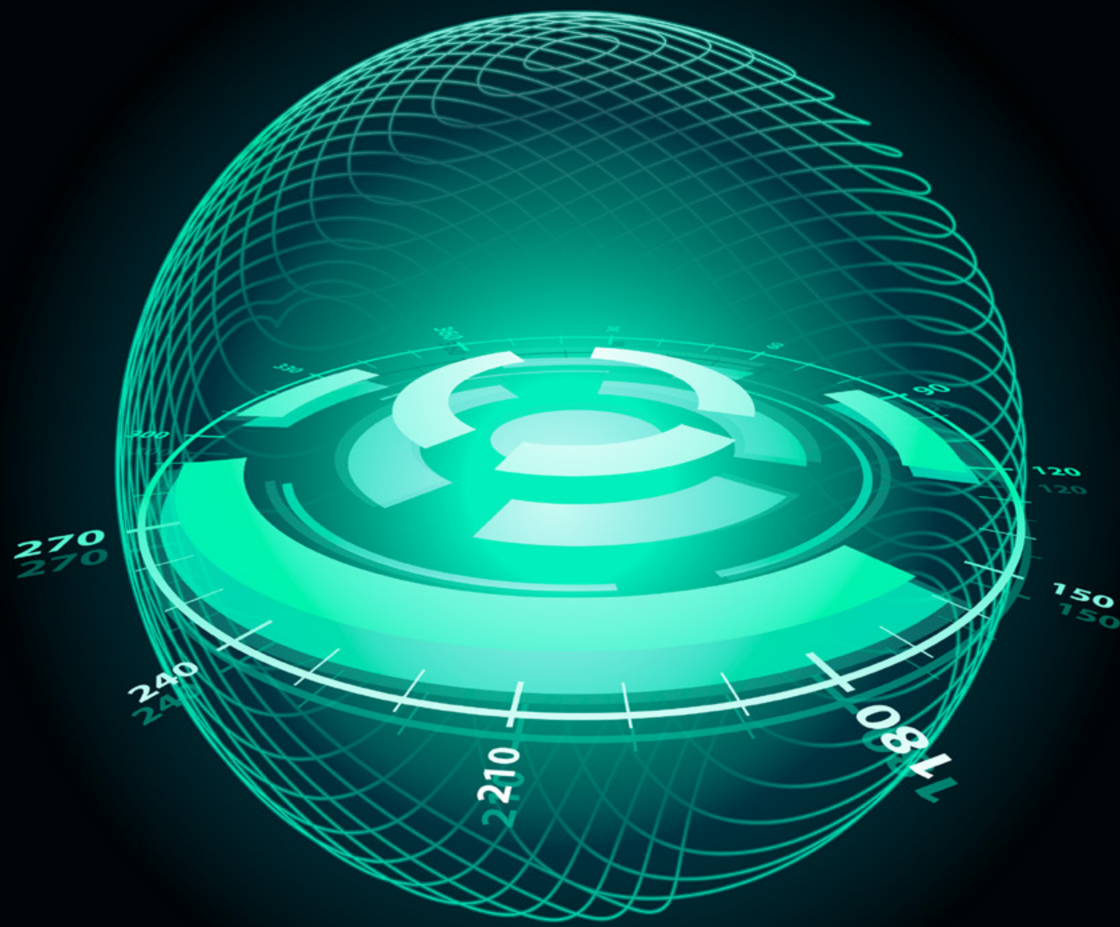
Proactively managing conduct risk



South African Insurance Outlook 2021 | Navigating the insurance landscape

Proactively managing conduct risk

Ticking the box no longer ticks the box

The expectations of the Financial Sector Conduct Authority (FSCA) regarding treating customers fairly have grown significantly in the three years since the FSCA's inception in 2018. While some institutions are responding to these expectations through well-planned conduct risk management programs, there remain institutions limiting their focus with regard to conduct risk and selecting a largely reactive response.

If we consider other regions where conduct risk regulation and monitoring is at a more mature stage, regulators have steadily increased the focus on conduct risk. This has resulted in exceptionally large remediation programs being undertaken. It is our view and expectation that, as has been the case globally, the market conduct regulator is likely to continue to tighten the screws on market conduct.

While the FSCA's expectations has certainly driven much of the industry's response to conduct risk, it is public opinion that also acts as a significant deterrent to delivering poor client outcomes. In today's environment where information is readily available and shared via social media, the delivery of unfair treatment or unfair outcomes to customers can, and usually does, lead to reputational damage. We do not need to look far for a number of heavily publicised cases that have occurred over the past three years to understand the potential negative impact on an insurance company's brand.

Regardless of the primary motivations that drive insurers, it is clear that conduct risk and the effective management thereof is no longer a conceptual requirement. The FSCA expects that insurers are actively measuring, monitoring and managing conduct risk, and customers are demanding the same. We would argue that any insurer without a pro-active conduct risk programme is at significant risk of governance failures, non-compliance consequences and reputational damage.

Our view on the approach to Conduct Risk

Effective conduct risk programmes comprise a number of key elements, including a framework design, governance structures, employee incentives which have amended baselines, strict product governance protocols and redesigned marketing and sales procedures. We suggest viewing the requirements from the perspective of three key questions, namely: who should be managing conduct risk within an insurer; how should conduct risk be effectively managed, and what should be measured and monitored to ensure customers are receiving fair outcomes?

The who

In all compliance and risk matters, there is always an important role for all three lines of defence, but who should have primary responsibility for implementing the conduct risk programme? Given that the central tenet of conduct risk is achieving fair outcomes for customers. In our experience it is the first line that is best placed to identify, understand and manage the potential conduct risks.

The key challenge with managing conduct risk is identifying all the business processes that play a role in what a customer's outcomes ultimately are. First line understands best which business processes impact customer outcomes. This identification and management is less obvious than it seems as a number of processes, beyond marketing and sales, directly impact customer outcomes – consider employee sales incentives and product design as two examples. Thus, we deem it crucial that the identification and management of conduct risk lies in the heart of the business, with the first line of defence.

When considering the complexity in identifying the conduct risk elements within a business, and understanding how to effectively map these to customer outcomes, second line can play a valuable role, especially as they operate across the organisation, and have a unique opportunity to understand and share first-line experiences and learnings. Similarly, third line should already be active in the conduct risk domain, and our view is that the value they best add at this point, is testing the process business is undertaking to identify and monitor the conduct risk drivers.

The person allocated the task of managing conduct risk should be given appropriate authority and be incentivised to drive and uphold a culture of fair customer treatment. Understanding the real threat to first line in having to balance business and financial targets, with conduct risk drivers will introduce a tension that will need to be carefully managed.

It is also worth noting that in our experience, there is often a disconnect in the definition of conduct risk and the identification of conduct risk drivers between business and traditional support functions such as human capital and marketing. This makes it imperative to define what conduct risk means in your organisation, as a critical initial step.

The how

In our experience, there is a danger that conduct risk becomes viewed largely as a soft issue (often mistakenly viewed as measured using a customer satisfaction score). This is, in our view, one of the biggest challenges within an institution. Conduct risk needs to be managed through ongoing training to ensure an accurate understanding of conduct risk, why it is relevant, and the role that each employee (and sometimes third party) plays in offering fair outcomes for the customer. Conduct risk drivers are tangible business processes, which can be clearly monitored through the correct management information – which is exactly what the global regulators are doing. To not capacitate your organisation to do the same will place your organisation at a distinct disadvantage.

These conduct risk drivers, and the data that underpins them, can and should be used to incentivise employee behaviour, which will in turn drive the right culture at all levels across an organisation. Consequently, an effective conduct risk programme requires a structured framework, supported by clear definitions of the concepts involved, underpinned by policy establishment and effective governance structures. An insurer is then equipped to understand where conduct risk drivers potentially exist, and how to monitor and effectively manage them. This requires consideration of all products, distribution channels, target audience and any support structures that impact on this, for example remuneration and incentivisation processes.

The what

Conduct drivers are best identified and managed through data indicators. The indicators that are leveraged to measure and monitor conduct risk require data from across business units, support functions and the data silos that reside in most insurers. The FSCA has identified and requested, from insurers, the key data required to evaluate market conduct in the form of the Conduct of Business Return (CBR). Due to the legacy systems within most insurers, accessing the required data at the right level of granularity, accuracy and quality in a consistent manner is challenging. In addition, the validation of data across consecutive CBR returns is an issue, as is alignment of data between various returns such as SAM reports. The challenge in this is that it is not data and analytics as usual. The way analytics is conducted will need to provide a conduct risk narrative, and not solely the business narrative.

While insurers have invested considerable time and effort in programmes to identify data and automate the population of the CBR, the FSCA appears understandably concerned that insurers see this as a tick-box exercise. It is expected that the data used to populate the CBR is a starting point only and that the monitoring of data to tell the story of conduct across the business should be an imbedded process within insurers. While all insurers already monitor a multitude of indicators regularly, it is expected that the data is viewed through specifically a conduct lens. The FSCA expects that insurers will identify those areas where there is potential conduct risk, and following on from those institutions must identify those key performance indicators (with relevant thresholds), that, when monitored and interpreted, alert the institution to conduct risks that either are surfacing or have surfaced. This is ultimately what the regulator will be looking to do.

The objective of measuring and monitoring these conduct indicators is to identify the conduct risks within business and to drive proactive action to prevent the risk from occurring. Hence, a review of last quarter's indicators, once a quarter, is not sufficient. A meaningful representation of the conduct story should be available, in near real time, for various stakeholders to monitor, investigate and act upon.

This was highlighted in a project that we recently executed with an insurer, where we analysed and visualised, through dashboards, their CBR data from the last four quarters. Through our analysis we were able to assess the quality of the submissions, as well as quickly see potential conduct risks across the various business units at a group level. Extending these dashboards to incorporate additional data from the insurer as well as public external data will enable deeper insights into public perception and the ability to complete root cause investigation – not three months after it has happened but in near real time.

Many insurers have also shared their concerns around the conduct risks posed by third parties that liaise with their customer base such as brokers and call centre agents. For this reason, it is important to gather an appropriate level of data to enable the monitoring of fair treatment of customers as the FSCA considers the insurer accountable.

In closing

The nature of conduct risk means that its management requires more careful planning and action than many other compliance topics. That said, because it is customer focused, our view is that it is a topic that is well worth addressing comprehensively – not only for compliance reasons (which are clearly important), but because it creates an opportunity to understand customers from a different perspective. Every organisation knows that their customers are their lifeblood, and conduct risk is a topic that will allow organisations to find real business benefit in managing risk.

As a parting word, our experience is that organisations always find something new and valuable about their clients through this compliance programme, and that is the intent behind going beyond simply complying.

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