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Market Conduct in the insurance industry

The primary objective of the new Conduct regulatory framework is the promotion of the fair treatment and protection of customers by financial institutions.

While some firms like to believe that Conduct will only become effective on the promulgation of the Conduct of Financial Institutions Bill ("COFI Bill"), in our view Conduct is already effective in sector specific legislations (for example in the Policyholder Protection Rules in the insurance industry). Our clients tell us that they have made good strides in embedding Conduct risk into their risk structures but that there is much work still to be done.

In this context, KPMG's Market Conduct practice conducted a detailed survey in which four banks, fourteen insurers and ten asset managers participated. The survey provides insight into the South African financial services industry's progress in embedding Conduct within their businesses.

Insurers have a bit of a bad reputation

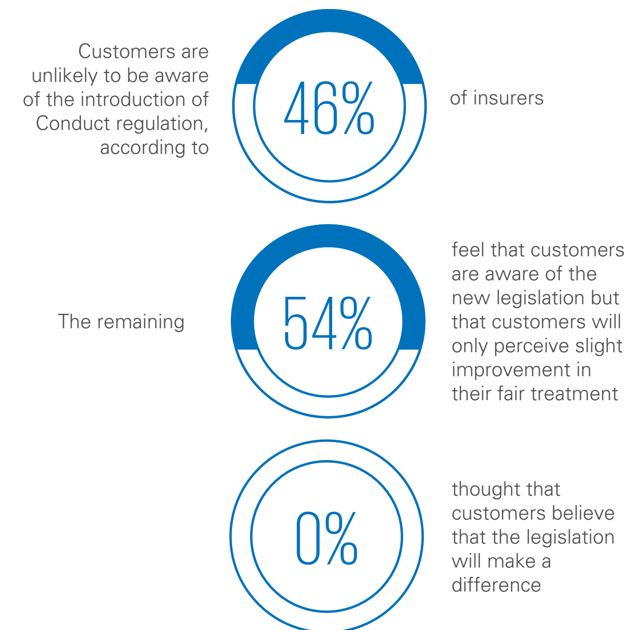
We asked participants what their perception of public trust is in the banking, insurance and investment management sectors (all 28 participating firms were asked to rank all three financial institutions out of 5, with 1 being no trust and 5 being complete trust).

The insurance sector was perceived to be the least trusted sector by participants and obtained an average ranking of 2.7 out of 5. Participants cited reasons ranging from negative Ombud reports to incidents relating to the non-payment of claims and claims not being settled on time. Arguably, an insurer is more likely than a bank to interact with a customer after a traumatic event in the policyholder's life, which may lead to the increased negative sentiment. This in itself creates opportunities for insurers to improve that interaction and make sure that there are no surprises for the customer at this point in the fulfilment process.

This perception of customer trust is probably not surprising to insurers with majority of insurers also believing that they would rank the least trustworthy in comparison to banks and asset managers.

We questioned whether the introduction of conduct-specific legislation (i.e. the COFI Bill) could come to participants' rescue by improving customer perception of their treatment. Forty six percent of insurers believe that customers are unlikely to be aware of the introduction of Conduct regulation while the majority of insurers believe that even if customers are aware of the new legislation they would likely only perceive a slight improvement in the fairness with which they are treated.

Will Conduct regulations improve customer perception?



Accordingly, the insurance sector will need to take some proactive steps to improve customer trust. Perhaps a good place to start is considering whether insurers are nurturing a culture of good conduct in their organisations particularly since culture is globally recognised as the root cause of continued misconduct.

In our experience, most firms do not set out to treat customers unfairly

Rather it is the confluence of factors in an increasingly complex business environment, including intermediaries, third parties and "hand-offs" in a firm and the inability to identify that the combination of these inadvertently leads to misconduct. It is for this reason that the Financial Sector Conduct Authority ("FSCA") is implementing targeted legislation that forces firms to consider all aspects of their business model.

Eighty six percent of the insurers who participated in our survey, told us that elements of their firm's culture have either unintentionally or intentionally contributed towards instances of misconduct.

Interestingly, twenty nine percent of the insurance participants told us that they have continued to sell products or deliver services despite having identified that at an industry level these products and services result in the unfair treatment of customers, believing that it would be unfair on their firm to lose the business while everyone else in the industry continues to profit from it.

It is encouraging to see that up to fifty seven percent of insurance participants have redesigned their products, services or practices where they have identified Conduct issues and forty three percent have discontinued them. However, it also suggests that Conduct considerations were not effectively considered at design stage. COFI will require that insurers and other financial institutions ensure that all products and services are designed and offered with due regard to the interests of the customer.

Individual accountability is now a global concept and is becoming a regulatory focus area around the world

Individual accountability is now a global concept and is becoming a regulatory focus area around the world to ensure that senior managers take responsibility for their actions and are held to account for their failures to act and the poor behaviour which results in Conduct failures.

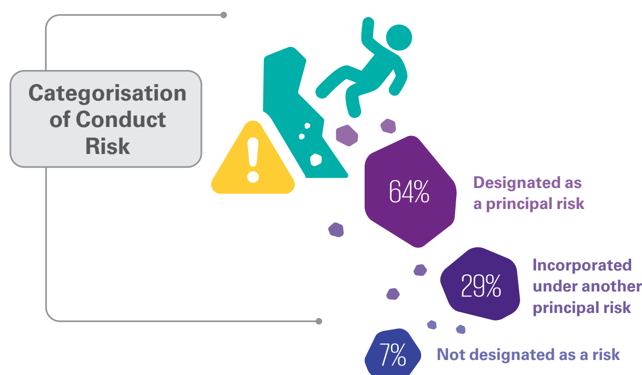
Many countries beyond the UK are introducing measures to enforce the individual accountability of senior managers and these measures are broadly similar to the UK's Senior Manager regime although details vary across countries. We don't have certainty on whether or not an individual accountability regime will be introduced in South Africa. However, it would be remiss to ignore the regulatory tone and direction being taken by financial regulators both globally and locally. All of the insurance participants unanimously agreed that there is value in the FSCA implementing an accountability regime similar to the UK's Senior Managers Regime.

What surprised us… is that very few firms make use of different incentive models to drive behaviours. At an executive level across the financial services industry, only thirty-nine percent of employees' remuneration is affected by Conduct outcomes. In our view, incentives and disincentives play a significant role in influencing behaviours and driving accountability without a formal accountability regime. Inappropriate remuneration and incentive schemes wholly driven by quantitative and financial targets can unintentionally result in instances of misconduct. Employees may question the importance of 'treating customers fairly' in an organisation where employee performance is wholly measured against quantitative/financial targets of the firm. Similarly, employees who are found to participate in instances of misconduct should be penalised (for example by applying claw-backs, bonus reductions or termination of employment). Setting appropriate Conduct KPIs and linking this to remuneration will go a long way in holding employees accountable in the absence of an accountability regime.

How are insurance participants managing Conduct risk?

In excess of one third of insurance participants have not designated responsibility for managing Conduct risk to an individual within their business. While all business functions and all employees have a role to play in managing Conduct risk, in our view it is most effective when driven by an individual incentivised appropriately to ensure the objectives are achieved.

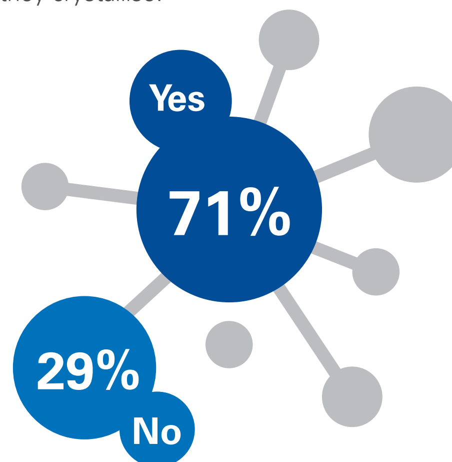
Thirty six percent of insurance participants have not yet performed a complete assessment of the impact of Conduct on their businesses and do not have a formal and documented Conduct risk identification and assessment process in place.



Sixty four percent of insurance participants have designated Conduct risk as a separate principle risk instead of incorporating it under another principle risk. One of the fourteen insurance participants has not designated Conduct as a risk within its firm.

There is no hard and fast rule on whether Conduct should be categorised as a principle risk or be a sub-category of another principle risk, however, it should be formally designated as a risk and should be assessed, monitored and reported on in the same way as other risks.

Data and analytics can be harnessed by organisations to effectively manage conduct risks by, for example monitoring conduct risks and even predicting and then mitigating conduct risks (such as mis-selling situations). More mature organisations are using data and analytics techniques to develop new products, identify new markets, improve customer experience and predict poor outcomes by monitoring trends pointing towards an undesired outcome. The FSCA is adamant that advanced data analysis is an important approach for large organisations to measure their Conduct risks and to identify trends and relationships that require investigation before they manifest in actual unfair treatment. Global benchmarking shows that large insurers have up to eighty conduct metrics that are measured on a monthly basis. This is not something that can be achieved without harnessing data and analytics. Insurers should consider investing in data and analytics systems which analyse more than just complaints metrics to enable them to identify, investigate and manage Conduct risks before they crystallise.



Seventy one percent of the insurance participants in our survey stated that they make use of data and analytics in one form or another to assist them in managing their conduct risk.

All but one of these participants agree that they believe they could be making more efficient and effective use of data and analysis tools and/or data and would like to have better quality Conduct specific data at their disposal.

So what concerns insurers the most about complying with Conduct?

Insurance participants have told us that they believe that they have received more intense regulatory and supervisory scrutiny over a longer period than other sectors, and they point to the new insurance laws, regulations, the Policyholder Protection Rules and FAIS Codes of Conduct.

Generally our survey shows that insurance participants are the most concerned with their ability to evidence a culture of fairness within their firms. Indirectly, acceptable scores in firms' Conduct KPIs provide evidence that culture is appropriate but we do want to challenge firms on the adequacy of their KPIs. It is possible that firms have not done enough to identify the bespoke Conduct risks that their products and processes expose them to; something that can only be done by a bottom-up analysis of every product and every process that touches the customer. The other way of evidencing an appropriate culture is through doing things like culture audits which are not as fluffy as one might expect and which do yield tangible evidence.

The second item that concerns firms most is when the fair treatment of customers is not within their control - yes, there’s no doubt that it’s harder to ensure that third parties are treating customers fairly – and this can span from whether intermediaries are giving proper advice or the plumber an insurer sent to the policyholders’ house is qualified. But it can be done; again through the identification and measurement of Conduct KPIs and a framework for identifying the risks that emanate from the third party arrangement.