13 August 2015

GFIA comments on IAIS issues paper "Conduct of business risk and its management"

General comments

The Global Federation of Insurance Supervisors (GFIA) commends the International Association of Insurance Supervisors (IAIS) for its comprehensive paper intended to provide a useful resource in assisting supervisors in understanding conduct of business (COB) risk and the tools that both they and industry have to mitigate such risk. The IAIS is taking a leadership role in international financial services in identifying and providing guidance on COB risk. This paper may prove a useful resource not just for insurance supervisors, but also for other financial supervisors.

However, GFIA believes it is also important to avoid creating the perception that a heavy-handed approach to regulation is required in all instances. GFIA believes that care needs to be taken in four areas in particular:

- Conclusions should not be drawn based on single examples of misconduct.
- At times, the line appears blurred between supervision and business intervention.
- At times, the paper leaves the impression that the industry does not, as a general rule, follow responsible and fair customer practices.
- Supervisors should, in all instances, be encouraged to fully analyse a particular issue and whether it is, in fact, prevalent in their local market, and thereafter consider their own legal environment and existing powers in determining an appropriate solution.

Comments on Paragraph 2

It is important to recognize that poor business conduct is not necessarily systemic. As such, GFIA suggests that the final sentence should read (italicized words added): *"*Not only does poor conduct affect individual customers, it can, *if systemic*, impact whole markets, the reputation of individual insurers and consumer confidence in the sector as a whole.*"*

Comments on Paragraph 12

GFIA agrees that key differences between conduct and prudential risks will lead to different, but complementary, approaches. Although these are laid out in subsequent paragraphs, the impression given is that there is an inherent link between COB and prudential risks, which may not always be the case.

Comments on Paragraph 24

GFIA agrees that coordination between conduct and prudential supervisors can be useful, from two perspectives:

- Possible linkages between COB and prudential risks, as noted in the paper.
- To understand the possible negative prudential impacts of market conduct interventions. For example, the consequence of overly intrusive product regulation could be a requirement to hold excessive amounts of capital. Liaison between conduct and prudential supervisors could help both to be more aware of the impact of regulatory actions.

Comments on Paragraph 26

The final sentence states that "it is crucial to apply both prudential and conduct considerations to an assessment of financial data". The possible implications of this could be problematic for jurisdictions where prudential and COB supervision is divided. As well, as noted earlier in the paragraph, prudential supervisors use objective indicators in

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assessing financial data. COB supervisors, on the other hand, will rely more on subjective and more holistic approaches.

Comments on Paragraph 27

GFIA agrees that monitoring COB risks needs to recognize the unique social and legal context of the jurisdiction, as well as the nature, scale and complexity of businesses. This paragraph suggests a scalability and judgement assessment that, GFIA would suggest, could be more prominent throughout the paper.

Comments on Paragraph 39

GFIA disagrees that a commission-based remuneration model creates an inherently conflicted situation. As noted in paragraph 38, intermediaries play a pivotal role in addressing the risks faced by customers. Also, as noted in paragraphs 36 and 37, consumers are not inclined to seek out insurance.

Comments on Paragraph 42

Information asymmetry can work both ways. Insurance is a good-faith contract. Not only is it important that good, clear information is available to the consumer so that they can understand the product and how it meets their needs, it is equally important that the consumer does not withhold or misrepresent information.

Comments on Paragraph 45

This paragraph notes that an interventionist approach towards products is sometimes taken to address information asymmetry risks. GFIA is concerned that this starts to move down a dangerous path and believes that supervisors should take great care to not blur the line between supervision and micro-management of businesses. The responsibility for running insurers ultimately resides with their management and Boards. Supervisory micro-management can impede a competitive marketplace and curb innovation, both of which could be to the detriment of consumers and result in market stagnation.

Comments on Paragraph 47

While GFIA wholeheartedly supports education and increasing the financial literacy of consumers, it finds some of the language in this paragraph unnecessarily biased. The second sentence reads that where financial literacy levels are low, "…the risks of exploitation of that asymmetry are increased". GFIA suggests the use of more neutral language.

Comments on Paragraph 50

GFIA agrees that financial education alone is not a panacea, and that disclosure and advice are key.

Comments on Paragraph 53

This paragraph, along with paragraphs 54 and 56, come across as suggesting fairly strong anti-industry biases and appear to use behavioural economics to support such biases. GFIA find this extremely concerning and would urge the IAIS to consider a more neutral approach. Paragraph 53 states: "This raises the prospect of insurers and intermediaries designing business models to take advantage of these behaviours, rather than designing products and processes to mitigate risks arising from these behaviours". This ignores the fact that most insurers and intermediaries have cultures, practices and business models geared towards treating customers fairly and doing the right thing, which would support using the information gained from behavioural economics to improve the consumer experience.

Comments on Paragraph 54

The example given in paragraph 54 suggests that consumers shouldn't trust likeable sales people and, more generally, that behavioural biases do not have a valid place in the formation of consumer choices. GFIA is concerned that this misleads consumers. If an intermediary works to understand a consumer's needs, to identify possible solutions and to explain those solutions in a manner in which the consumer understands, they will surely have earned the trust of the consumer. The intermediary will, in most jurisdictions, have also explained what their qualifications are and for whom they act. In GFIA's view, the suggestion that the only weight the consumer should consider is economic incentives is unfounded and potentially does a disservice to intermediaries.

Comments on Paragraph 56

GFIA takes grave exception to this paragraph, which states that "this can cause significant problems that financial markets, left to themselves, will not solve". The Payment Protection Insurance (PPI) example is used to justify that broad statement. While that was a serious case, GFIA does not believe that extrapolating it to the entire industry and all jurisdictions is appropriate. As noted above, most insurers and intermediaries have cultures, practices and business models geared towards treating customers fairly and doing the right thing.

Comments on Paragraph 72

This paragraph, as well as paragraph 73, discusses "bundled" products and points out some risks that may exist if insufficient information is provided. This leaves the impression that bundled products are bad for consumers. Some balance could be provided by noting that there can be convenience and cost benefits for consumers. This would provide a more balanced view, while still retaining the concerns about disclosure.

Comments on Paragraph 79

This paragraph, as well as paragraph 78, discusses the sale of products without advice. GFIA is concerned that some of the approaches suggested in paragraph 79 could be seen as overly paternalistic and could encroach on the consumer's freedom of choice. If consumers choose to purchase through a non-advice channel, GFIA agrees that measures need to be taken to provide good information and ensure that the customer is in a position to make an informed decision. However, consumers should not be forced to obtain (and pay for) advice where they neither require nor desire it.

Comments on Paragraph 98

This paragraph leaves the impression that any type of competition (too much or too little) is bad. In fact, competition and innovation provide positive benefits for consumers, in terms of product choice and value and price. It is GFIA's view that the paper should recognize this. Instead, it seems to imply that the only way to protect consumers is through restrictions.

Comments on Paragraph 99

While GFIA agrees that supervisors need to be alert to systemic issues that call for "collective action", it would suggest that they also need to exercise caution, so that they don't extrapolate a single case into a systemic risk and/or move too quickly to interfere with competitive market forces which are generally understood to be positive for consumers.

Comments on Paragraph 100

As with paragraph 98, this paragraph leaves the impression that competition harms consumers. Competition and innovation, and hence consumer choice, are important in benefitting consumers and contribute to consumer protection. GFIA believes that a balance must be struck that protects consumers from abuses, but also allows competition and innovation to thrive.

Comments on the Conclusions

The conclusions are wrapped around the linkage between prudential and COB risks. GFIA wonders if that gives undue weight to the linkage. There may not always be a linkage, yet COB risks are still important to recognize and mitigate.

Comments on the Annex

The introduction to the Annex is, on the whole, balanced, pointing out that these are examples and that supervisors should develop their own indicators while considering their legal system and culture. However, it could be clearer, both in the introduction and throughout the Annex, that it is difficult to identify any one element as a definitive risk indicator or metric and further, that all indicators in the Annex may not apply to all jurisdictions, and each supervisor should mix and match the factors that are relevant to their jurisdiction.

As a general observation, the descriptions of their various indicators and potential implications identify areas that "may" create risk and positive actions that supervisors can look for that manage or mitigate risks. An outlier to this is 1.5 where it states "the quality of disclosure…may indicate information asymmetry risk". To be consistent with the approach otherwise used, the IAIS may wish to state "the quality of disclosure…may mitigate information asymmetry risk". Likewise, 1.4 (use of "big data") states only this tool "may be used to unfairly take advantage of behavioural biases". This doesn't recognize that it is more likely to be used to develop products that meet customer needs. (Please see our comments under paragraph 53.) And finally, we don't find profitability (2.13) as a robust unit of measure. High profitability can indicate both good value and poor value, depending on the situation.

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About GFIA

Through its 39 member associations, the Global Federation of Insurance Associations (GFIA) represents the interests of insurers and reinsurers in 59 countries. These companies account for around 87% of total insurance premiums worldwide. The GFIA is incorporated in Switzerland and its secretariat is based in Brussels.