable to manage tactical and operational risks.

Annex I: Examples of Conduct Risk KRIs

Examples of possible Key Risk Indicators (KRIs) with regard to Conduct Risk are:

- Number of complaints (split by category, e.g. product documentation, sales, service, claims);
- Complaints outcomes (e.g. number of complaints upheld/rejected, split by category);
- Ombudsman/ADR complaint referrals;
- Ombudsman/ADR complaint referrals upheld;
- Number of claims (split by product/service);
- Claims outcomes (e.g. number of claims paid/declined, split by product/service);
- Loss ratios;
- Actual v expected sales (split by product/service);
- Sales quality (e.g. outcomes of quality assurance testing, mystery shopping, split by distribution channel);
- Actual v expected profit (split by product/service);
- Target market (i.e. data on sales within/outside target market, split by product/service);
- Number of sales not taken up/cancellations at outset (i.e. within cooling off period);
- Persistency rates (e.g. number of early surrenders/transfers);
- Service outcomes (e.g. quality assurance testing, service standard adherence);
- Regulatory breaches;
- Customer satisfaction (e.g. post-sale surveys, focus groups);
- Product review findings;
- Internal Risk Oversight/Audit findings;
- Internal Risk Oversight/Audit overdue actions;
- Results from periodic reviews of products, activities, business areas;
- The remuneration structure of the commercial department;
- Identification of deviant behaviour in relation to codes of conduct that may cause reputational risk for the company.

CRO FORUM

Annex II: For further reading

- OECD (2013). Update report on the work to support the implementation of the G20 High-level principles on financial customer protection.
- Financial Conduct Authority (2013). FCA Risk Outlook 2013.
- Financial Conduct Authority (2013). Applying behavioural economics at the Financial Conduct Authority.
- Mike Ritchie (2013). Conduct Risk: what is it and can you measure it?
- Deloitte (2013). Conduct Risk: Developing and maintaining an effective framework.
- PWC (2013). Right first time: Staying ahead of the conduct agenda.
- Voice of the customer - Time for insurers to rethink their relationships, Ernst &Young 2012.

The CRO Forum is supported by a Secretariat that is run by
KPMG Advisory N.V.

Laan van Langerhuize 1, 1186 DS Amstelveen, or
PO Box 74500, 1070 DB Amsterdam
The Netherlands

www.thecroforum.org