LMA DA Auditor conference 2016

Breakout Information and Sample Answers

This document contains information to support the facilitation of the breakouts at the LMA Delegated Authority Auditor Conference held on 9 February 2016. The information was used to help guide conference attendees by providing relevant background information and example answers to the questions posed. Please note that the example answers provided are non-exhaustive and are intended to promote thought and discussion. They do not constitute formal guidance.

Breakout 1

Consider all of the activities in your allocated stage of the value chain. What are the customer risks and why are these important?

Insurance Value Chain

Sample Answers

What are the customer risks in the value chain?	Why are these important?
1. Product development • Failing to identify and/or understand the customers needs and reasonable expectations • Unable to identify the customer type • Product designed without considering needs and expectations of customer • Product wording/language not clear or not suitable for the target customer • Product terms and exclusions unclear or subject to interpretation or discretion • Product too complex for target customer type • Product intended distribution not suitable for product type and/or target market • Value of product to customer is not clear • Product to be sold as an add-on to another product (not restricted to another financial service – e.g. car, mobile phone, holiday) • Insurer or its agents are unable to meet the likely service demands of the product • When product is designed by a third party, that third party fails to take into account customer needs and requirements of the carrier **2. Marketing and advertising** • Product features are not explained clearly in marketing and promotional materials • Financial promotions are unclear, unfair, or misleading • Significant/key exclusions are not explained. • Material not designed for the target market. • Material fails to reach target market or is presented to wrong target market(s). • Language issues when material designed for multi-lingual sales. • Full terms and conditions not available prior to purchase.	• Without identifying, understanding and considering customer needs and reasonable expectations, a product may fail to meet them. This can have a commercial impact as well as a regulatory. • Failing to identify the customer type risks products being sold outside of their intended target market to customers who the product may be unsuitable for. It also makes it difficult for insurers to improve products over time. • Inappropriate, overly complex, misleading, unclear or discretionary product wordings can confuse customers and create problems when it comes to handling claims when they arise. Products may also be mis-sold as a result of customers believing something was covered when it was not intended. • Product distribution channels or partners may be unsuitable for the target market and/or the product. This can result in a lack of sales or products being mis-sold • Products must offer value to customers to be both commercially successful and compliant with regulations • Behavioural economics suggests that products sold as an add on to a more engaging product may not be given sufficient attention by purchasers and are therefore more susceptible to mis-selling (whether intentional or not). • Without considering likely service demand, a product may be designed for which the insurer or its agent is unable to provide service. • Regulatory fines or censure for underwriters and / or distributors • Reputational impact on the business of poor customer experiences • Future redress paid out to customers in compensation for mis-selling • Remuneration arrangements (ordinary commission, contingent commission, profit share) can encourage a distributor to establish practices or procedures that may lead to mis-selling • Sales incentives and other reward/bonus schemes to staff (of either the underwriter or distributor) can be designed in such a way that they incentivise the delivery of poor outcomes (such as risk of mis-selling, lower claims reserving or settlements, incorrectly rejecting complaints) • Advisors must be competent and must not be swayed in making recommendations that detriment customers one way or another (such as through sales incentives)

Sample Answers

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<u>What are the customer risks in the value chain?</u>

3. Sales
- Products are sold to customers for who the product is unsuitable / not the target market
- Sales personnel do not adequately assess the needs of customers when selling the product
- There is a lack of oversight from carriers over their agent’s sales practices
- Significant features are not clearly explained at the point of sale
- Customers are given poor advice at the point of sale
- Sales incentives create a risk of products being mis-sold
- Poor speed of service (quotation and purchase).
- Poor product knowledge by sales staff.
- Inappropriate or inaccurate sales scripts.
- Poor control over broker/introducer networks.
- Use of cold calling/call centres with inadequate controls.
- Internet sales.
- Bundled products – customers given the choice, clarity of cover and price differences.

4. Service
- Unreasonable barriers exist preventing customers from cancelling, switching, or amending products
- Customers receive poor post-sale support when they try to cancel, switch or amend
- Service demand exceeds insurers’ capability
- Service availability fails to meet the needs and reasonable expectations of customers (e.g. timeframes for emergency coverage)
- Communication channels are inappropriate for vulnerable customers or excessively onerous.
- Language issues (e.g. service only available in English despite being sold to a broader customer base)
- Consistency of marketing material and documentation.

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<u>Why are these important?</u>

- Barriers to cancelling, switching or amending products can discourage customers from purchasing, or lead to frustration and subsequent complaints if discovered after purchase.
- Poor post sale support is likely to lead to complaints, reputational damage and a low renewal rate.
- Service demands that exceed the availability/capability of insurers to deal with can ultimately lead to customer dissatisfaction and increased costs as overtime or outsourcing becomes necessary.
- Service availability is a key expectation of customers for certain types of product (such as travel or household emergency).
- Communication issues (such as inappropriate channels, limited languages, or delays) can lead to poor product performance and customer dissatisfaction.
- Products should always deliver on their promise.
- Customers may not understand technical language, legalistic language or industry jargon.
- Product may no longer be relevant or appropriate (e.g. change of legislation).
- Customer may be given the wrong level of cover for their needs (too much or too little).
- Product may be undervalued when being designed and therefore incorrectly priced to cover costs.
- Impact of social media on reputation.
- Marketing may not highlight the features, benefits and exclusions of most relevance to the customer.

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Sample Answers

What are the customer risks in the value chain?	Why are these important?
5. Claims • Unreasonable barriers exist making it difficult to make a claim • Customers are not provided with sufficient info on how to make a claim • Claims are not handled fairly and promptly, or are rejected unreasonably • Claims staff are not experienced or knowledgeable enough to investigate claims • Claims authority limits are too restrictive to allow claims to be settled promptly • Claims processes are inefficient or onerous, leading to delays for claimants • Communication to claimants is poor, with lack of updates (especially for claims that take a long time to resolve). • Lack of product understanding by coverholders or TPAs. • Too many links in the chain causing delays in claims handling or customer confusion. • Use of automated call systems that upset customers. • Customers are not provided with progress updates. • Inadequate control over third parties (loss adjusters, engineers) **6. Complaints** • Customers face barriers when making a compliant • Customers are not clear how to make a complaint, or who to complain to • Customers are not aware of their FOS rights (where eligible) • Complaints are not recognised or recorded accurately • Complaints are not handled fairly, having regard to customer expectations • Lack of feedback loops to rest of business to improve products and/or service • Complaints are resolved without investigation of the underlying root cause • Complaints processes are inefficient or onerous, leading to delays for complainants • Communication to complainants is poor, with lack of updates on progress	• Customers are unable to claim on the policy they have purchased • Failure to handle claims promptly and fairly for any reason is likely to lead to poor customer experiences and increased costs. • Claims payments may fail to match customer expectations. • Failure to identify complaints, investigating the root cause and providing feedback to the business is likely to result in insurers being unable to improve their products making them less competitive. • It will also result in reputational damage and possible regulatory intervention.

Additional Considerations

Understanding the customer risks presented by a product at each stage of the value chain is the first step in being able to identify issues as part of an audit that need to be examined and reported on.   Below are three examples of possible ‘red flags’ under each stage of the value chain that is likely to warrant this attention.

1. Product Development
- No formal product development process or product control framework in place
- No evidence of research in to customer needs and reasonable expectations
- No way of identifying and reporting customer types

2. Marketing and advertising
- No design and approval process for marketing material or financial promotions
- Evidence of material being produced in the absence of approval
- Limited control/retention/recording of marketing materials produced and in use

3. Sales
- No QA or peer review processes, or no consideration of conduct risk and customer outcomes as part of QA or peer review
- Incentives that give risk to potential conflicts of interest and/or promote a poor culture that does not put customer interests first
- Lack of or inadequate sales records
- Poor or incomplete MI from coverholders on sales

4. Service
- No process to identify and assess barriers for ‘reasonableness’ and ‘fairness’
- No process for monitoring and reporting service demand vs resources
- No process for or lack of evidence of stress testing for relevant products

5. Claims
- No QA or peer review processes, or no consideration of conduct and customer outcomes as part of QA or peer review
- Lack of clear claims philosophy and / or process in place
- File review of claims demonstrate consistent poor customer outcomes
- Unclear claims authority limits or escalation procedures
- Excessive use of ‘without prejudice’ payments with no clear explanation of use
- No clear settlement procedures

6. Complaints
- Immediate offers of redress without investigation
- Lack of understanding of what constitutes a complaint
- No feedback loops/lack of follow-up from systemic issues identified through complaints
- Coverholder/TPA not reporting all complaints to MA

Breakout 2

Considering all aspects of the audit lifecycle, how can audit messages add value when reviewing Conduct Risk, and what work do auditors need to do to deliver these messages?

Principles of ‘Value Add’ Messages

F irmly linking the ‘case for change’ to business objectives … … helping to make the business better, and steer clear of trouble

A sking ‘why?’, ‘why?’, and ‘why?’ again to source the underlying root cause

T hinking more closely about risk/control behaviours and mind-sets exhibited by people

J oining the dots to draw together information into impactful broad themes for key stakeholders

Sample Answers

<u>How can audit messages add value when reviewing Conduct Risk?</u>
Auditing can add increasing value by embedding matters of 'customer risk' in the lifecycle. The auditors are in a prime position to comment on the following:

Governance environment

- The tone at the top in relation to the customer (aims, commitment, culture)
- The process management undertakes to remediate self-identified control issues
- How risk appetite is set and embedded (in relation to customer)
- Whether findings could result in the firm breaching its risk appetite (either directly or indirectly)
- Establish coverholder business objectives and determine compatibility with that of managing agents.

Products

- How "customer outcomes" are focused on in developing new products
- Whether existing processes are driving desired outcomes (comment from a customer's perspective)
- Whether feedback from claims and complaints influences product development and enhancement

Customer interface

- Competency of staff
- The potential regulatory/financial impact of issues identified (think 'Customer first', then Managing Agents)
- Whether audit findings call into question the achievability of strategic/business objectives (in relation to the customer)
- The extent to which findings indicate potential culture issues (that may require further investigation and remediation)
- The implications of poor customer outcomes throughout the Value Chain
- The root cause of findings (to indicate if findings are systemic or spanning multiple lines or business units)
- Ensure all staff understand the product(s) being sold.
- Ensure products are clearly understood by customers.

Reporting audit outcomes

- The degree to which control issues identified from the audit are already known to management
- Highlighting facts that the Managing Agent themselves not aware of (in relation to their own due diligence process)
- Periodic assessment on Conduct themes (year-on-year trends, control maturity)
- Report to a more senior audience (and tailor messages and format accordingly)

Sample Answers

<u>What work do audits need to do to deliver these messages?</u>

The financial crisis has prompted change in the audit profession. There are many ways in which LMA arrangements might evolve further:

Planning

- Audits might consider different or more extensive background information
- Audits may be risk-based and more bespoke
- Auditors may need to meet different stakeholders – and more senior than before
- Obtain input from other Functions – e.g. the Risk Function and Compliance Function in the Second Line of Defence
- Ensure coverholder has a clear understanding of the objectives and process of the audit.

Auditing

- Getting to the ‘root cause’ of control challenges
- Identifying material and systemic issues.
- Assessing the coverholders culture and ‘tone from the top’.
- Assessing behaviours exhibited by management and personnel.
- Constantly question, “why” control failures happened– e.g. behaviours? Management gap? Breakdown in dependencies? Habits? Informal controls?
- Question staff awareness of risks, controls and Conduct

Reporting audit outcomes

- Set the scene with quality Executive Summaries
- Report broader findings
- Draw conclusions based on the evidence obtained.
- Report, potentially, fewer findings: fewer but findings of more significance
- Identify how management will act to address concerns raised from audit work.
- Make business recommendations when issues are identified.

Feedback loops

- Re-connect with the stakeholders consulted in Planning
- Provide audit actions to the Second Line of Defence as intelligence