



Institute
and Faculty
of Actuaries

Do Customers Understand our Life Products?

Risk and Customer Outcomes Working Party



Agenda

1. Objectives and background
2. Scoping topics
3. Implications

Agenda

1. Objectives and background
2. Scoping topics
3. Implications

Overall objectives of the Working Party¹

The Working Party was set up with the key objectives to look at risk and customer outcomes.



How can we help customers understand risks and outcomes for insurance products



How to avoid poor customer outcomes / maximise good customer outcomes



Explore the management of risk from the customer's perspective



Key goal: demonstrate how customer outcomes could be improved if the ideas and conclusions of the research are followed

¹ Research to be completed in 2016

Questions explored so far

Do our customers really understand our products?



Do our customers truly understand the range of risk-return possibilities in life insurance offerings

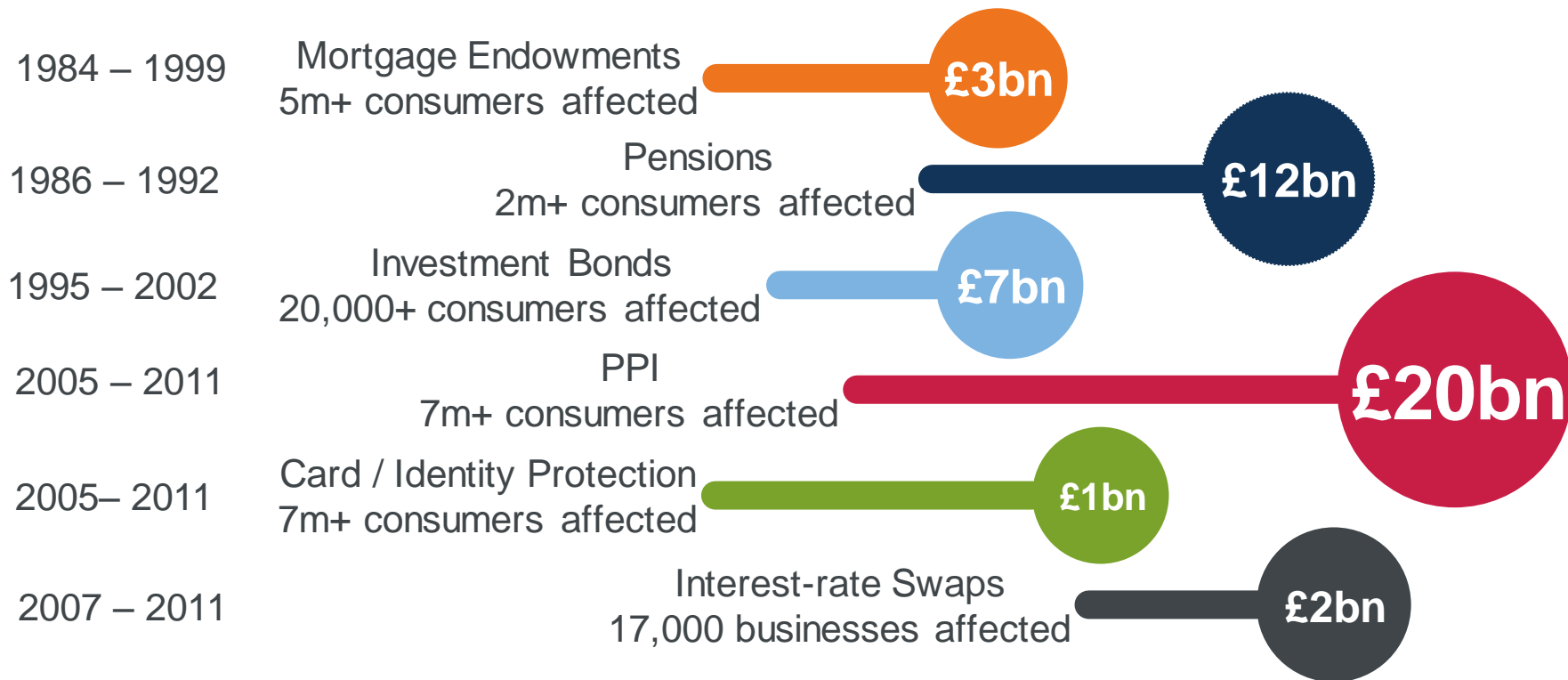


What can we do to clearly express the customer value proposition



How can we easily measure and express variability in potential customer outcomes and disclosure of poor/worst-case outcomes

Continued mis-selling “scandals” have proved costly to the industry



Root causes of mis-selling

Prevailing sales
based culture
within firms

Remuneration
policies for front-
line staff

Tick-box approach
to compliance

Poor product
design

Misleading or
poor quality sales
processes

Lack of effective
competition

Firms ignored the
warning signs of
mis-selling

A weak regulatory
approach

Firms rejecting
legitimate
complaints

Agenda

1. Objectives and background
2. Scoping topics
3. Implications

Scoping for improving customer outcomes

Customer	Needs, risk profile, expectations, knowledge			Changing needs and outcomes
Company	Product approval <ul style="list-style-type: none">• Target market• Customer value proposition• Product features vs customer needs• Value for Money (VfM)• Stress testing	Sales and compliance (S&C) <ul style="list-style-type: none">③ • Needs based selling (NBS)• Conflicts of interests• Incentives and remuneration• Key Information Doc• Reduction in yield• Payback period• Risk / return profile• Worst case scenarios		Ongoing assessment <ul style="list-style-type: none">• Regular communication• Portfolio check vs evolving needs• Complaints handling
	<ul style="list-style-type: none">• Good VfM• Meet needs• Simple to understand / explain to customer	<ul style="list-style-type: none">• Tools to facilitate disclosure	<ul style="list-style-type: none">• Product training & information• Remuneration	<ul style="list-style-type: none">• Low litigation risk
① Regulator	<ul style="list-style-type: none">• IDD – Product approval• MIFID – Product design• POG – Product oversight and governance	<ul style="list-style-type: none">• IDD – S&C, Conflicts of interests• MIFID – Marketing	<ul style="list-style-type: none">• IDD – Disclosure• MIFID – Disclosure• PRIIPS - KID	<ul style="list-style-type: none">• IDD – Complaints handling• Solvency II Directive – Complaints handling
	UK specific regulation			
	Product design	Distribution	② Disclosure	④ Review and remediation

► Complex landscape: wide range of stakeholders, objectives and intricate regulatory layer

1

European regulation impacting Risk and Customer Outcomes – Key for scoping

Insurance Distribution Directive (IDD)

- Harmonise national provisions for distribution
- Increase level of customer protection across the EU
- Requirements for intermediaries, disclosure and cross-selling
- Formal product oversight and governance
- Additional requirements for products with investment elements

Markets in Financial Instruments Directive (MiFID)

- Increased transparency within markets and investor protection
- Pre and post trade transparency requirements
- Tailor products to target market and inform clients
- Information requirements on charges, cost of advice and how it is paid

Product oversight & governance(POG)

- Guidelines aimed to minimise consumer detriment
- Management of conflicts of interest in product design
- Identify target market, design products to meet target market's needs
- Product testing and monitoring
- Distribution should be appropriate for the target market

Packaged Retail & Insurance-based Investment Products (PRIIPs)

- Improve transparency in the investment retail market
- Create a level playing field for product manufacturers
- Standardised Key Information Doc allowing product comparisons
- Manufacturers' liability in case of damage suffered by investor

Focus points from the scoping

Focus points

Objective: Help customers understand risks and outcomes

2



Clear disclosure and illustration of risk / return profile

Objective: Avoid poor customer outcomes

3



Needs based selling

Objective: Explore risk management from customers' perspective

4



Ongoing product assessment and regular communication



Meet customers needs throughout product lifecycle is key

2

Customer understands risks and outcomes – key considerations

Clear disclosure of risk / return profile

- Illustrate probability / uncertainty of different outcomes
- Understand that higher returns can mostly be achieved by taking more risk
- Compare risk / return profiles of different products
- Comparison to a risk free return
- Online illustration system allowing input of own scenarios
- Impact of charges and distributor remuneration (e.g. RiY)

Worst case scenario / maximum loss

- Worst case scenario excluding provider's default
- What happens when the provider defaults
- Does this match the customer's risk tolerance?

Link to needs

- How the product serves the needs – why the product was chosen / recommended
- How to access benefits
- What to do if needs change



Lack of financial education and increasingly complex products do not easily enable customer understanding

3 Needs based selling (NBS) – understand customer needs

Needs based selling

Target market	Propositions design	Distribution
<ul style="list-style-type: none"> • Needs and expectations • Risk profile and tolerance to losses • Investment objectives and horizon • Liquidity needs • Level of customer financial knowledge 	<ul style="list-style-type: none"> • Value for money • Product features match target market's needs • Product stress test: scenarios when product fails to meet the needs. Document these to enable actions when they occur • Customer can access benefits when needed 	<ul style="list-style-type: none"> • Distribution is appropriate for target market • Remuneration is compatible with NBS • Ability to discover / identify needs • Process for matching needs / risk profile and product features • Explain to customer how the product can meet the needs • Manufacturer provides adequate information to distributor

Examples of product features for various customer needs

Protection (own / family)	Education	Savings	Retirement income	Inheritance
<ul style="list-style-type: none"> • Standalone / rider • Limited / whole life • Limited savings / accumulation component 	<ul style="list-style-type: none"> -> Accumulation up to e.g. university age, then drawdown benefit -> Additional protection benefits to ensure original needs are met 	<ul style="list-style-type: none"> -> Investment linked / universal life -> Investment risk matches customer risk profile -> Low protection level (riders) -> Investment options / fund switching -> Flexible premium payment / top-ups 	<ul style="list-style-type: none"> -> Investment linked / draw down / traditional annuity -> Fixed term or whole life annuity -> Guaranteed income -> Inflation protection -> Dependent pension 	<ul style="list-style-type: none"> -> Investment linked / universal life traditional whole life -> High protection component (death benefit as estate payout) -> Investment options / fund switching / top-ups

3 Needs based selling (NBS) – understand customer risk profile

Same need can be met at different risk levels

Source of product risk

- Risk not adequately presented through corresponding product literature
- Unreasonable expectations through inappropriate illustrations at sale
- Performance worse than expected. e.g. market performs poorly
- Designed to meet a certain customer risk profile – sold to a different market
- Benefits not available when needed, e.g. low surrender value due to MVA

Align product risk and customer risk profile over product life cycle

Customer risk appetite

- Current net worth
- Investment horizon
- Impact of product loss on financial position
- Other protection available (e.g. state protection fund)
- Other invested assets / insurance protection
- Financial awareness
-

- How do you define / measure customers' risk appetite?
- How to align to product risk?
- How do you maintain alignment over the long-term?

► Understanding customers' risk appetite is key for recommending suitable products

3 Potential solutions to tackle the issue

Taking inspiration from other markets

Asia

- Generic savings type product
- Risk riders attached which can be changed over the lifetime of the product

US

- Brokers carry out frequent assessments of products and suitability
- Alternatively, could contact customers or push them to change products through a suitable distribution channel

UK/Netherlands

- “No commission” structure; can be complimented with further automated/simple methods
- Drawdown products in retirement – choice and flexibility for retirees

Brazil

- Allow products to change with household income; e.g. insuring part of a car


Africa

- HIV market? What do they do here?


Other suggestions

- **Mandatory product / policy review:** Set max term on all policies to ensure they are reviewed and remain appropriate
- **EIOPA:** Offer various ways of presenting expenses and risk which encourage consistency and a pan-European solution
- **Technology:** Innovative apps/systems to help people understand their products; increase number of contact points
- **Big data:** possibly machine learning/big data analytics to notify when a customer should change their products

4 Ongoing assessment – key considerations



Regular performance review	<ul style="list-style-type: none">• Check product continues to meet target market needs• Check performance vs initial illustration• Check performance against worst case scenario
Regular communication	<ul style="list-style-type: none">• Change in product risk / return profile relative to initial illustration• Exit charges, expected returns over the remaining term• Remind customers what was the original need the product was sold for
Post sale analysis	<ul style="list-style-type: none">• Complaints, claim, surrender data by category / reason• Sales data relative to the characteristics of the target market the product was designed for• Customer satisfaction surveys

 Flexible product design is needed to ensure ongoing alignment to client needs

Agenda

1. Objectives and background
2. Scoping topics
3. Implications

1 Impact and Possible Actions of Regulation

Easier to compare products

Demonstrate propositions' value

Transparent remuneration

More disclosure requirements

Clearly defined responsibilities

Product design • Differentiate via services and propositions

Steering

- Restrict business steering via commissions
- Back to direct selling model – own sales force – to ensure full control of distribution

Compensation • Move from commissions to fees

Transparent fees means that simple, commodity-like products appear relatively more expensive resulting in a 2 tier market:

Mass market

- Simple, standardised products
- Self-administration on online platforms
- Automation, standardisation, processes are key

HNWI market

- High value, complex products and propositions
- Advice is still needed
- Services are key

Unintended consequence: Potential gap in the market not served by advice

Voting question



Should the state step in to correct the market failure regarding the availability of advice ?

1. Carry on as before
2. Government authorised products
3. Sponsored advice centres
4. Dedicated website to improve education

2 Customer understands risks and outcomes – implications

Product risk rating	<ul style="list-style-type: none">• Risk rate products, assess customer risk profile and automatically match• Actuarial profession can play a role in defining the methodology• Companies would risk rate their products and disclose the rating at PoS• Regulator / professional body provides the oversight
Illustration systems	<ul style="list-style-type: none">• Key is to facilitate understanding of risk / return profiles, variability and uncertainty of outcomes• Should customers be enabled to choose scenarios / provide input?• Define and illustrate worst case scenarios• Take customers through the “what could go wrong / in what circumstances will this prove a bad decision” scenario• Develop value-for-money KPIs
Product design	<ul style="list-style-type: none">• Try to mitigate large negative outcomes, e.g. use out-of-money options• Simple and transparent charges, focus on propositions to “rescue” some products (e.g. UL vs Asset Management products)



Recommendation: independent risk-rating of products

Voting question



What approach for product and customer risks do you prefer?

1. Restricted choice: can only choose products with risk level lower than customer risk profile
2. Informed free choice: information on best risk matching, customer free to choose
3. No risk rating needed

Voting question



Which approach for product risk rating do you prefer?

1. Firms define own methodology within principles set by regulator
2. The regulator defines the methodology with input from the Profession
3. No risk rating needed, only illustrate the variability of potential outcomes

3 Needs based selling (NBS) – implications

Product development	<ul style="list-style-type: none"> Start from target market's needs (not from products we like to design) Generic needs (e.g. protection, retirement) vs needs of niche markets (e.g. coverage for impaired lives)
Product design: features and flexibility	<ul style="list-style-type: none"> Simplify design – focus on how basic benefits serve the needs Flexibility to adapt to evolving needs Granularity – generic market vs niches
Commissions and remuneration	<ul style="list-style-type: none"> Ensure distributors actively identify and adequately match customer needs Commission steering not suitable / allowed. Would fee based sales solve the issue?
Innovation	<ul style="list-style-type: none"> Simple, standardised benefits vs targeting continuously evolving needs of niches
Optimal product choice	<ul style="list-style-type: none"> Should decline to offer a product when this is not the best match in the in the market for a particular need? E.g. insurer does not offer impaired annuities, but these would be the best option for a customer in poor health



“What needs does this product meet? How flexible it is to meet future needs?” should be the top line of any product development and sales capture

4 Ongoing assessment – implications (1)

Responsibility for the regular reviews and actions

Option 1: Company / distributor

- E.g. US brokers required to annually check the product suitability for VA, update client risk profiles, investment objectives, review existing investments against the updated client objectives

Option 2: Customer

- E.g. self administration, very flexible products that allow the customer to change pieces at will online
- E.g. Short-term products with mandatory renewal from customer's side

Product design

- Avoid one-off irreversible decisions, e.g. buy a lifetime annuity on retirement, exit charges
- Flexibility, but avoid overly complex products
- Modularity – supply building blocks targeted at specific needs plus innovative platforms to (re)combine these in real time

- Short term renewable products
- Cross-subsidisation between different generations of policyholders (e.g. use in-force profits to offer better terms for the new customers)
- Cost of flexibility / regular reviews – are the customer prepared to pay?



One-off irreversible decision to buy a product should be avoided

4 Ongoing assessment – implications (2)

Ongoing communication to customer / distributor

- Annual touchpoint to encourage customers to assess if product is still suitable
 - E.g. pre-filled anniversary letter to capture already known customer information
 - Plus recommendations such as “if your personal / family / health / working / income / wealth status has change significantly, please contact ...”)
- Customers are encouraged to switch / shop around – impact on profitability



Annual touchpoint: circumstances captured in annual statement with hotline touchpoint in case of changes

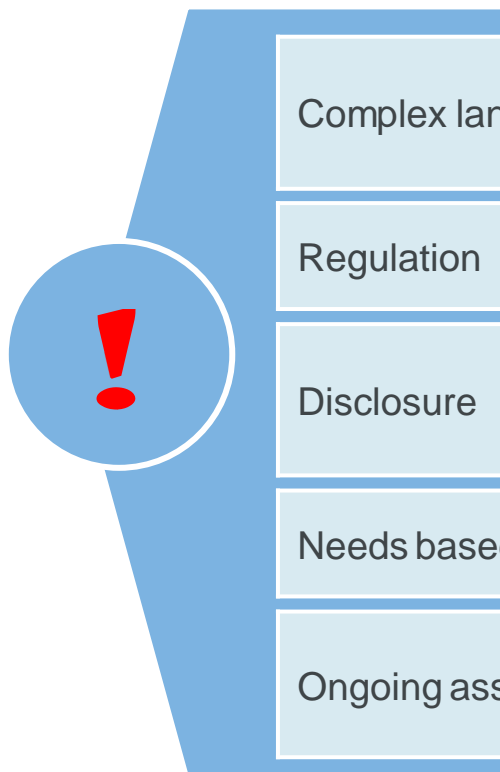
Voting question



Who should be responsible for the ongoing assessment of product suitability?

1. Customer
2. Company
3. Shared burden (annual touchpoint, customer decide)

Conclusions



Complex landscape	<ul style="list-style-type: none">• Need to consider all stakeholders involved• Be prepared to adapt to an intricate and rapidly changing regulatory landscape
Regulation	<ul style="list-style-type: none">• Unintended consequences: different products for mass and HNWI markets and potential gap in the market not served by advice
Disclosure	<ul style="list-style-type: none">• Product risk rating and better match to customer risk profile can help improve outcomes and manage expectations• Ensure customer understands “what could go wrong”
Needs based selling	<ul style="list-style-type: none">• Reconsider the way we design products and propositions: start from target market and customer needs
Ongoing assessment	<ul style="list-style-type: none">• Avoid as much as possible one-off irreversible decisions• Increase number of touchpoints with customers to ensure products remain appropriate



Questions



Comments

The views expressed in this presentation are those of invited contributors and not necessarily those of the IFoA. The IFoA do not endorse any of the views stated, nor any claims or representations made in this [publication/presentation] and accept no responsibility or liability to any person for loss or damage suffered as a consequence of their placing reliance upon any view, claim or representation made in this presentation.

The information and expressions of opinion contained in this publication are not intended to be a comprehensive study, nor to provide actuarial advice or advice of any nature and should not be treated as a substitute for specific advice concerning individual situations. On no account may any part of this presentation be reproduced without the written permission of the IFoA.