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Insurance conduct and culture: Fire and general insurers update

Findings from our evaluation of New Zealand fire and general insurers' responses to the 2019 Life Insurer Conduct and Culture review

FMA
FINANCIAL MARKETS AUTHORITY
TE MANA TĀTAI HOKOHOKO

About this report

This report summarises findings from our evaluation of New Zealand fire and general insurers' responses to the Life Insurer Conduct and Culture review undertaken by the Financial Markets Authority (FMA) and the Reserve Bank of New Zealand (RBNZ) in 2019. It is important that insurers consider how they comply with FMA expectations for good conduct and culture as they prepare for the introduction of the new conduct licensing regime set out in the Financial Markets (Conduct of Institutions) Amendment Bill.

Contents

Executive summary

The FMA and RBNZ released the Life Insurer Conduct and Culture review in 2019. After publishing the report, the FMA asked fire and general insurers to review their operations to make sure there were no material conduct issues within their business.

While current laws do not provide specific conduct requirements for insurers, the FMA and RBNZ expect insurers to demonstrate good conduct in their dealings with consumers. The FMA has clearly communicated these expectations over the past several years. Furthermore, the Government has since announced that insurers will be covered by the new conduct licensing regime set out in the Financial Markets (Conduct of Institutions) Amendment Bill (CoFI).

We followed up in late 2020 and received responses from 42 insurers. The responses were well below our expectations. The majority of insurers did not complete their reviews to an appropriate standard. Only two insurers, IAG and MAS, met our expectations in full. We considered 30 to be inadequate and a further 10 to be deficient in some way, having addressed some but not all of our expectations.

Overall, the responses showed there is a poor understanding of and commitment to good conduct and culture practice across the sector, and that the majority of these insurers are not yet prepared for the new CoFI regime.

In particular, our review found:

- The level of conduct maturity was low, with some insurers demonstrating that they did not see conduct and culture as relevant to their organisation.
- Product and policy-holder review processes need to be improved.
- Insurers need to have a clearer line of sight on commissions paid to intermediaries, including whether they are fair and reasonable to customers, and understood by customers.
- Insurers should have greater oversight of how intermediaries are selling and managing the insurers' products.
- Many boards are yet to support the development of an organisational culture that promotes good conduct, rebalance shareholder and customer interests, and set an appropriate conduct risk appetite.
- Not enough has been done to ensure remediation activity is completed promptly and addresses the root cause of issues.

Next steps

We have written to all review participants and have met with industry bodies to advise them of our findings. We have also asked providers to complete the work we requested (see page 7).

We have repeatedly made our expectations around conduct and culture clear. It is now time for the industry to take meaningful steps to improve or risk facing regulatory action.

With the introduction of a new conduct licensing regime, insurers need to give more attention to how they are identifying, managing and mitigating conduct risks within their business. The vast majority of these insurers need to do much more work to meet our expectations and prepare for the new regime.

The FMA, and every New Zealander who puts their trust in insurers to protect their families, businesses, lives and assets, are expecting it.

Review findings at a glance

2 Just 2 insurers out of 42 met the FMA's expectations in full.

95% Around 95% of responses did not meet our expectations.

71% of responses were considered inadequate. A further **24%** were considered deficient, addressing some but not all of our expectations.

Only **14** insurers demonstrated that they had completed and presented all five items in their action plan to the Board.

9 Just 9 insurers recognised customer vulnerability as a key issue.

57% Only slightly more than half of respondents completed the gap analysis against the Australian Royal Commission Final Report, despite the FMA providing a how-to guide.

36 insurers out of 42 provided the requested explanation on how they would meet FMA's expectations on incentives and commissions.

30 insurers out of 42 completed the action plan, **but 19 provided insufficient detail.**

22 insurers completed the product review. **Six** acknowledged improvements were required to the product review process.

28 out of 42 insurers removed or committed to removing volume-based incentives for internal staff.

27 insurers completed the FMA Conduct Guide gap analysis, but only **15** addressed this by adding the subsequent actions to their plan.

Foreword: Protecting what New Zealanders value most

New Zealanders rely on insurance to protect what they value most. Customers rightly expect to be treated fairly, have their interests properly considered, and have access to products that are fit for purpose.

Providers that work hard to uphold these standards help build confidence in our financial system. At the very minimum, customers are entitled to expect that insurers will do what they say they will, and come through when it matters.

In 2019 the FMA asked fire and general insurers to review their businesses. We wanted to ensure they had the systems and controls in place to ensure good conduct and fair treatment of customers. This was an opportunity to demonstrate their readiness for a new conduct licensing regime that will be ushered in with CoFI Bill.

With their substandard response to FMA's request, insurers have not only failed to do this, they have also revealed a worrying lack of commitment to ensuring good customer outcomes. While new legislation is not yet in place, core conduct standards should apply across the entire financial sector. The FMA has made this point repeatedly over several years.

Just two insurers provided sufficient responses that met our expectations in full. We considered around 95 per cent of responses to be inadequate or deficient in some way. The overall tone of the responses suggested that a number of insurers did not consider conduct and culture as relevant to their organisation.

Prior to our enquiries, many industry players claimed they were confident no significant issues existed. But this review has revealed a number of instances of poor conduct. I suspect many of these issues would not have been identified without the FMA requiring insurers to review their products and policies.

We expect that one of the key tenets of CoFI Bill will require providers to apply a set of principles to ensure good customer outcomes. This will require a shift in approach from compliance-led to conduct-led, encouraging insurers to consider core principles and act beyond minimum requirements.

Given the issues highlighted in our review, some insurers will need to carefully consider what they need to do to meet the proposed requirements for a licence to operate under the new regime. They will need to ensure that their products and services are clearly understood by customers and suited to their needs.

Insurers must ensure they are operating responsibly by taking their conduct obligations seriously and creating meaningful change where it is needed to achieve fair customer outcomes.

That way, we can all have confidence the financial system is working as intended – to serve the needs of customers.

Clare Bolingford

FMA Director of Banking and Insurance

Background and introduction

The Australian Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry in 2018 prompted the FMA and RBNZ to take a closer look at the conduct of banks and insurers in New Zealand.

In January 2019 the FMA and RBNZ published the Life Insurer Conduct and Culture review, which identified extensive weaknesses within the life insurance sector. These included weaknesses in governance and accountability for conduct and culture, oversight of advisers who sell products, product design, training and support, policies and processes, identification and remediation of issues, and incentives.

The review included a directive for all insurers to actively consider conduct risk within their business[1]. It asked insurers to assess their conduct and culture governance frameworks, and consider and act on all relevant recommendations within the report.

A few months later, we wrote to all licensed New Zealand fire and general insurers[2] asking them to complete the following specific tasks:

1. Develop an action plan to address any issues in their business arising from the recommendations in the conduct and culture report.
2. Explain how they will meet the FMA's expectations regarding incentives and commissions.
3. Complete gap analyses against the Australian Royal Commission's final report and the FMA's 2017 Conduct Guide.
4. Undertake a systematic review of products and policy-holder portfolios.

We also requested that the action plans be presented to the insurers' boards.

We asked insurers to review their operations promptly and made it clear that we expected them to be able to show us what they had done to be comfortable there were no material conduct issues within their business.

We clearly signalled the importance of our request through our communications with insurers, and provided 'how-to' guides for completing the work in addition to our regular stakeholder engagement programme. We held face-to-face meetings with directors, chief executives and senior managers, during which we reminded insurers of the need to credibly demonstrate a commitment to making change where required.

We requested insurers' responses in December 2020, around 18 months after our initial request, due to the impact of COVID-19.

1: Financial Markets Authority, Life Insurer Conduct and Culture 2019 review, p 10.

2: We have classified fire and general insurers as those providing house, contents, vehicle, commercial, liability and health insurance. Insurers providing only commercial or liability insurance for businesses will not require a licence under the new regime (CoFI).

Findings

42 out of the 43 insurers we approached responded to our enquiries, with the remaining one in the process of winding down its operations. Overall, the responses were well below our expectations, with only two insurers completing all activities asked of them to an appropriate standard. Only 30 submitted an action plan and just 14 demonstrated they had presented all five items to the board. 19 provided an action plan with an insufficient level of detail.

This section summarises our review of the insurers' responses, and discusses the key areas of conduct maturity, product reviews and remediation, incentives and commissions, oversight of intermediaries and governance and risk management.

Conduct maturity

The failure of most fire and general insurers to complete their responses to an appropriate standard demonstrates a poor understanding and commitment to conduct and culture in this sector.

The tone of some of the responses suggested that a number of insurers did not consider conduct and culture to be relevant to their organisation, treating the task as a tick-box exercise rather than an opportunity to genuinely evaluate their business.

A number of insurers said they were comfortable that they did not have any conduct issues, despite not assessing their organisation in any meaningful way. At least three insurers appeared to only undertake the actions and exercises requested by the FMA in December 2020 when we followed up on our initial request.

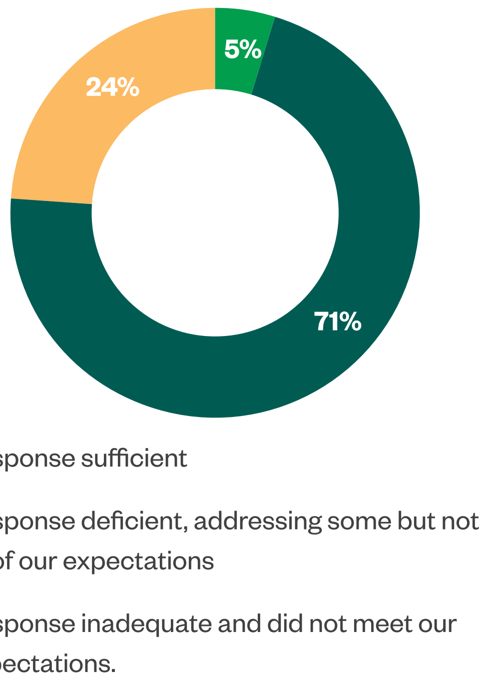
On a positive note, one-third of insurers engaged an external consultant to support completion of their response.

At least nine insurers recognised customer vulnerability as a key issue. Often this involved defining a vulnerable customer in the context of their business or carrying out workshops to gain insight from frontline staff to help develop a framework to address vulnerable customers. One insurer developed specific guidance for staff. Several intermediated insurers addressed the issue of vulnerability poorly, appearing to consider it not applicable in situations where they did not have direct contact with customers.

Insurers' responses did not meet FMA expectations

We analysed responses for comprehensiveness and maturity, assigning them a score out of 5. 5 was the highest score and 1 was the lowest. 47% scored a 1 (very low).

We also rated them as sufficient, deficient or adequate.



Overall, we found the responses concerning. With the introduction of new legislation such as the Financial Services Legislation Amendment Act (FSLAA) and the upcoming CoFI Bill, insurers should give more attention to how they are identifying, managing and mitigating conduct risks within their businesses. The new regime will encourage insurers to apply principles with the intention of achieving fair customer outcomes. This may require a deeper examination of the organisation's existing culture, governance, policies, processes and procedures.

Product and portfolio reviews

We asked insurers to conduct a systematic review of products and policy-holder portfolios. 22 out of 42 insurers completed this review, with all but four identifying major issues.

These issues were mostly related to weak systems and processes, poor value and legacy products, and lack of ongoing monitoring of suitability throughout the product lifecycle. In the majority of cases there was little or no ongoing communication with customers, which can be a cause of recurring poor customer outcomes. Where action plans were completed, insurers incorporated the outcome of the product and policy reviews into the plans. Six acknowledged improvements to the product review process were required, and several identified customer communication as an area for improvement.

At least six insurers withdrew poor value or legacy products from sale – a positive outcome. However, we recommend that these insurers also review the current policy-holders of these products to see whether they are still suitable.

Larger insurers and those who engaged third-party resources for this part of the review submitted responses which were more detailed and constructive, and included analysis of the root causes of issues. At least four didn't undertake root cause analysis, citing resource constraints or lack of in-house capability.

Some mentioned that system limitations such as manual processing and data collection impacted their ability to complete the review. We are disappointed with the ongoing lack of investment in capabilities to manage conduct risk.

Remediation

Several insurers now have large-scale remediation activity underway as a result of our reviews.

Issues requiring remediation include pricing and multi-policy discounts not being applied, over-charging on the agreed premium amount, no-claims bonuses not being applied, late payment fees being charged without appropriate cause, customer data (eg date of birth) not being accurate, and out-of-date product features and benefits that are unlikely to ever be claimed.

While the remediation activity is good news for thousands of customers who will be receiving refunds, the issues themselves are possibly the most disappointing aspect of our review.

The basic requirement that premiums are accurate, transparent, administered correctly and with value communicated to the customer has clearly not been met in a number of situations.

This is particularly important for fire and general insurance products, where it is very hard for the customer to understand how their premiums have been calculated.

Furthermore, remediation needs to be done correctly. Where issues requiring remediation are identified, insurers must commit sufficient expertise and resources to ensure customers are recompensed in a timely manner and the root cause is addressed so the issue does not reoccur.

Examples of remediation activities identified in our review

Case studies and photographs are fictitious and for illustrative purposes only but are based on real examples identified in our review.

Fred and Sylvia were charged double premiums

Fred and Sylvia, both in their 80s, arranged insurance with a broker many years ago and premiums were debited from their account every month. They didn't pay too much attention as it all happened automatically. However, they later discovered that they had been double charged – paying their premiums twice a number of times due to a system fault. After complaining to their provider, they were eventually refunded around $800.

Luke and Sarah paid too much on their insurance policies

Luke and Sarah, both 36, stretched themselves financially to purchase their first home, a two-bedroom brick and tile unit in a suburb not too far from the city. Sarah arranged insurance for their new home with their bank and was told that if she purchased multiple policies (house, contents and motor vehicle) they would receive a multi-policy discount. The couple didn't discover they were over-paying until several years later, when their insurer wrote to them to let them know the multi-policy discount had never been applied and they would be entitled to a refund.

Maddie and Kayleigh paid too much to insure their festival tickets

Best friends Maddie (20) and Kayleigh (22) were excited to attend a summer music festival. The tickets cost a lot of money and Maddie bought them both on her credit card. She chose to get insurance in case anything happened that meant they couldn't attend. Instead of paying a small percentage of the ticket price, she was charged a much higher flat fee due to IT problems with the website.

Incentives and commissions

We asked insurers to provide an explanation of how they will meet our expectations regarding staff incentives and commissions for intermediaries, as set out in the conduct and culture review.

36 out of 42 insurers provided an explanation on incentives and commissions. 28 had removed or committed to removing volume-based sales incentives for internal staff.

Some indicated they were exploring incorporating non-financial conduct- and culture-related considerations into staff performance indicators – for example, management promoting a culture of staff acting ethically.

Intermediaries were considered more complex and were not being addressed as proactively as staff incentives. Some intermediated insurers justified their incentive rates as either in line with or lower than market rates. In some instances, no evidence was provided to support why their rates were considered 'market'.

Insurers must ensure commission levels are appropriate for the ongoing service provided to support clients. They need to have a clearer line of sight on commissions and whether they are fair and reasonable, and understood by customers.

Insurers did not provide sufficient explanation of how their remuneration structures incentivise good conduct of intermediaries or ensure delivery of fair customer outcomes.

Oversight of intermediaries

In the initial conduct and culture review of life insurers, we found that some insurers appeared to believe they have no responsibility for customer outcomes that are influenced by the conduct of intermediaries, and made little effort to maintain visibility of customer outcomes where an intermediary is involved.

Our review of responses found that this is also a key issue within fire and general insurers. There are important obligations regarding intermediaries, especially within the new financial advice regime, and insurers need to be mindful that they and their distributors adhere to the requirements in the new Code of Professional Conduct for Financial Advice Services. For example, Part 1 of the Code requires ethical behaviour, conduct and client care, and Code Standard 1 explicitly states "A person who gives financial advice must always treat clients fairly."

As we said in the Life Insurer Conduct and Culture review, insurers need to take ultimate responsibility for whether or not customers are experiencing fair outcomes from their products, regardless of how they are sold.

Many insurers were passive in their approach to embedding conduct and culture into intermediated relationships. They felt they had little control, so were reluctant to seek improvement. Some were proactive, engaging with intermediaries to understand customer interactions, feedback and complaints, and disclosure requirements, but overall the responses reinforced that insurers need greater oversight of how intermediaries are selling and managing their products.

Governance and risk management

Boards are responsible for leading an organisation's approach to conduct and setting the tone for how it is to be addressed. In our review of insurers' responses, the level of board engagement appeared mixed.

We asked insurers to present to their board the findings from the actions we asked them to complete. 30 out of 42 insurers presented to their board. Of those, 14 completed all four actions requested, 12 completed two actions and four completed one action.

There were some examples of engaged boards. One board amended its charter to reflect governance of conduct and culture. Some boards used audit and risk committees to discuss conduct and culture issues, commenting on the level of resourcing, and requesting more detailed information.

Others were not sufficiently engaged. While eight insurers had audit and risk committees, conduct and culture risks were often overlooked and excluded in the risk appetite and risk management framework. In several cases it was not made clear how conduct and culture risk identification and management would be integrated and embedded across the business.

In a positive example, one insurer indicated a new team of risk advisers was created, with team members positioned across different business units.

For the smaller, foreign-owned insurers, there was unclear accountability of the New Zealand operation to the board. The tone of responses from these insurers reflected a relatively low level of commitment to the exercise.

There is clearly still work to do. Boards must set the tone from the top, developing a culture that balances the interests of shareholders with those of customers, and establishing an appropriate risk appetite that acknowledges conduct risk is material.

The board's expectations must be made clear to the organisation. Boards and senior management should be prepared to invest in systems and controls to manage conduct risk if required.

Appendix

Additional resources

- A guide to the FMA's view of conduct 2017
- Life Insurer Conduct and Culture: Findings from an FMA and RBNZ review of conduct and culture in New Zealand life insurers
- Conflicted remuneration (soft commissions) in the life and health insurance industry

Participants

Thank you to the following fire and general insurers for their participation in our review. Participants are listed in alphabetical order:

AA Insurance Limited	New Zealand Medical Professionals Limited
Acanthus Insurance Company Limited	nib nz limited
AIG Insurance New Zealand Limited	Pacific International Insurance Pty Limited
Aioi Nissay Dowa Insurance Co., Ltd	Police Health Plan Limited
Atradius Credito y Caucion, S.A. de Seguros y Reaseguros	Provident Insurance Corporation Limited
Beneficial Insurance Limited	QBE Insurance (Australia) Limited
Booster Assurance Limited*	Quest Insurance Group Limited
Brightsideco Insurance Limited	Southern Cross Benefits Limited
Chubb Insurance New Zealand Limited	Southern Cross Medical Care Society
Consumer Insurance Services Limited	Teleco Insurance (NZ) Limited
DPL Insurance Limited	The Hollard Insurance Company Pty Ltd
Factory Mutual Insurance Company	The New India Assurance Company Limited
First American Title Insurance Company of Australia Pty Limited	The North of England Protecting and Indemnity Association Limited
First Insurance Limited	Tokio Marine & Nichido Fire Insurance Co., Ltd.
FMG Insurance Limited	TOWER Limited
Health Service Welfare Society Limited	Union Medical Benefits Society Limited
IAG New Zealand Limited	Vero Insurance New Zealand Limited
Indemnity and General Insurance Company Limited	Vero Liability Insurance Limited
Manchester Unity Friendly Society	Veterinary Professional Insurance Society Incorporated
Medical Insurance Society Limited (trading as MAS or Medical Assurance Society)	Virginia Surety Company, Inc
Mitsui Sumitomo Insurance Company, Limited	Zurich Australian Insurance Limited

*Booster was not included in the 2019 Life Insurer Conduct and Culture report but responded as part of this non-life review of conduct and culture. Booster operates as a life insurer.

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