

Conduct & Reputation Risk in insurance – a next steps proposal

This short note is a proposition:

1. to advocate the Conduct & Reputational Risks (C&R Risks) are **increasingly material threat to Insurance Industry**,
2. to propose the **main areas of C&R Risk exposure** in Insurance Industry – esp. from the actuarial perspective
3. to propose types of supportive of use for the Actuaries working in the RM area, needed to assure C&R risks management

Ad.1. C&R Risks - increasingly material threat to Insurance Industry

What C&R risks relate to?

C&R risks are relating to behavior of the company vs its partners:

- customers
- contractors
- employees
- competitors/markets
- social-economic-natural environment of the company including markets

In particular:

Conduct risk relates to actions which are:

- legal (i.e. acceptable / in line with the formal written **rules**)
- &
- right (i.e. acceptable / in line with the in-formal & not always written **principles**)

Reputational risk relates to actions which are impacting the emotional connection between stakeholders and organisation. The Reputation Institute describes the reputational event as issue that **reduce peoples' believe** that regarding:

- **Products / Services:** the company deliver high quality products and services that are good value for the money
- **Innovation:** the company an innovative company that brings new products and services to the market first
- **Workplace:** the company have the best employees and that we treat them well
- **Governance:** the company is open, honest, and fair in the way we do business
- **Citizenship:** the company is a good corporate citizen who cares about local communities and the environment
- **Leadership:** the company have a clear vision for the future and are a well-organised company
- **Performance:** the company is a profitable company with strong growth prospects.

How C&R risks may materialize in Insurance industry?

Materialization of C&R risks goes mainly via 2 main issues:

- regulatory / criminal fines/penalties
- lack of further cooperation with the stakeholders / loss of business continuity with the given individual or group of stakeholders

In particular **for specific risks**:

- C: Fines
- C&R: lapses
- C&R: lack of NB
- C&R: employees churn
- C&R: business contractors churn

Examples of the materialization:

- **Enron / Artur Andersen** (y 2001-2002). Enron company on regularily provided public with improper financial statements. This was supported by one of the Big 5 Auditor firms – Arthur Andersen which has a consultancy service fee as an incentive to cooperate in the misconduct procedure. As a result of the issue being revealed during the prosecutors investigating Enron's case – Artur Andersen lost trust of its clients and closed it's world-wide operations in just few months.
- **UL business in Poland** (and similar in the Netherlands). The 2002-2007 hossa period attracted clients to UL products. They were sold with not appropriate analysis of the clients need and low information on the investment risks and product costs/fees. The global crisis of 2008 started period of equity loses and "0 or negative interest rates / returns". This made customers aware of the misseling issue. Because of scale and regulatory, political intervention the UL Life products became de-facto not sale-able in Poland esp in its single premium form and surrender fees level were imposed to be changed for the new and existing contracts despite being written in the signed contracts rules / GT&C.
- PPI Insurances in UK
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Why C&R risks are increasingly material in Insurance industry?

Increase of C&R risks goes mainly due to following:

- Financial Service companies as institutions of the **public trust lost lot** of reputation after the **2008 Financial Crisis** (e.g. movement "Occupy WallStreet"),
- **Life Insurance** companies are systematically no longer able to provide long term guarantees as in the past and need to **redefine the Life Insurance idea for the low interests environment**
- Globalization and information revolution – **speed of the news spread via Internet**
- **Social Media growing influence** – speeding up the news spread and increasing the reputation incident butterfly effect.

Ad. 2. Main areas of C&R Risk exposure in Insurance Industry

- **Sales area related:** e.g. of life insurance **long term products** esp. with the investment element
- **Underwriting area related:** esp. **Environment and Social sensitive** P&C insurance – e.g.. regarding the Big Infrastructure, Nuclear energy, Weapons, Gambling related etc.
- **Retail products offer related:** esp. **Loss ratio level, commission structure and level.**
- **Investment area related:** Embargo and Social/Environment related
- **Operational area related:** Personal Data Protection (esp. GDPR), Anti Money Laundry

Ad.3. Tools of support of use to assure C&R risks management

AAE may consider providing European Actuaries working in RM with the following:

- **Definitions of the C&R risks** – to improve common language communication on the issue
- Provide list of first choice / best practice **sources of references** regarding the C&R management practice in Financial Institutions e.g. FCA UK (Finacial Conduct Authority)
<https://www.fca.org.uk>

- List of **C&R materialization cases** with lessons learnt
- List of best practice / main **types of risk responses** with relevant types of the C&R materialisations.

Useful Sources / References:

<https://www.reputationinstitute.com/sites/default/files/pdfs/Defining-and-Managing-Reputation-Risk-2015.pdf>

<https://www.fca.org.uk>

[https://www.researchgate.net/publication/227012643_Managing_reputational_risk -
_From_theory_to_practice/download](https://www.researchgate.net/publication/227012643_Managing_reputational_risk_-_From_theory_to_practice/download)