Regulatory changes face insurance sector

Insurance companies and intermediaries are bracing themselves for rapid, far-reaching regulatory changes that are due to be introduced in 2016.

FSB's Jonathan Dixon says significant changes are on the cards for insurers and one of the most significant is the principle of Treating Customers Fairly. Image: [FANews]

"These changes are necessary to address the combination of factors behind far too many examples of poor customer outcomes still being encountered in the industry," says Jonathan Dixon, Deputy Executive Officer: Insurance at the Financial Services Board (FSB).

Speaking at the quarterly Insurance Management Forum hosted by Norton Rose Fulbright South Africa in Johannesburg Dixon stated that to address these inadequacies, regulation and supervision must become "more forward-looking, pre-emptive, risk-based and outcomes-focused".

This is the purpose of the regulatory changes being introduced across the financial services sector over the next two years. The changes revolve around Twin Peaks legislation, the Treating Customers Fairly model, Retail Distribution Review, the Solvency Asset Management project and reforms to the FAIS framework.

"There's no doubt that the current period is seeing the most fundamental and fast-paced change to financial regulation in a generation," he said.

Dixon outlined the implications of the coming changes for insurance firms, intermediaries, clients and the FSB itself.

"For insurers, through their own efforts and our checking of their efforts, I believe we will see real evidence of a customer-centric approach, as opposed to mere lip service," he said.

Insurers will also have to enhance their risk management, which should include conduct risks and not just financial risks. "This will raise the bar for insurance companies, but it will also promote competition," he said.

There needs to be greater transparency in terms of fees paid and charges levied by insurers according to the FSB

For financial advisers, the FSB envisaged a simpler, cleaner system where advisers don't have to try to negotiate elaborate schemes with product providers, to bypass regulation and earn extra income," he said.

Instead, financial advisers would be able to build value into their businesses, and demonstrate their expertise and the value they bring to customers.

He says customers stand to gain a real sense of confidence and trust that they are dealing with firms that will treat them fairly. Ultimately, this is the key to a sustainable future for the financial services sector.

Commenting on the changing role of the FSB, Dixon said it was evolving into a new, dedicated market conduct authority with an enhanced mandate for intensive supervision of business conduct.

"As a market conduct regulator, the FSB is primarily concerned about the fair treatment of customers," he said, adding that the Treating Customers Fairly (TCF) model was an outcomes-based approach that would be less about ticking boxes in compliance reports and more about measuring results.

Providers accountable for product development

Another critical aspect of TCF will be increased scrutiny of the way firms develop products. The emphasis will be on products that offer value to customers and meet their reasonable expectations.

The way that insurance is sold may lead to misunderstandings between the service provider and the insured, resulting in unfair practices by some insurance companies. Image: CarVK

"Also, product providers will have primary responsibility for ensuring that their products are marketed and distributed in a way that does not undermine fair outcomes - including much more rigorous oversight over their chosen distribution channel," Dixon said.

"It's been far too easy in the past for product providers to blame poor outcomes on intermediaries. It must now be clear that delivery of fair outcomes is a shared responsibility," he added.

He said the FSB is busy developing the new regulatory and supervisory framework for the TCF model, which will outline what requirements firms need to meet and how their implementation will be monitored.

"Insurers are already expected to have started embedding TCF into their culture and governance framework, and we are already using the TCF framework in our engagement with insurers to strengthen the pre-emptive approach to supervision."

Dixon warned that the FSB will be applying "increasingly harsh" financial sanctions against firms that do not proactively address poor practices.

Fundamental flaws in current commission model

During his presentation, Dixon said there were many concerns about incentives and business models that failed to deliver fair outcomes for customers. Chief among these are conflicts of interest in adviser remuneration and low levels of understanding among customers about the service they can expect from financial advisers.

According to the FSB fees charged by insurers for advice need to be declared so that the customer knows what it will cost, particularly in big-ticket items such as house and householders insurance products. Image: Money Saver

These concerns are driving the Retail Distribution Review (RDR) that is under way, the aim being to promote financial advice that is fair, appropriate and affordable, and to ensure a framework that supports a sustainable business model for financial advice.

"We believe the current, complex distribution landscape is fundamentally flawed," Dixon said. "It creates risks not only to fair customer outcomes and effective supervision, but also to the sustainability of intermediaries and advisers - and, in fact, the whole intermediated business model," Dixon said.

Through the RDR, two main remuneration-related risks to TCF have been identified, one being the current model that product providers use to pay commission and fees. "This can lead to incentive-driven advice rather than advice that is in the best interests of the client."

Secondly, the current commission system is opaque in that commission charges are built in, and intermediation and advice costs are hidden. This may lead customers to believe they are not paying for financial advice, weaken accountability for advice given, and undermine product value because hidden costs tend to be less competitively priced.

The current commission model also poses risks to effective supervision, as well as to the sustainability of intermediaries. Among other problems, intermediaries often receive no remuneration for time spent on financial planning or product advice, unless they make a sale.

Activity-based definitions address anomalies

To address these challenges, the insurance industry will be moving to an "activity-based" definition of advice and intermediary services, comprising three categories:

- Services to the customer (such as financial advice);
- Outsourced services to the product provider;

- True intermediary services when an intermediary acts as the go-between in selling or servicing a product.

"The aim is to clarify which services are provided to which party and in what capacity an intermediary acts when performing these activities," Dixon said.

When interacting with customers, intermediaries will be expected to disclose the nature of their relationship with product providers and clearly describe the services they are offering. They will also have to charge separately for each component of advice and intermediary services. In the case of an advice fee, the adviser should negotiate the advice fee with the client and the product provider should facilitate collection of the fee.

The FSB envisages limiting commission to life risk products, Dixon says.

"In other words, commission and other product provider fees will be prohibited in the investment product arena," he says.

Replacing commission with an advice fee will ensure a level playing field across investment products. For instance, no commission is currently paid for collective investment schemes.

However, the FSB is considering introducing a special remuneration dispensation, on a commission or salaried basis, for investment and risk products for low-income markets, where there could be an advice gap.

Plans are also being made to deal with conflicted remuneration, which occurs when incentives introduce bias in product advice or interfere with the duty of an adviser to act in the best interests of the customer.

"It's been far too easy in the past for product providers to blame poor outcomes on intermediaries. It must now be clear that delivery of fair outcomes is a shared responsibility," he said.

Source: The Times via I-Net Bridge