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CONDUCT RISK INDICATORS

Actuarial Association of Europe Position Paper

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1. Purpose of Document

The purpose of this document is to identify the areas of potential consumer detriment and the indicators which may suggest a potential source of consumer detriment.

This document has been prepared by the consumer protection task force of the Actuarial Association of Europe to help EIOPA develop relevant Conduct Risks Indicators.

Although the paper only refers to insurance products, some of these indicators might be applicable to pensions and banking products.

Similarly the risks identified may not be the sole responsibility of the insurers but also of the sales forces which act as agents.

This document provides the overview of risk to customers and link between various indicators and their associated risks. These indicators do not focus on individual cases, but their purpose is to flag the area/products where a more in depth analysis should be carried out.

2. Risk To Customers

Before proposing what would be potential risk indicators, it may be useful to define what the main areas of potential consumer detriment are.
One way to approach this could be to use the following list of the main risks for consumers when purchasing a financial product:

A. Products are not developed and marketed in a way that pays due regard to the interests of customers

B. Customers are not provided with clear information before, during and after the point of sale

C. Customers are sold products which are not appropriate to their needs

D. Customers receive poor quality advice

E. Customer complaints and disputes are not dealt with in a fair manner

F. The privacy of information obtained from customers is not correctly protected

G. The reasonable expectations of customers are not met.

It therefore becomes possible to classify the risk indicators according to these risks.
Also it is possible to characterise each risk indicator according to its timing in relation to the realisation of the risk concerned: lagging, coincident, leading.

Obviously the indicators that will be of most interest will be the "leading" or possibly the "coincident" indicators. Nevertheless, prompt identification through lagging indicators can still help resolve an issue before large numbers of consumers are impacted.

3. Indicators of Potential Conduct Risk

Quantitative metrics can provide an indication of where there is a greater risk of conduct related issues. They can however only provide an indication of where further investigation and analysis could be carried out, and will never be prima facia evidence of conduct issues.

Many indicators are not systematically captured through regulatory returns and may require bespoke review or data collection by supervisors. Indicators can be collected at a company level and at a market or a sectoral level.

Each indicator has been given three different characteristics, these are:

- Data availability:
  Summarises availability and accessibility of a given indicator. Some indicators might be easier to measure and collect than others. It is important to note that these should be measured and collected on a sufficiently granular level to ensure consistency between various companies/markets. These indicators also should be collected/calculated for homogeneous groups, so the supervisor can perform benchmarking and comparisons between companies/markets.

- Consumer Risk:
  Defines the risks (as per section 2. Risk To Customers), which could be measured/identified by this indicator. Each indicator may indentify one or many different potential risks to customer detriment.

- Timing:
  This characteristic defines any time availability constraints of a risk indicator for given product/group. Each indicator can be defined as Leading, Coincident or Lagging.

Please note that:

- The following are only indicators, which may indicate potential sources of consumer detriment, hence it does not mean that any product, which is being flagged by any of the above criteria, is the subject of consumer detriment, but further analysis should be carried out.

- Any product which does not satisfy any of the above criteria may still cause consumer detriment.

- The below are generic indicators which should be available from each EU market. Nevertheless national supervisors may include some additional indicators, which may help them to identify potential sources of consumer detriment.

The table below provides a list of potential indicators. The detailed specification of the metric may vary according to the relevant market and availability of data.

Table 1: Risk Indicators

Indicator	Data availability	Consumer Risk	Timing	Comments
Profit	Not generally disclosed at a sufficiently granular level. Firms will usually have internal management metrics that can be used.	A, C & F	Coincident/Lagging	High profit may indicate products which offer poor value to consumers or may indicate high incentives for inappropriate sales or marketing behaviors. Equally it is possible that a provider may be earning high profits because it is efficiently managed and may offer good value to customers.
Growth	Available historically at a high level. May lack granularity to identify problem growth areas. Supervisors may have access to business plans and future growth plans.	A, C, D & F	Coincident/Lagging	High growth (historic and planned) may be an indicator of aggressive selling practices, but also a consequence of a really good consumer policy.
Complaints	May be some public disclosure of complaints data. In a number of markets, the financial ombudsman is an important source of trends in complaints not resolved by firms.	A, B, C, D & F	Coincident/Lagging	High levels of complaints may indicate conduct issues. It will be important that new themes are investigated promptly.
Lapses/Surrenders	Some public reporting but may not be at sufficiently granular level.	A, B, C & D	Lagging	High levels of lapses, especially early lapses, may indicate poor product design or high pressure sales.
Cost Cutting	May be best identified through public announcements by insurers rather than through regulatory returns.	F	Leading	Significant cuts in costs may impact service or operational resilience levels to the detriment of consumers

Claims Ratios	May not be available at a sufficiently granular level.	A, C	Coincident	Very low levels of claims relative to premiums may indicate value or conduct issues. Low claims ratios may suggest high volume of refused claims, which may indicate misselling or bad wording of the product. Of course there may be other reasons why there is a low claims ratio which are not to the detriment of customers (see 4. Indicators measures)
Impact of Charges (reduction in yield)	In some markets, this forms part of the disclosure regime to customers so possible to identify high cost products. Need to consider the value on early termination as well as if held to maturity.	A, B, C	Leading/Coincident	A key indicator of the value of the product to the end consumer for investment products.
Probability distribution of potential customer outcomes for savings/investment products	Not generally available. Would require bespoke review.	A, C	Coincident	May indicate inappropriate characteristics of product for target market.
Policy size by contract type	Some data available from regulatory returns	C	Lagging	Indicator of market business is sold into (trends over time may be of interest)
Deviation of returns for different groups of similar contracts	Some public reporting of the level of remuneration	G	Lagging	Indicates that the insurer favors some clients at the detriment of others

Commission levels		**A, C, D**	**Leading/Coincident**	**High commission level may lead to misleading and aggressive selling practices.**
Illustration growth rate	Regulations will apply in many markets but there may be areas of discretion	B, D & F	Leading/Coincident	Insurers may illustrate policy returns to customers that are unlikely to be achieved in practice
Number of waivers agreed to by policyholders where a product has been advised as not suitable	Internal data available where the adequacy questionnaire exists	B	Leading	Indicator of risk of misselling

4. Indicator Measures

This section suggests measures for some of the indicators in *Table 1.* Please note that these are preliminary suggestions and further discussion will be carried out.

For some indicators, different measures will be applied for Life insurance, Non-Life insurance, Pension and Health insurance as these businesses have different characteristics

- Profit
    - Measured by New Business Value
    - Measured by Accident/Underwriting Year profit

  Product/Portfolio allocated capital should be taken into account when analysing this indicator. Some products cover low frequency /high severity risks, hence ultimately such products have high expected profit. It is highly recommended to supply RoC (return on capital) as a part of this indicator as a secondary measure.

- Growth
    - Change in Gross Written Premium/Change Of The Market Share in given segment.

- Complaints
    - Number of complaints

- Lapses/Surrenders
    - Difference/Ratio between the expected number of surrenders vs. actual number of surrenders.
    - Difference/Ratio between the change of reserve due to surrenders, and change of reserve excluding surrenders.

- Claims Ratios
    - Accident/Underwriting year loss ratio. Estimated 1 in 200 loss ratio (allocated capital) should be supplied as some products cover low frequency /high severity risks, hence ultimately such products have low claims ratio.

- Cost Cutting
    - Maintenance costs per policy/Gross Written Premium

- Commission levels
    - Percentage of Annual Gross Written Premium (Acquisition Costs)
        - Potentially might include claw back clauses and renewal commission percentage