

Placing “Treating Customers Fairly” at the heart of insurance



February 2024

Treating customers fairly is everybody’s responsibility

Treating Customers Fairly (TCF) is the focus of Insurance Core Principle 19 issued by the International Association of Insurance Supervisors. It is gaining greater attention from insurance regulators and is the focus of the December 2023 edition of ‘Conduct in Focus’¹ issued by the Hong Kong Insurance Authority (HKIA). This edition reminded the insurance industry to put themselves in their customers’ shoes for all aspects of the insurance product lifecycle. Whilst it is all too easy to rely on a Compliance function to be responsible for gate-keeping, it is clearly the responsibility of all parties to take ownership for TCF.

This echoes HKIA’s Guidance GL 21 which specifies that an insurer has the responsibility for good conduct of business throughout the insurance lifecycle. For that purpose, the HKIA requires firms to manage the conduct as a distinctive risk within its enterprise risk framework, in order to ensure fair treatment of customers². Effectively managing these conduct risks requires effort from every function relevant to the insurance product lifecycle, from product design, marketing, sales and advisory, intermediary management, claims and servicing.

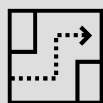
Whilst previous publications have discussed the importance of communication at the heart of TCF³, our current focus is on other parts of the insurance lifecycle, which are equally important.

Product design and pricing

Put simply, complex and difficult to understand products introduce greater risk of poor customer outcomes than simple, transparent propositions. As examples:

- Product optionality – Features such as early encashment may be portrayed as flexibility; however, the terms on which they are granted may be detrimental to returns; and
- Disclosure – Inadequate explanation of complex features such as currency risk and equity price volatility.

It is common for some classes of business, like medical reimbursement, to offer guaranteed coverage but for premium rates to be reviewable. Spurred by increasing complaints from customers, the Australian Prudential Regulatory Authority (APRA) reviewed companies’ practices in this area and identified areas of non-compliance including premium increases where not permitted under the contractual terms. APRA has reminded⁴ firms to be vigilant in this regard. At the same time, unfair contract term legislation has applied in Australia since 2021 on in-force and new business, bringing additional protection for policyholders.



Product options

A customer’s successful navigation of product options requires clear disclosure and good design-decisions at the outset



Re-pricing

Re-pricing needs to be managed carefully to balance the interests of the customers and the insurance company

1. Conduct in Focus Issue 8 https://www.ia.org.hk/en/legislative_framework/files/Eng_Conduct_in_Focus_Issue_8_Dec_2023.pdf
2. Guidance GL 21 Enterprise Risk Management https://www.ia.org.hk/en/legislative_framework/files/GL21.pdf
3. From promises to performance: The power of clear and transparent communication in insurance policies <https://www.pwchk.com/en/industries/financial-services/insurance/publications/from-promises-to-performance-sep2023.html>
4. Premium increases in life insurance <https://www.apra.gov.au/premium-increases-life-insurance>



Incentive structure

Hong Kong Guidance GL16 places responsibility for a fair compensation structure on the Controller and Board of Directors



Training of intermediaries

Balanced (not focussing just on the positive features) and timely training of intermediaries is important. The HKIA publishes a CPD compliance league table to ensure this remains an area of focus for insurance firms

Intermediaries are a key part of TCF

There may be an asymmetry of understanding and experience between the insurance provider and the customer¹, which places greater reliance on the intermediary to help customers navigate the product selection process. The role of the intermediary, raises further considerations for fair treatment of customers. For example, HKIA Guidance GL16 requires that a remuneration structure does not create misaligned incentives for mis-selling or aggressive selling and in the recent Conduct in Focus, the HKIA raises questions about the ability of commission structures to incentivise the servicing role of intermediaries and whether they adequately consider non-sales / conduct KPIs¹.

Examples exist in other jurisdictions. For example, the Monetary Authority of Singapore has introduced a Balanced Scorecard Framework including non-sales KPIs in the determination of remuneration alongside the requirement for an independent audit function to review sales conduct⁵.

Adequate training of intermediaries is also paramount. The HKIA requires on-going training and professional training for sales intermediaries with a CPD requirement.

Claims handling and policy definitions

Prompt and accurate claims handling are critical elements in the fair treatment of customers. Companies are starting to promote the number and proportion of claims settled as a positive feature of product offerings as a counter to focussing solely on price.

High rates of declined claims may be indicative of inadequate explanation of policy benefits or under disclosure by customers of their own and their family's previous medical history. The sales intermediary plays a critical role in ensuring customers truthfully and accurately report their medical condition on application for cover. Technology (smart systems) can help to eliminate unnecessary and lengthy medical questionnaires and the collection of health data from smart wearable devices is starting to be seen in the pricing process for insurance.

A new source of risk in connection with insurance policies comes from claims definitions. Reliance on out-dated and no longer relevant diagnoses may be over-ridden. A recent court case in ASIC v MLC⁶, was ruled in favour of the plaintiff and against the company for failing to update medical policy definitions for the diagnosis of severe rheumatoid arthritis.



Contract definitions

Medical advances should be routinely considered to ensure coverage remains available and relevant to customers

5. Notice FAA-N20 Requirements for the Remuneration Framework for Representatives and Supervisors and Independent Sales Audit Unit <https://www.mas.gov.sg/regulation/notices/notice-faa-n20>

6. Australian Securities and Investments Commission v MLC Limited [2023] FCA 539 (18 May 2023) <http://www.austlii.edu.au/cgi-bin/viewdoc/au/cases/cth/FCA/2023/539.html>



Eligibility and transparent sales

PPI and credit life policies require good explanation of coverage and cost. Above all, the optional nature of the policy should be disclosed.

Case study: Policyholder protection insurance (PPI)

PPI is often linked to an underlying credit arrangement, such as a credit card, car loan or mortgage. It is intended to pay some or all of the credit repayments in the event the insured is ill or made redundant. Widely sold, it was estimated the premium income in the period 2001-2009 amounted to circa GBP 34b⁷. PPI was very profitable with estimated claims ratios between 11% and 28% of the gross premium⁸.

The Financial Services Authority subsequently discovered a range of issues including:

- Eligibility – people were ineligible to claim under the policies from the outset due to self-employment status or pre-existing medical conditions;
- Sales conduct – pressurised sales and bundling of the insurance policy with the credit application and failing to stress the optionality of the cover; and
- Weak price disclosure – for single premium policies this was typically added to the loan balance at outset.

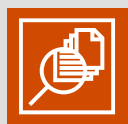
As a result, the sale of PPI became prohibited at point of sale and single-premium PPI policies were outlawed. The compensation and redress process lasted until 2019 and it is estimated that over GBP 38b was paid to customers in premium refunds. There were also enforcement cases taken against individual firms with penalties reaching GBP 7m⁸.

7. PPI complaints <https://www.fca.org.uk/consumers/ppi-complaints>

8. Background note on Payment Protection Insurance https://www.eiopa.europa.eu/system/files/2019-03/eiopa_ppi_background_note_2013-06-28.pdf

How can we help?

Our team comprises insurance and broader financial services professionals with extensive experience of:



sales process
governance and
independent reviews



review of policyholder
communications for
fairness



product design and
review

We would be delighted to explore how we provide support to your business.

Contact us

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