August 13, 2021

Dr. Victoria Saporta
Chairperson
Mr. Jonathan Dixon
Secretary General
International Association of Insurance Supervisors (IAIS)
Centralbahnplatz 2
CH-4002 Basel
Switzerland

Re: Draft Issues Paper on Insurer Culture

Dear Dr. Saporta and Mr. Dixon:

The Institute of International Finance (IIF) and the members of the IIF's Insurance Working Group are pleased to respond to the IAIS's consultation on a Draft Issues Paper on Insurer Culture (Draft Issues Paper). We appreciate the link between insurance conduct risks and the financial soundness of the industry, particularly when widespread or material misconduct produces suboptimal outcomes for policyholders and other insurance counterparties, as this reduces confidence and trust in the sector.

In the first instance, management and the board of directors of an insurer are responsible for corporate culture and for addressing conduct risks that may arise from cultural issues. However, when an insurer fails to establish a culture aligned with good customer outcomes and the fair treatment of customers or fails to prevent or address market misconduct, the group or lead supervisor should take action to protect policyholders. Prompt and effective supervisory action in these instances also helps to mitigate reputational risk for the industry as a whole.

We encourage the IAIS to engage in an open discussion with a wide range of stakeholders in order to further explore issues of insurer culture and best practices for the supervision of insurer culture. The IIF would be pleased to help facilitate these discussions.

Overarching Comments

The Multi-Dimensional Elements of Culture. We appreciate the IAIS's recognition of the multi-dimensional elements of culture and the fact that there is no one 'right' or 'good' insurer culture. An insurer's culture is influenced by the values and goals that are established and communicated by the organization's leadership and reinforced in the decisions about how the organization is run and managed. These organizational values, in turn, are influenced by a wide variety of external and internal factors, including the purpose of the organization, the types of customers it serves, and national cultural values.

We agree with the statement in the first sentence of Paragraph 48 of the Draft Issues Paper that it is not the role of supervisors to define a specific set of values for insurers. Companies differ in the extent to which they emphasize certain values such as results orientation, people focus, teamwork, innovation, risk taking and competitiveness. Values may also be influenced by the lines of business in which the organization engages and the nature of its customer base, including whether the company is primarily retail focused or engaged in B2B business lines. A wide range of cultures that emphasize different values can be aligned with good customer outcomes and treating customers fairly, including in accordance with contract terms and conditions. A one-size-fits-all approach to culture is not appropriate in the insurance sector, with its diversity of business models.

As detailed in the March 8, 2020 FCA Insights article, *Measuring corporate culture: a warning*[1], we agree with the authors' assessment that, "it is very hard to capture a corporate culture in simple observable or quantifiable metrics." We concur that there are risks to focusing on available and easily assessed data, as it will "largely fail to measure the deeper and stronger aspects of a corporate culture's hidden assumptions and automatic and accepted behaviors." A focus on culture is important, but,

"The big question is how can we be sure what a healthy, ethical, safe culture is or when a corporate culture is toxic, unethical and unsafe. The idea of unobtrusive measurement implies that through measurement we automatically evaluate and diagnose culture. The problem is that in the current body of scientifically validated knowledge there is no clear consensus of what in an organizational culture predicts wrongdoing and rule breaking."

Quantitative culture assessments are limited by the fact that the dimensions of culture vary internationally, across industries, and even within global companies and, therefore, a one-size-fits-all approach cannot capture unique features of an organization. Additionally, in the search for simple and unobtrusive metrics for culture, there is a risk that the availability of data drives the development and then the outcomes of quantitative cultural assessments. In the example from the Australian Securities and Investments Commission (ASIC) that follows Paragraph 51, ASIC found that insurers generally focused on fairly limited or short-term metrics, such as customer service measures, to measure customer outcomes. These metrics, while helpful at some level, are not designed to reflect the values, beliefs and assumptions that underlie an insurer's culture. A summary of recent discussions among compensation professionals hosted by the Financial Stability Board's (FSB) Compensation Monitoring Contact Group (CMCG)[2], on the other hand, noted that the use of less objective non-financial measures in compensation decisions (e.g. customer protection) requires a certain level of discretion and that there is a risk that these measures could be potentially engineered. Neither of these options – quantitative measures or more qualitative measures – can reliably assess the complexities of an organization's culture.

In the search for easy measurement, a number of service providers have recently begun to offer cultural assessments. This commoditization and industrialization of cultural assessments can be dangerous if the services provided and the tools used in providing those services have not been scientifically or academically validated. These services and tools can lead to a false sense of security in 'good' culture measures that gloss over underlying issues in the deeper and stronger aspects of a corporate culture that may be hidden from view.

As noted in the introduction to this response, the board of directors has the primary responsibility for establishing the organizational culture and management has the primary responsibility for implementing and communicating that culture throughout the organization. Supervisors do not have a mandate or the responsibility for establishing or changing corporate culture; rather, they have a mandate to require

[1] https://www.fca.org.uk/insight/measuring-corporate-culture-warning
[2] https://www.fsb.org/wp-content/uploads/P090821.pdf

management or the board to take appropriate corrective action when evidence indicates that the board and management have failed to establish a culture that is aligned with good customer outcomes and treating customers fairly, including in accordance with contract terms and conditions or when evidence indicates that the culture or subculture of an organization has fostered market misconduct.

An Outcomes-Focused, Evidence-Based Approach to the Supervision of Culture. Following from our observation that a wide range of cultures can be aligned with good customer outcomes and treating customers fairly, we encourage the IAIS to adopt an outcomes-focused and evidence-based approach to the supervision of culture. We note that an outcomes-focused approach is reflected in Section 1.2.2 of the Draft Issues Paper but this approach could be better reflected in subsequent sections of the Paper, as noted in our Specific Comments, below.

Focusing on customer outcomes can help to tie expectations regarding insurer culture to supervisory goals such as the protection of policyholders. A focus on outcomes can also avoid an overly subjective approach that could result in different supervisory responses depending upon the individual or the jurisdiction that is responsible for supervision. An outcomes-focused approach ties directly to the supervisory mandate, as it looks at particular aspects of an insurer's culture that can impact market conduct and avoids emphasizing organizational-specific characteristics or styles that can vary significantly without any negative effect on customers. It can also reflect differences across insurers based on their lines of business or core customer base.

An evidence-based approach to the supervision of culture identifies a specific attribute or artefact of an insurer's culture that is inconsistent with supervisory goals and works with the organization's board and senior management to correct the misalignment. An evidence-based approach facilitates a focus on root causes of misalignment between organizational culture and supervisory goals. The example from ASIC that follows Paragraph 38 in the Draft Issues Paper demonstrates an evidence-based approach that linked shortcomings in insurers' and distributors' quality assurance frameworks and sales training materials to poor customer outcomes.

The FSB's Ongoing Work on Remuneration. We respectfully question the IAIS's need for additional work on the topic of remuneration given the considerable ongoing attention this subject has received at the FSB. The FSB's work has been continuous since 2009 and has encompassed compensation policies and practices at insurers, asset managers and banks. The FSB's CMCG monitors and reports on national implementation of the Financial Stability Forum's (the predecessor to the FSB) *Principles for Sound Compensation Practices*[3] and the *Implementation Standards*.[4] As noted above, in its most recent workshop earlier this year, the CMCG and executives responsible for managing compensation processes at internationally active firms, including insurers, discussed how firms use non-financial criteria and measures, behaviors and firm culture in setting variable remuneration , effective practices for aligning risk and compensation, significant legal and regulatory impediments to the use of compensation tools, such as malus and claw-back, and compensation-related actions in relation to COVID-19.

[3] https://www.fsb.org/wp-content/uploads/r_0904b.pdf
[4] https://www.fsb.org/2009/09/principles-for-sound-compensation-practices-implementation-standards/

Given this extensive cross-sectoral work on remuneration issues and the IAIS's active participation in the work of the FSB, we respectfully question whether the IAIS needs to devote additional resources to insurance-specific remuneration considerations.

<u>Support for Further IAIS Work on Conflicts of Interest Management</u>. We welcome the IAIS's further consideration of conflicts of interest management by insurers, as proposed in Paragraph 87 of the Draft Issues Paper. We believe that this is a topic that would benefit from IAIS discussion with stakeholders and the IIF would be pleased to facilitate a dialogue.

Specific Comments

The second sentence of Paragraph 13 points to an organization's formal governance arrangements, policies and processes, office lay-out, dress code and style of communication as indicia of the organization's transparency and credibility. We believe that these organizational characteristics or styles can vary significantly among companies that have a corporate culture that is consistent with good customer outcomes. An overly detailed review of an organization's characteristics and style can promote granular expectations that lead to culture 'grades' of excellent, good, fair or bad, which we believe is inappropriate. We propose to delete this sentence from Paragraph 13.

The example of 'rolling bad apples' from the banking industry in Paragraph 39 points out the importance of rigorous vetting and background checks for new employees, especially those with management roles. However, given informational asymmetries, supervisors should expect that the review of new employees will be on a 'best-efforts' basis.

Paragraph 48 notes that it is not the role of supervisors to define a specific set of values for insurers, a statement with which we agree, as noted above. However, in the second sentence, we propose a clearer link to good customer outcomes as follows:

However, in assessing whether an insurer's values point to a desirable overall culture, it may be instructive for supervisors to consider the extent to which its values and underlying purpose align with expectations for appropriate market conduct set out in applicable regulatory requirements.

Paragraph 49 describes the maximization of shareholder value, on the one hand, and the pursuit of long-term viability and the fair treatment of customers, on the other hand, as a zero-sum game. Both are consistent with positive customer outcomes. The maximization of shareholder value, company growth and increased revenue benefit customers through expanded and improved products and services, better customer service and a solid financial base that ensures that commitments to policyholders will be met. We do, however, appreciate that an *excessive* focus on short-term profitability can be detrimental to the organization and, ultimately, to its customers. We would rephrase this Paragraph as follows:

An excessive focus on short-term profitability can be detrimental to the long-term viability of an insurer and result in negative impacts on customer outcomes. Insurers should balance short- and long-term objectives and goals with a view towards positive customer outcomes including expanded and improved products and services, better customer service and a solid financial base that ensures that commitments to policyholders will be met consistent with contract terms and conditions.

Relatedly, we caution against the notion that revisiting contract terms and conditions to benefit a particular group of policyholders is necessarily evidence of 'good' culture or good customer outcomes.

The supervisory focus should be on positive outcomes for all customers, consistent with contract terms and conditions. Preferential treatment of one segment of the customer base can be detrimental to the interests of other policyholders and inconsistent with sound risk management that benefits all stakeholders.

The examples following Paragraphs 63 and 70 from the U.K. are more indicative of internal control failures than of cultural issues. We encourage the IAIS to refocus these examples on cultural problems at the insurer and on how those problems actually impacted customers.

In Paragraph 78, basing promotional programs for senior management on short-term revenue horizons or quantitative hard targets can be consistent with a culture that advances good market conduct and customer outcomes. Much depends on the design of the program and the alignment of the program with positive customer outcomes. Non-financial quantitative targets, such as customer satisfaction metrics, can support positive customer outcomes. Quantitative targets can be directly tied to incentives in a transparent manner and are more easily monitored and audited than qualitative targets.

Promotional programs based on short-term revenues or quantitative hard targets can further important business goals that are consistent with positive customer outcomes. For example, when rolling out a new line of business or product, an insurer may wish to incent its employees to focus on that line of business or product in the short term as part of a marketing strategy in order to embed the line or product in its offerings for the benefit of consumers of that product and the business.

We propose to reword Paragraph 78 as follows:

In designing promotional programs for employees and, in particular, for Senior Management, insurers should take care to avoid design features that could result in negative customer outcomes such as poor selling practices or unfair treatment of customers. Programs that are based exclusively on short-term revenue horizons and/or quantitative hard targets should be carefully designed by the insurer to avoid unintended consequences. Promotional programs should be aligned with positive customer outcomes.

Paragraph 83 describes profitability and quantitative metrics, on the one hand, and qualitative and service-oriented outcomes, on the other hand, as a zero-sum game. This characterization is contrary to ICP 7.6.12, which is discussed in Paragraph 82. ICP 7.6.12 reflects a balanced approach that allows for a holistic assessment of performance based on a full range of financial and non-financial indicators and metrics.

Similar to our comments with respect to Paragraph 49, both quantitative and qualitative indicators and metrics are important and both can advance good customer outcomes. Moreover, service-oriented indicators can be either quantitative or qualitative. We note that the balanced scorecard approach described in the example from Singapore following Paragraph 84 emphasizes the inclusion of both financial and non-financial components that can align incentive structures with good customer outcomes (as well as sound internal controls, prudent risk management and compliance with regulatory requirements).

We propose to delete Paragraph 83 from the Draft Issues Paper, as it does not reflect the balanced approach of ICP 7.6.12 and of the G30 report on banking conduct and culture referenced in that Paragraph. In order to reflect a more balanced approach, and in order to reflect that management and/or the board of directors have the responsibility to change remuneration plans that may lead to inappropriate incentives, we propose to revise Paragraph 84 as follows:

In the case of misconduct, management and/or the board of directors should consider whether the design of variable components of remuneration could have provided incentives to engage in the misconduct or if the design of the variable remuneration plan is indicative of governance issues at the insurer. If the answer to either question is in the affirmative, management or the board of directors should take prompt corrective action to change the plan design and/or to address underlying governance issues. If timely corrective action is not taken by management or the board of directors, the lead or group supervisor should instruct the insurer to take appropriate action.

We appreciate the opportunity to comment on the Draft Issues Paper and would welcome the occasion to further discuss our views with IAIS members.

Respectfully submitted,

MF Monroe

Mary Frances Monroe