



# Insurance Regulation Reimagined

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## Overview of The Emerging landscape of Insurance Regulations

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# Overview of The Emerging landscape of Insurance Regulation

## Emerging Regulatory Environment – Globally and Locally

1. Move toward group-wide supervision and regulation of insurance groups
2. Move toward Risk Based Capital frameworks
3. Global/Domestic Systemically Important Insurers (G-SIIs/D-SIIs) - Identification and enhanced regulatory supervision (e.g. Recovery and Resolution Plans (RRPs))
4. Enhanced focus on Non-Traditional Non Insurance activities
5. Rising Importance of Risk Culture
6. Emerging focus on conduct and consumer outcomes



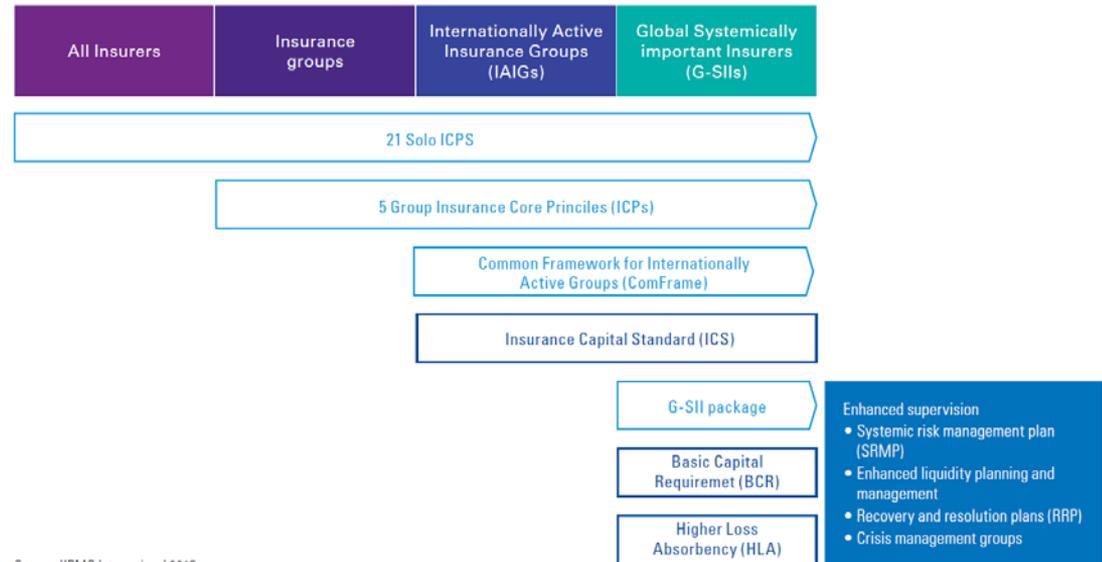


# Overview: IAIS Global Supervisory Framework

## IAIS Supervisory Framework

- The diagram to the right illustrates the emerging global supervisory framework and its application to insurers
- The Insurance Core Principles (ICPs) are principles-based standards for the supervision of insurers in all jurisdictions
- The Common Framework for IAIGs (ComFrame) applies further requirements to the insurance groups that meet the IAIG definition
- The G-SII population (nine groups currently) must comply with all the above and are subject to enhanced supervision due to their perceived systemic risk

Figure 1: Application of the IAIS Framework to different types of insurers/insurance groups



Source: KPMG International 2015.

## Implications

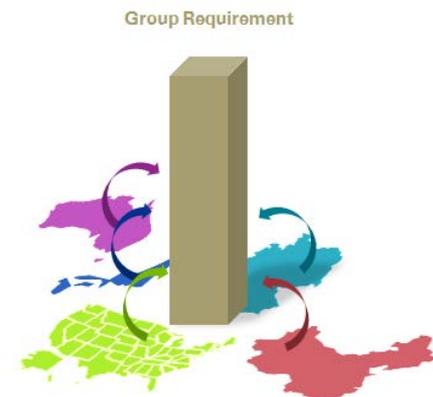
- Australia currently has no G-SIIs, however, may well have a number of IAIGs that would be expected to comply with the IAIS proposed regulatory framework
- IAIS members are expected to implement the ICPs into their own framework with compliance assessed by the IMF and World Bank who conduct reviews



# Move toward Group-wide Supervision

## International Association of Insurance Supervisors (IAIS) Group-Wide Supervisory Framework

- The global capital frameworks being developed by the IAIS is a set of group-wide minimum capital requirements applying to the largest insurance groups
- The group-wide framework represents a single requirement across an entire insurance group as opposed to requirements at the individual entity or jurisdictional level of a group
- At this stage, the interaction between existing jurisdictional requirements and the proposed group-wide capital framework is yet to be confirmed



### Implications

- Group-wide capital requirements targeting Internationally Active Insurance Groups (IAIGs) are expected to be implemented
- This may potentially limit the availability of capital arbitrage opportunities globally
- Assessments of fungibility of capital across insurance groups will need to be conducted
- It is likely that this will add another layer of reporting and capital requirements that insurers will need to satisfy on top of existing local requirements

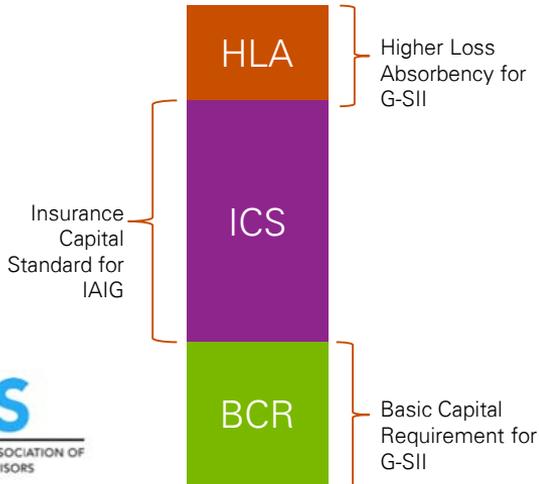
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# Move to Risk Based Capital Frameworks – ICS

## Risk Based Capital Frameworks

- Europe - Solvency II
- Australia - LAGIC
- Hong Kong – RBC Framework
- Global IAIS – Insurance Capital Standard



## Proposed New Frameworks

- Risk based standard formula of capital
  - Four or more risk categories: market risk, credit risk, underwriting risk and operational risk
  - Economic valuation
  - Realistic estimate plus risk margin
  - Tiering of capital resources
- Own Risk and Solvency Assessment
  - Enterprise Risk Management
  - Asset Liability Management process
  - Stress testing for all authorised insurers
  - Board oversight and ownership
- Supervisory reporting
  - Public disclosures
  - Pillar 1 and Pillar 2 information
- Insurance group requirements across all 3 pillars
  - Intra-group transaction reporting

## Potential Implications

- Capital volatility
- Shift in risk awareness
- Data and Systems
- Product, pricing, ALM
- People and process



# 2015 CRO interviews: Views Expressed



OLDMUTUAL

MetLife®



ZURICH



## Views Expressed on Proposed Global Capital Framework

- 1) Both industry practitioners and regulators recognize the value in achieving greater international consistency and harmonization of insurance requirements
- 2) Similarly, there was strong support for the continuation of supervisory colleges and ongoing cooperation and engagement by supervisors with each other. Generally the consensus was that the college process should in itself lead to a convergence of regulatory practices over time
- 3) Concerns were raised however as to whether this could be practically achieved, particularly in relation to how the new global standards would interact with local laws
- 4) The need to recognise the regional differences in insurance products, exposures and the distinctions between insurance and other financial sectors was also considered to be necessary preconditions for an effective global framework
- 5) It remains unclear from the current ICS consultation paper how such issues will be addressed, but the decision to allow more time for the debate may help resolve some concerns raised by the interviewees
- 6) Such outcomes raise the very real prospect nonetheless of duplicate or contradictory regulations emerging which seemingly goes against the overriding aim and expected benefits of achieving greater consistency and harmonisation of requirements by having an ICS

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# G-SIIs/D-SIIs and systemic importance

Category	No.	Weighting	Indicator
Size (5%)	1	2.5%	Total Assets
	2	2.5%	Total Revenues
Global Activity (5%)	3	2.5%	Revenue derived outside of home country
	4	2.5%	Number of countries
Interconnectedness (40%)	5	6.7%	Intra-Financial assets
	6	6.7%	Intra-Financial liabilities
	7	6.7%	Reinsurance
	8	6.7%	Derivatives
	9	6.7%	Turnover
	10	6.7%	Level 3 Assets
Non-Traditional Insurance and Noninsurance Activities (40%)	11	7.5%	Non-policy holder liabilities and non-insurance revenues
	12	7.5%	Derivatives trading
Insurance and Noninsurance Activities (40%)	13	7.5%	Short term funding
	14	7.5%	Financial guarantees
Substitutability (5%)	15	7.5%	Minimum Guarantee on variable insurance products
	16	7.5%	Liability Liquidity
	17	5.0%	Premium for specific business lines



The identification of G-SII's is based on a 5 Phase approach:

- **Phase I:** Data Collection from approximately 50 insurance groups in the assessment pool
- **Phase II A:** Quality Control and Scoring, including data verification and ranking based on the quantitative calculation
- **Phase II B:** Determination of Quantitative Threshold, which will divide insurance groups into *potential* G-SIIs and non-G-SIIs

For the group of *Potential* G-SIIs identified:

- **Phase III:** Discovery phase, where additional information, both qualitative and quantitative considerations, will be taken into account
- **Phase IV:** Exchange with Prospective G-SIIs, allowing the relevant insurance groups the opportunity to present other information that may be relevant to the assessment of their G-SII status and
- **Phase V:** IAIS Recommendation to the FSB



# RRP requirement – G-SIIs and D-SIIs

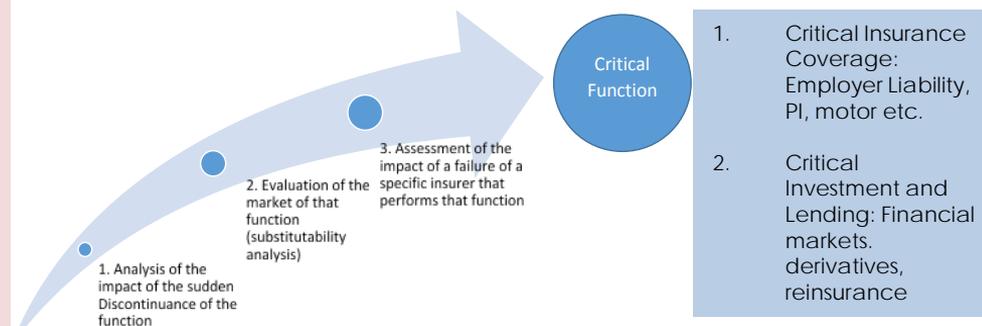
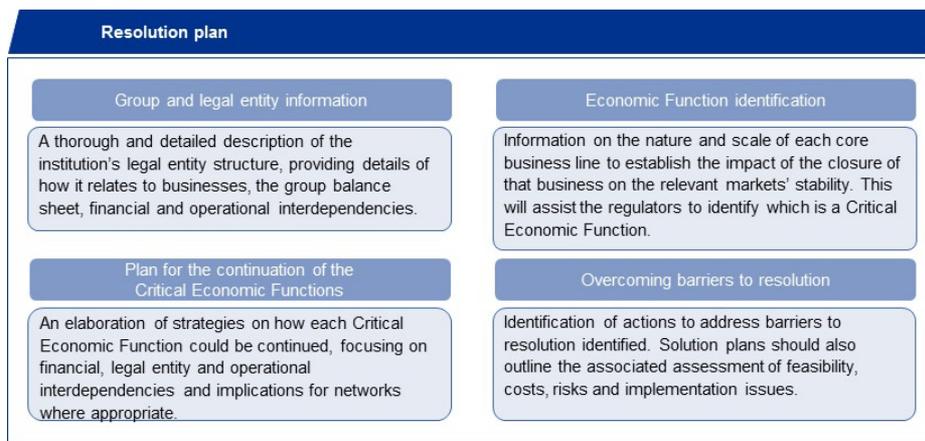
## Developing a Recovery Plan

- Recovery options
  - Consider the company's own Recovery options to deal with financial stress and what practical steps can be taken to restore financial sustainability
  - Set trigger points for when and how recovery options become triggered
- Recovery Governance
  - Have a governance framework in place setting out how monitoring and decision making will be conducted

## Implications for Insurers

Local supervisory authorities (APRA) may well implement some form of the G-SII framework being proposed by the IAIS for the regulation of D-SIIs within their own jurisdictions. This can include:

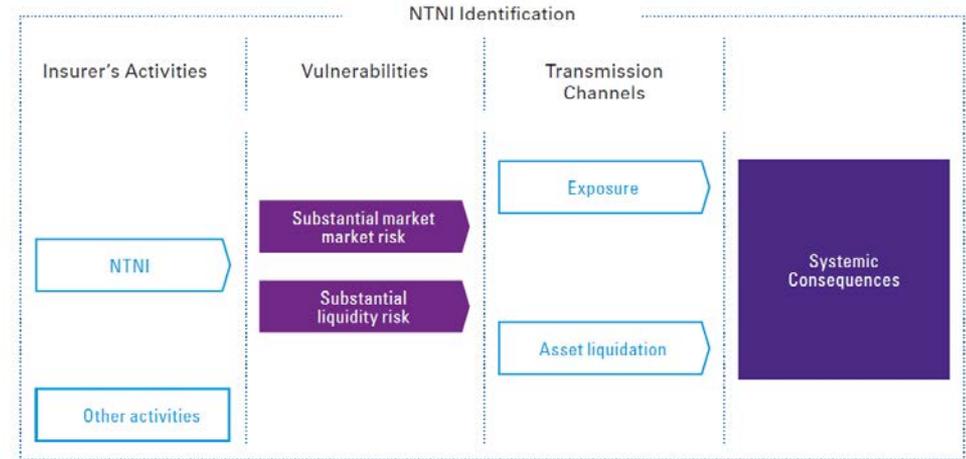
1. Emphasis on identifying, possibly separating and reducing the level of NTNI activities
2. Focus on developing an adequate and practical recovery and resolution plan that can be utilised under stressed business conditions
3. Analysis of critical functions leading to an assessment of the insurers overall systemic importance
4. Supervisory efforts targeted at systemic risk of insurance groups





# Non Traditional Non insurance activities

- Increasing focus on identifying and ring fencing or regulating NTNI activities
- The IAIS has noted that:
  - The presence of guarantees within insurance contracts can give rise to **substantial market risk**
  - The extent to which an insurer can invest in assets to match the cash flows of the guaranteed payments are critical considerations
  - Also, the existence of options allowing for withdrawal could give rise to **substantial liquidity risk**
  - The delay period between repayment notification being received and payment actually being made and the size of any fee that the insurer can apply as a result of the withdrawal are important considerations



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# Rising Importance of Risk Culture



## Implications for Insurers

- Clear articulation of the gaps between an organization's target risk culture and current state
- Evidence of understanding risk culture and measures required to influence it going forward
- Risk appetite focused on achieving earnings stability, solvency and maintaining sustainable growth
- Ensure that business risks are identified, assessed and managed in a manner consistent with the risk appetite
- Staff to understand and abide by the risk management framework
- Align remuneration incentive arrangements with long-term organization financial soundness



# Background – APRA expectations

## Definition of risk culture by APRA

- Cultural norms that influence risk management
- The way that people actually behave

## Prudential requirements

- Board to annually form a view on risk culture and how it supports operations within the risk appetite
- Identify any desirable changes to risk culture and ensure rectification and demonstrate steps taken

## Board expected to ensure strong foundations

- Strong governance practices
- Effective risk management framework
- Strong foundations of capital and risk management
- Clearly articulated risk appetite statement

## Four drivers of effective risk culture

1. Risk appetite unambiguous and widely used
2. Espoused values are clear and consistent with risk appetite and strategy
3. Values embraced and decision making consistent with values
4. Decision making process clear:
  - Remuneration and incentives aligned with desired behaviours and culture
  - Appropriate role modelling by the Board and management evidenced



## KPMG view of an effective risk culture framework

### Indicators of good risk culture

- Tone is set from the top – the Board and senior management demonstrate their commitment to risk management
- Risk personnel have adequate profile and authority within the organisation
- Risk function has direct/dotted line of reporting to the Board
- Board receives timely and complete risk reporting
- All staff have an understanding that risk and compliance responsibilities apply to everyone
- Continual education and training of risk is essential
- Non-compliance behaviour is not tolerated
- Ethical behaviour is encouraged through an effective 'Code of Conduct' and formalised ethical programs



# Assessing risk culture – two key elements

## Architectural Elements

### Enterprise Risk Management Framework

Examines whether the corporate governance and risk management frameworks are in place and operating as expected and includes an assessment of:

- The corporate governance and risk management framework established
- Strategic business plan
- Risk management strategy
- Risk appetite statement
- Monitoring and reporting frameworks
- Management information systems
- Remuneration policy

These structural risk elements are then overlaid by a behavioural competency framework that assesses how the corporate governance and risk management framework influences behaviours and outcomes in regards to risk culture by assessing:

- Strategy and direction of the insurer
- Relationships and organisation
- Responsiveness
- Motivation
- Competencies

## Behavioural Competency Elements

### Strategy & Direction

The way the strategy and direction drive behaviours and outcomes in regards to risk culture.

Low risk appetite

High risk appetite

Profit focus

VS.

Customer focus

### Relationships & Organisation

The extent to which configuration of the firm and relationships between people within the organisation support effective risk culture.

Questioning

VS.

Acceptance

Siloed working

VS.

Collaborative working

### Responsiveness

The ways in which the organisation and its people respond to risks and issues.

Understanding root causes

VS.

Short-term fixes

Effective escalation

VS.

Fear of bad news

### Motivation

Individual and collective motivation factors that drive risk outcomes.

Career advancement

VS.

Financial reward

'Greater good'

VS.

Profit

### Competency

Individual and collective competency to manage risk culture.

Clear understanding of risk

VS.

Lack of risk awareness

Clear accountabilities

VS.

Ambiguous accountabilities



# Example of diagnostic output

KPMG Risk Culture Framework						
	Risk Infrastructure	Strategy & Direction	Relationships & Organisation	Responsiveness	Motivation	Competency
Corporate governance	Green	Yellow	Yellow	Green	Yellow	Yellow
Strategic business plan	Yellow	Green	Green	Green	Red	Green
Risk management strategy	Yellow	Green	Yellow	Yellow	Yellow	Green
Risk appetite statement	Green	Green	Yellow	Yellow	Green	Green
Monitoring and reporting	Green	Yellow	Green	Yellow	Yellow	Yellow
Management Information	Yellow	Red	Green	Green	Yellow	Yellow

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# Other impacts - Conduct risk

## Summary of global impact



Conduct risk is changing the global regulatory landscape. The aim is to drive financial services firms to revisit their approach to enterprise risk management; to move from a profit driven business model to a strategy that places customer centricity at its heart to rebuild trust in the market. Regulators have been clear; this is not a time for complacency.

The next significant move by the IAIS and other insurance supervisors is beginning to occur in regards to conduct risk.



### EXTERNAL DRIVERS

#### Digital Disruption

Competition from new market entrants and FinTech are changing traditional distribution models



#### Customer Expectations

Customers desire transparency and simple products that perform as expected. Trust in banks is at a low



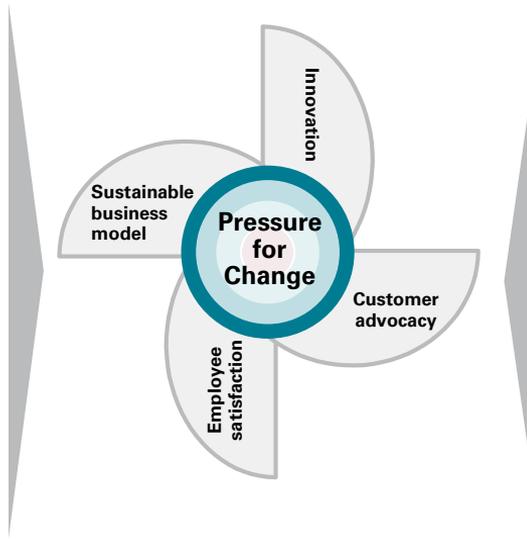
#### Social Media

Level of customer advocacy becomes more visible. Increased opportunities for client interaction



#### Regulatory Intervention

Sustained regulator and government investigation increases the risk of fines and unsustainable strategies



### DIVERGENT INTERESTS



# Regulatory Drivers In Australia



## Australian Securities and Investments Commission (ASIC)

- Corporate plan 2015 – focus on conduct and culture
- Incorporating culture in to risk based reviews
- Committed to taking enforcement action when issues arise
- Launch of the 3C's approach to conduct risk: communication, challenge and complacency

## ASIC Report 413 – Review of Retail Life Insurance

- Review sampled pre-FoFA sales files (including advice to new clients, product replacement and scaled life insurance)
- Critical of both the quality of advice and the perceived misalignment of financial incentives

## Future of Financial Advice (FoFA)

- Improving the clients' best interest duty
- Enhanced fee disclosure statement

## Financial System Inquiry (FSI)

- Suggestion to adopt UK FCA approach and introduce product intervention powers for ASIC (with permission from APRA)
- Proposal to improve product design with compulsory stress testing, identification of target market and consideration of customer need.

## ASIC Report 415 – Review of Retail Life Home Insurance Sales

- Review 415 was a review of the sales practices of 12 insurers representing 30 home insurance brands) who sell home insurance across Australia
- Findings made in relation to telephone and online sales
- Further findings made in relation to online calculators, advertising and promotions, staff training and monitoring

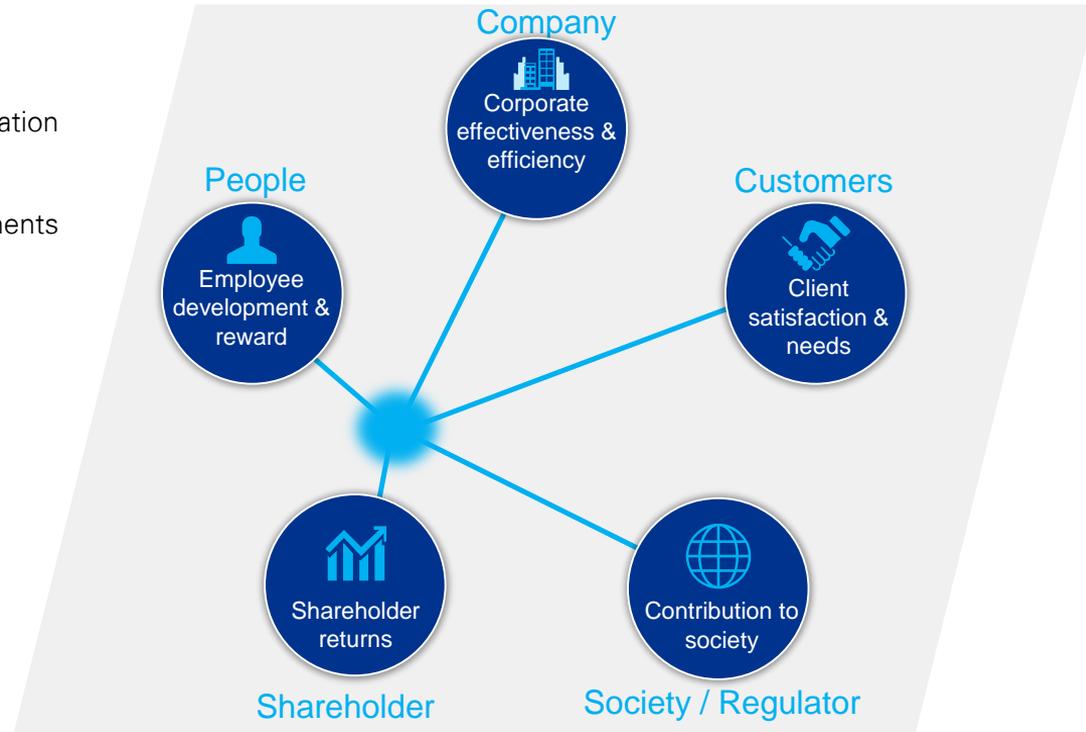
## Trowbridge report

- Appointed by AFA and FSC to provide independent recommendations to ASIC 413
- Recommendations made in relation to adviser remuneration, quality of advice and insurer practices including creation of a Life Insurance Code of Practice

# Balancing stakeholder outcomes

Financial services organisations current focus is skewed towards Shareholders & Employees:

- Product manufacturing over customer centred organisation
- Employee incentives can create conflict in the sales process
- Cost reduction over sustainable productivity improvements
- Product complexity over simplicity
- Rules based compliance over principles





# Conduct risk framework considerations



Conduct risk can be driven from one or more factors in a company's customer strategy and business model which combine to result in poor customer outcomes.

## Product design/strategy/development

- Impact of the organization/BU level strategy on conduct
- Balance of revenue goals with long term sustainability of the business model and to deliver customer needs
- The values of the organisation and how is this driven through policies and processes to create positive customer centric culture
- The link between product design and meeting customer needs

## Communicating and Marketing

- Effectiveness of marketing processes to ensure that communications are clear, fair and do not mislead customers
- Alignment of brand and values to drive honest and open communication with customers

## Sales Quality and advice

- Training provided to staff to ensure that they make a 'compliant' sale.
- Sales incentives and their impact on driving culture.
- The level of cross subsidization in the business model
- Controls in place to ensure that good customer outcomes are delivered

## Sales Quality Assurance

- Oversight and assurance of sales to delivery good customer outcomes
- Level of oversight and QA from the first line of defence

## Product Governance

- Measurement, monitoring and identification of product risks
- Mitigation of identified customer risks in the product design or sales process
- Drivers for product enhancements

## Post sales and servicing

- Delivery of good customer outcomes post sale
- Customer needs and expectations and whether they are central to policies and processes regarding arrears management, claims and servicing



# The Evolving Nature of Conduct Risk

## Managing Conduct Risk Effectively

Fit with  
Enterprise  
Wide  
Risk  
Management

Agreeing  
a sensible  
Conduct  
Risk  
appetite

Cultural  
transformation

Ownership  
and  
Governance  
-1st and 2nd  
line  
activities

Reporting on  
customer  
outcomes

Upgrading  
core  
processes

Developing a conduct risk appetite that drives decision-making is a necessary first step in addressing compliance. Such statements could include a combination of quantitative and qualitative tolerance statements and metrics.

### Implications for Insurers:

- Impact of conduct risk on specific lines of business that deal directly with the consumer
- Demonstrate and ensure the delivery of fair consumer outcomes
- Perform a conduct risk assessment as part of strategy planning
- Review historic decisions and the resulting customer consequences of them
- Regulators moving toward a forward-looking, proactive, and judgment-based supervisory approach

### Insurance Claims Investigation

- **Assistant Treasury initiates investigations** - Requested ASIC to conduct a broader review of claims handling across the life insurance industry to determine whether there are systemic problems in claims handling across the life insurance sector. This initial review is expected to last for a few months and will identify the need for further detailed investigation and review.



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# Thank you

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