



**IAIS**

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INTERNATIONAL ASSOCIATION OF  
INSURANCE SUPERVISORS

**APPLICATION PAPER ON  
APPROACHES TO CONDUCT OF BUSINESS  
SUPERVISION**

**OCTOBER 2014**

## **About the IAIS**

The International Association of Insurance Supervisors (IAIS) is a voluntary membership organisation of insurance supervisors and regulators from more than 200 jurisdictions in nearly 140 countries. The mission of the IAIS is to promote effective and globally consistent supervision of the insurance industry in order to develop and maintain fair, safe and stable insurance markets for the benefit and protection of policyholders and to contribute to global financial stability.

Established in 1994, the IAIS is the international standard setting body responsible for developing principles, standards and other supporting material for the supervision of the insurance sector and assisting in their implementation. The IAIS also provides a forum for Members to share their experiences and understanding of insurance supervision and insurance markets. In addition to active participation of its Members, the IAIS benefits from input in select IAIS activities from Observers representing international institutions, professional associations and insurance and reinsurance companies, as well as consultants and other professionals.

The IAIS coordinates its work with other international financial policymakers and associations of supervisors or regulators, and assists in shaping financial systems globally. In particular, the IAIS is a member of the Financial Stability Board (FSB), founding member and co-parent of the Joint Forum, along with the Basel Committee on Banking Supervision (BCBS) and the International Organization of Securities Commissions (IOSCO), member of the Standards Advisory Council of the International Accounting Standards Board (IASB), and partner in the Access to Insurance Initiative (A2ii). In recognition of its collective expertise, the IAIS also is routinely called upon by the G20 leaders and other international standard setting bodies for input on insurance issues as well as on issues related to the regulation and supervision of the global financial sector.

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Application Papers provide additional material related to one or more Insurance Core Principles, including actual examples or case studies that help practical application of supervisory material. Application Papers could be provided in circumstances where the practical application of principles and standards may vary or where their interpretation and implementation may pose challenges. Application Papers can provide further advice or recommendations to supervisors on how supervisory material may be implemented.

This paper was prepared by the Market Conduct Working Group in consultation with IAIS Members and Observers.

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## Application paper on approaches to conduct of business supervision

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## **1. Introduction**

### **1.1. Background and purpose**

1. The IAIS Insurance Core Principles (ICPs) recognise the insurance regulatory and supervisory system's dual purposes of protecting policyholder interests and contributing to the stability of the financial system<sup>1</sup>. Historically, insurance supervisors sought to protect policyholder interests mainly by focusing on the financial soundness of individual insurers and, in more recent times, extending this focus to the financial soundness of insurance groups and conglomerates. Although it has also long been recognised that supervisory systems should also protect consumers from unfair or abusive business practices, this has typically been regarded as secondary to maintaining financial soundness.

2. The global financial crisis highlighted the importance of not only monitoring threats to individual institutions or groups, but actively monitoring risks to the stability of the financial system as a whole. The crisis demonstrated that systemic risks can arise not only through failings in individual institutions' and groups' financial and capital management, but also in poor conduct of business (COB) practices. The indiscriminate marketing and poorly targeted sales of sub-prime mortgage products is a well-documented example of how COB failings can contribute to systemic financial instability.

3. The crisis and its aftermath have highlighted the need for financial services consumers to have trust in the financial sector. This trust entails both confidence in the soundness of institutions, and confidence that institutions will act in their customers' best interests and treat them fairly. Accordingly, financial sector policy makers recognised the need to ensure that regulatory and supervisory frameworks adequately address both prudential and COB risks. This includes risks inherent in the sectors and institutions they supervise, and the inter-relationships between these risks.

4. Poor COB practices and unfair treatment of policyholders have major implications for individuals, but these can also be indicators of underlying financial issues within an insurer. Supervisors must have tools to detect as soon as possible any COB risks that could negatively impact individual policyholders, insurers and, potentially, the financial system as a whole.

5. Against this background, in 2012 the IAIS revised ICP 9 (Supervisory review and reporting) highlighting the need for insurance supervisors to focus on COB and policyholder protection, in addition to prudential and financial soundness issues.

6. This Application Paper documents ideas on the scope of, and approaches to, COB supervision that IAIS members may wish to consider when implementing the related components of ICP 9, as well as supervising compliance with the requirements of ICP 19 (Conduct of business), and incorporating them into their broader supervisory frameworks.

### **1.2. IAIS survey on approaches to COB supervision**

7. In preparation for the drafting of this paper, the IAIS Market Conduct Subcommittee (MCSC) surveyed IAIS Members in 2013 ("the COB survey"), asking questions relating to their jurisdiction's framework. Forty-four IAIS Member authorities participated in the survey. Among them 39 authorities are responsible for both prudential and COB supervision, and 5 for prudential supervision only. The survey covered:

- supervisors' mandates
- cooperation between prudential and COB supervisors
- supervisory review and reporting on COB matters

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<sup>1</sup> See the introductory paragraph to the ICP's.

- supervisory powers and information sources
- general approaches to COB supervision.

8. Various examples of COB supervisory approaches discussed in this paper are drawn from the survey responses. Relevant aspects of survey responses are highlighted or summarised in text boxes headed “*COB survey responses*”.

### **1.3. Structure of this application paper**

9. This paper is structured as follows:

- Section 2 discusses different approaches to defining and determining the scope of a supervisor’s COB mandate. It also discusses how certain jurisdiction-specific context and conditions influence the COB supervisory approach.
- Section 3 follows the sequence of ICP 9. Subsections 3.1 to 3.7 discuss each of the ICP 9 standards and their supporting guidance from the perspective of COB supervision.
- Section 4 elaborates on possible approaches to off-site monitoring and on-site inspection from a COB perspective. These are discussed with reference to supervising the fair treatment of customers at various stages of the insurance product life cycle, as contemplated in ICP 19. In presenting the approaches, Section 4 distinguishes between (i) specific requirements that may be set by the supervisor; (ii) the governance processes within insurers that supervisors may monitor to determine whether these supervisory requirements are being met; and (iii) specific insurer activities that supervisors may monitor in determining whether the supervisory requirements are being met.
- Section 5 discusses some additional potential COB supervisory tools and approaches that some jurisdictions have adopted, which may also be of interest to jurisdictions developing or reviewing their approach to COB supervision.
- Annex I contains references to other international standards and jurisdiction-specific material applicable to COB supervision.

## 2. Approaches to the COB supervision mandate

### 2.1. Defining and scoping “COB supervision”

10. Approaches to COB supervision differ by jurisdiction, as reflected in their insurance supervisory frameworks and their broader financial sector supervisory frameworks. Jurisdictions may not use the term “COB”, or where they do use the term, they may define or interpret it in different ways. Nevertheless, typically the supervisory authority will – either explicitly or implicitly – be required to supervise the manner in which insurers conduct their business in relation to policyholders.

11. The introductory guidance to ICP 19<sup>2</sup> describes conduct of insurance business as “primarily concerned with the fair treatment of customers”, and it is in this sense that the term “COB” will be discussed in this paper.

#### **COB survey responses**

*Respondents were asked whether their authority has a COB supervision mandate, and if so, whether and how this mandate is defined and addressed in legislation.*

Responses indicated varying degrees to which COB supervision mandates are explicitly addressed, with most describing the COB supervision mandate with reference to the supervisor’s overall enabling or founding legislation. In a number of cases, the COB supervision mandate appears not to be explicitly set out, but is implicit in the sense that the legislation governing insurers sets out certain COB obligations for insurers themselves, and the supervisor is in turn mandated to supervise compliance with those obligations.

Examples of more explicit COB mandates or definitions from the survey responses include:

- A mandate to supervise elements described as “business practices”; “recognised principles of orderly business activities”; “fair treatment of customers”; “sound commercial practices”; “fair dealing”; “responsible, diligent and respectful management of the interests of clients”; “business-to-consumer commercial practices”; and similar terms.
- Mandates entailing supervision of adherence to specific documented business standards, good practices or codes of conduct, and/or prohibitions of specific documented instances of poor practice or unfair treatment.
- Mandates requiring supervisors to actively monitor and intervene in cases of abuse or improper, detrimental or unfair conduct.
- General mandates referring explicitly to policyholder or consumer protection as the supervisor’s responsibility.
- “Twin Peaks<sup>3</sup>” models of financial supervision where the market conduct “peak” has an explicit COB supervision mandate.
- The supervisor’s mandate including an obligation to supervise compliance with a general, overarching consumer protection law, over and above supervising compliance with specific insurance/financial services specific COB laws.

### 2.2. Specific factors to consider in defining and scoping the COB mandate

12. Jurisdictions need to consider how broad a mandate it should give the supervisory authority with respect to COB. For example, it could include:

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<sup>2</sup> See ICP 19.0.6.

<sup>3</sup> The term “Twin Peaks” is used to describe supervisory models where prudential supervision and market conduct or COB supervision are allocated to separate authorities.

- broader “market conduct” supervision
- consumer education and/or financial literacy
- financial inclusion
- promotion of competition
- combating financial crime
- independent dispute resolution.

Each of these is discussed below.

### **2.2.1 Is COB supervision a sub-component of a broader “market conduct” mandate?**

13. In some cases, the term “market conduct supervision” is used interchangeably with “COB supervision”. In these cases, both the supervision of COB (in the “customer treatment” sense) and the supervision of market efficiency and integrity are seen as sub-components of a broader “market conduct” mandate.

14. Other jurisdictions consider “market conduct supervision” to be separate - focussed on market efficiency and integrity through supervising issues such as disclosures to the financial markets, financial market infrastructures (e.g. securities or other exchanges), insider trading and market abuse, and related activities.

15. Regardless, the approach should reflect the scope and objectives of the supervisor’s COB mandate. Where different supervisors are responsible for COB and market efficiency/integrity supervision, it is important to ensure that the responsibilities are appropriately delineated and coordinated. Where the supervisor supervises both dimensions, the framework should be structured to ensure each component enjoys appropriate priority.

#### **COB survey responses**

*Respondents were asked whether their COB supervision mandate extended to supervising market efficiency and integrity (for example the supervision of disclosures to the financial market, trades on securities exchanges, monitoring of insider trading and market abuse, etc.).*

Approximately half the survey respondents answered “Yes”, in most cases because the insurance supervisor forms part of an agency that is also responsible for the supervision of financial markets infrastructures (such as securities exchanges and clearing and settlement facilities). Those respondents who answered “No” to the question typically indicated that the supervision of financial markets infrastructures falls under a separate agency or, even where it fell under the same agency, regarded this as a separate mandate from the COB mandate.

In some cases, it appears from survey responses that, although the insurance COB supervisor is not necessarily also the supervisor of financial markets infrastructures, the COB supervisor sees its mandate as including the market efficiency and integrity of insurers through supervising market disclosures by insurers and/or through its overall supervision of insurers’ risk management processes.

### **2.2.2 Does the COB mandate include responsibility for consumer education and/or financial literacy?**

16. A key objective of COB supervision is to protect consumers from potential abuse arising from the asymmetry of information between consumers and financial institutions. In jurisdictions where consumers have low financial literacy levels, the risk of such abuse is exacerbated.

17. ICP 19.13.4 provides guidance on how the supervisor should promote consumers' understanding of insurance contracts. It sets out steps consumers can take to protect themselves and make informed decisions.

18. A number of jurisdictions confer a financial literacy mandate on the insurance supervisor to complement its COB mandate. The supervisor may be explicitly tasked with developing and implementing consumer education and financial literacy programmes, or may be indirectly required to support broader sectoral or jurisdictional strategies in this regard.

19. In a number of cases, agencies adopt multiple approaches to consumer education, including developing and disseminating their own materials and programmes, sometimes in partnership with other stakeholders.

### **COB Survey Responses**

*Respondents were asked whether their COB mandate includes responsibility for consumer education and/or financial literacy. They were also asked whether they believe that supervisors should play a role in financial education and what their authority is currently doing or planning in this regard.*

Approximately half the survey respondents indicated that they do have a consumer education and/or financial literacy mandate, although the mandate is expressed in different ways. Examples of how such mandates are fulfilled include:

- operating dedicated financial consumer education services such as dedicated websites
- establishing a dedicated consumer education department/function within the agency
- making consumer education material available on the agency's normal website
- supporting and participating in broader financial literacy strategies and joint consumer education initiatives with the financial services industry and/or consumer representative bodies
- arranging targeted financial consumer education campaigns on specific consumer risks or for classes of vulnerable consumers
- designing financial education programmes aimed at school pupils, university students and/or teachers, typically together with the formal education authorities and in some cases including academic prizes or bursary offerings
- including a focus on the financial education of intermediaries.

Different approaches to the funding of the consumer education/financial literacy mandate, where applicable, are used. These include requiring the supervisor to budget for such programmes through its normal sources of funds; explicit fiscal grants; a requirement to allocate some or all income from administrative fines to consumer education funding; the power to charge regulated institutions a specific consumer education levy; or approaching industry or other donors for voluntary contributions. In some cases the supervisor operates or supports dedicated financial consumer education funds/trusts/similar structures to finance financial consumer education initiatives.

Where respondents stated that they do not have a consumer education/financial literacy mandate, this was in some cases due to the existence of a separate authority being responsible for financial consumer education in the jurisdiction. A number of respondents indicated that, even where they have no explicit consumer education mandate, they carry out some consumer education activities nonetheless.

### **2.2.3 Does the COB mandate include responsibility for financial inclusion?**

20. Some COB supervisory mandates include a level of responsibility for ensuring increased access to insurance products or services for consumers. This mandate is sometimes related to the consumer education and financial literacy responsibility. The supervisor's role may be set out in an explicit mandate, or may be less direct requiring the supervisor to support broader financial inclusion policy objectives.

21. Without compromising the level of protection provided to consumers, supporting financial inclusion could include:

- taking steps to enhance inclusion (for example creating micro-insurance products and frameworks, or even setting specific inclusion targets)
- ensuring that supervisory and regulatory frameworks do not present barriers to inclusion (for example creating customised, less burdensome licensing and supervisory frameworks for insurers and intermediaries operating in markets focussed on inclusion)
- allowing sufficient flexibility for the use of innovative approaches in the provision of financial services.

### **COB Survey responses**

*Respondents were asked whether their COB mandate includes responsibility for financial inclusion.*

Only a minority of respondents indicated that they have an explicit financial inclusion mandate, albeit expressed in different ways. In a number of these cases, the financial inclusion activities were closely aligned with the consumer education mandates and initiatives discussed above. In some cases, financial inclusion was seen as being achieved through measures to prevent discriminatory or exclusionary underwriting practices. Some jurisdictions indicated that a dedicated micro-insurance policy was in place to address inclusion objectives.

Cases where this question was answered "No" were supported by explanations that the jurisdiction is primarily a wholesale market, or that access to insurance is already at a high level in the jurisdiction so there is less need for a specific inclusion objective. Some respondents indicated that, although they have no explicit consumer education mandate, the agency promotes inclusive practices nonetheless, while others indicated that explicit financial inclusion objectives are to be implemented shortly.

#### **2.2.4 Does the COB mandate include promotion of competition in the industry?**

22. COB approaches vary from conferring an explicit mandate on the supervisor to promote competition (i.e. on price and quality that benefits consumers), to requiring the supervisor to have due regard to competition.

23. Supervisors may need to find a balance between conduct supervisory and regulatory requirements and competition that promotes consumer protection objectives. For example, an insurance supervisor, who has the authority to approve product structures or to prescribe product features, needs to balance this authority against the risk of stifling innovation and competition. Where the supervisor has the authority to prescribe standardised product disclosures (such as standardised "key information" templates), care may need to be taken to ensure that the level of standardisation is aimed at improving comparability for consumers (a pro-competitive aim), without unduly dictating product design.

24. Where a separate authority is responsible for competition regulation, the insurance COB supervisor should ensure that effective coordination mechanisms are in place to align policy priorities.

### **COB Survey responses**

*Respondents were asked whether their COB mandate includes promotion of competition in the industry.*

Responses to this survey question were fairly evenly split, although the concept of a competition mandate was evidently interpreted in different ways. “Yes” responses included examples of explicit mandates to promote competition; cases where the primary competition mandate is held by a separate agency, but the insurance supervisor also sees its mandate in relation to financial markets efficiency and integrity and/or fair practices generally as including a competition related responsibility; cases where the authority sees its role in enabling foreign entrants into the industry as promoting competition; and cases where the authority indicated that the fact that insurers are largely free to design products, policy conditions and set charges without material regulatory intervention is supportive of competition.

Where the question was answered in the negative, this was mainly based on the existence of a separate competition authority in the jurisdiction. In one case, although the supervisor does not have an explicit competition mandate, the supervisor is obliged to take into consideration, as a guiding principle, the “desirability of minimising the adverse effects of [the supervisor’s] activities on competition in the financial services sector.”

### **2.2.5 What is the COB supervisor’s responsibility in relation to combating financial crime?**

25. ICPs 21 and 22 deal with the insurance supervisor’s responsibilities in relation to countering insurance fraud and to combating money laundering and terrorist financing.

26. Requirements and other measures that seek to combat financial crime (such as insurance fraud) can sometimes impact the fair treatment of policyholders. For example, requiring insurers to have effective processes in place to detect and avoid fraudulent claims, could potentially conflict with the requirement that insurers have policies in place to handle claims in a timely and fair manner.<sup>4</sup> Similarly, rigorous AML/CFT control processes could be seen as unreasonable or unfair restrictions on entering into or servicing policies, or as potential barriers to financial inclusion. The COB supervisor needs to balance its objectives in relation to combating financial crime and promoting fair treatment, for example through ensuring that appropriate and sufficiently rigorous procedures are in place to meet both objectives as well as the applicable legal requirements.

27. Mitigating crime has both a prudential and COB supervision component. Where COB and prudential supervision are carried out by separate authorities, the roles and responsibilities of each authority should be clear.

#### **COB Survey responses**

*Respondents were asked what the COB supervisor’s responsibility is in relation to combating financial crime.*

The majority of respondents indicated that they do have an AML/CFT supervision mandate. Examples of how this mandate is structured include an explicit mandate held directly by the COB supervisor concerned; cases where the primary AML/CFT mandate is held by a separate agency, but the insurance COB supervisor has an explicit responsibility to co-operate with and/or carry out AML/CFT supervision on behalf of that agency; cases where AML/CFT supervision is conducted by a specific division or unit within the supervisor; and cases where in addition to its own AML/CFT activities, the supervisor oversees indirect supervision by self-regulatory organisations.

Where the question was answered in the negative, this was mainly based on the existence of a separate AML/CFT supervision authority in the jurisdiction. However, some of these

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<sup>4</sup> See ICP 19.9.

respondents indicated that they nevertheless have an obligation to co-operate with or report AML/CFT issues to the relevant separate authority.

Examples approaches to combating financial crime, over and above AML/CFT measures, included defining claims fraud as a specific crime; reviewing insurer controls in this regard as a specific on-site focus area; and issuing guidance to the industry on managing financial crime risk.

## **2.2.6 What is the COB supervisor’s responsibility in relation to independent dispute resolution or redress mechanisms?**

28. The guidance in ICP 19<sup>5</sup> includes recommendations for effective dispute resolution mechanisms.

29. Different jurisdictions use different approaches to the scope and establishment of “independent” (or “alternative”) dispute resolution (IDR) mechanisms, and in doing so aim to ensure that the objectives and practice of the IDR align with those of the regulatory framework. For example, jurisdictions can differ in:

- structure and number of IDR mechanisms
- methods they consider most effective to ensure accessibility of the IDR structure
- ways they ensure independence of the IDR structure (including, for example, whether it is government or industry funded, and the process used to appoint its officials)
- extent to which they use purely legal/contractual approaches to resolving disputes rather than an equity or fairness-based approach that may go beyond the strict terms of the contract and take into account the broader circumstances
- extent to which their decisions are binding and/or subject to appeal or review, and by which parties
- relationship between the IDR structures and the formal legal system
- types of disputes and parties over which IDR structures have jurisdiction
- types of resolution and redress they are empowered to grant.

30. Legal structures of IDR mechanisms vary. Options include:

- one or more IDR structure(s) created by statute
- structures created voluntarily by industry but subject to supervisory standards and oversight
- wholly voluntary structures.

31. In some jurisdictions, in order to be licensed, insurers or other entities must subscribe to a recognised IDR structure. Jurisdictions may favour:

- having a single IDR structure for consumer matters generally
- having a single structure for all financial services disputes, or
- having different IDR structures for different industry sub-sectors or product types.

32. Usually supervisors do not take the role of adjudicating or arbitrating disputes, but they may monitor and analyse relevant data and take this into account in assessing conduct risks and determining their supervisory approach.

33. Supervisors may create, or recommend the creation of, IDR channels, such as:

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<sup>5</sup> See ICP 19.10.7 to 19.10.9.

- ombudsman
- arbitration
- conciliation
- other quasi-judicial approaches.

### **COB Survey responses**

*Respondents were asked what the COB supervisor's responsibility is in relation to independent dispute resolution or redress mechanisms.*

Although more than half of the respondents stated that they do have responsibilities in this regard, the responses indicated a broad range of approaches. Examples from supervisors surveyed are as follows:

- licensed entities are required to be members of an IDR scheme, as a condition of licensing
- the supervisor itself operates and/or supervises the IDR scheme
- the supervisor acts as secretariat for an independent body tasked with the recognition and oversight of industry-based IDR schemes
- the supervisor requires insurers to maintain their own dispute resolution policies and processes, often subject to standards prescribed by the supervisor, and the supervisor monitors adherence to such policies and processes
- the supervisor itself carries out a mediation/conciliation function in relation to disputes
- the supervisor is empowered to order insurers to compensate consumers (among other remedies) in cases of breach of consumer protection obligations.

Where supervisors replied that they do not have a mandate in relation to alternative dispute resolution or redress, this was in some cases due to the existence of a separate alternative dispute resolution framework, not linked to the COB supervisor. Some respondents indicated that, although no dispute resolution mandate exists, the supervisor does from time to time mediate in resolving disputes.

### **2.3. Monitoring COB risks**

34. In accordance with ICP 9.3, the supervisory framework should provide the supervisor with a holistic view of all risks to which the insurer is exposed, as well as risks which are posed by the insurer. This includes COB risks.

35. COB risks require focus not only on risks to which the insurer itself is exposed, but also risks to which the insurer's conduct exposes its customers. COB supervisors need to use risk indicators that are different from, or additional to, those relied on for prudential supervision. For example, COB supervisors need to consider the extent to which the risk management frameworks and risk categorisation tools used by insurers are effective in identifying COB risks.

36. As COB risks may not constitute immediate or direct threats to the insurer's sustainability or soundness, and, consequently, may draw the attention of COB supervisors but not that of prudential supervisors, there is a need for COB and prudential supervisors to communicate and collaborate. While there should not be a conflict between managing COB risks and financial soundness/prudential risks, there may be, in the short or medium term, trade-offs in managing these two types of risks.

37. Material and persistent failure to manage COB risks can increase an insurer's exposure to reputational, legal and regulatory risks<sup>6</sup> and ultimately threaten an insurer's soundness and sustainability. As mentioned above, failure to manage COB risks may create systemic risk. Also, systematic, or market-wide, risks can threaten the reputation of the broader insurance market and financial system. In this regard, COB risks and consideration of their potential financial impact require close communication and cooperation between conduct and prudential supervisors.

38. Different "lines of defence" may exist to identify, manage and mitigate COB risks. These "lines of defence" usually comprise a range of governance structures and people in risk management roles, operating at different levels both within the insurer and externally. The COB supervisor should consider the range of "lines of defence" and the inter-relationships between them, when assessing the risk exposure of an insurer.

39. Structures that play a role in this regard include:<sup>7</sup>

- the insurer's Board and Senior Management, supported by its internal governance structures<sup>8</sup>
- external governance structures of the insurer, such as external auditors<sup>9</sup>
- industry and professional bodies (e.g. industry associations, self-regulatory organisations, and professional standards bodies<sup>10</sup> for accountants, auditors, actuaries, and compliance officers)
- the supervisor or other supervisors with jurisdiction over the entity concerned
- ombudsmen or other dispute resolution schemes<sup>11</sup>
- international standard-setting bodies including, but not limited to, the IAIS.

### **COB Survey responses**

As part of the response to a more general question regarding recent and pending changes in their approach to COB supervision, a number of supervisors mentioned an increased focus on risk-based supervision and enhanced requirements in relation to corporate governance and risk management frameworks for insurers.

### **2.4. Jurisdiction specific context and conditions**

40. As noted in ICP 19, COB, including business practices, is closely linked with a jurisdiction's tradition, culture, legal regime and the degree of development of the insurance sector. For this reason, regulatory and supervisory approaches to COB tend to vary.<sup>12</sup>

41. The extent to which COB supervisors protect individual customers may be influenced by the availability of consumer recourse mechanisms. Some of the consumer support structures set out in sections 2.4.1 to 2.4.4 below will be more prevalent in developed insurance markets than in emerging markets. Where no, or only some, consumer support structures exist, or where they are not well developed, particularly where consumers' level of

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6 Risk of breach of regulation resulting in regulatory action.

7 See also various references in 9.4 and 9.8 to governance and risk structures

8 See also ICP7

9 See also ICP7

10 See also references in ICP18

11 See also ICP18

12 ICP 19.0.2

financial education is also low, a jurisdiction may place greater responsibility on the supervisor to protect individual rights of consumers and/or provide financial education.

42. Conversely, if consumers' financial education is high and they have access to all or many of the support structures mentioned, the need for additional supervisory intervention may be correspondingly lower. This is not to say, however, that supervisors in such jurisdictions should not remain vigilant to the risks of financial information asymmetry. Even relatively well educated consumers may nevertheless be at a knowledge and bargaining disadvantage in relation to the more technical aspects of financial products. In these jurisdictions, the supervisor may take a "collective" approach to consumer protection. This means that the supervisor will not usually become involved in conduct related incidents affecting individual policyholders, but rather monitors insurer compliance with laws and other supervisory requirements which protect and ensure fair outcomes for policyholders collectively.

43. Even in jurisdictions where the consumer support structures are relatively advanced, COB supervision is still required, but the approach may be tailored taking these additional support structures into account.

44. Elements of a jurisdiction's tradition, culture, and legal regime that support consumers and are therefore likely to influence the approach to COB supervision include:

- the level of consumers' financial education
- the role of consumer protection associations
- the role of industry associations
- the role and accessibility of the court system.

#### **2.4.1 Level of consumer financial education**

45. The supervisory approach necessary to encourage appropriate COB practices and fair customer outcomes varies considerably depending on the level of financial education. In jurisdictions or sectors where consumers have high financial education standards, the approach to COB supervision could allow the supervisor to place less emphasis on specific consumer protection measures. This approach would be less suitable where a high proportion of consumers are vulnerable to abuse because of low financial, or even general, literacy levels and in such cases a more intensive focus on specific COB practices could be appropriate.

#### **2.4.2 Role of consumer protection associations and other emerging players**

46. In some jurisdictions, strong consumer protection associations exist. Such institutions can play a valuable consumer protection role by, for example:

- reviewing and comparing the quality of insurance products and contracts
- carrying out mystery shopping<sup>13</sup>
- offering training and educational services on consumer topics
- generally challenging insurers who are seen to treat consumers unfairly.

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<sup>13</sup> The supervisor may consider gathering information directly from insurers by using representatives or appointees (which may include individuals engaged by a consumer protection association or a market research firm) to approach insurers, their agents or their appointed representatives in the role of potential retail consumers. This is known as "mystery shopping". Supervisors use mystery shopping to help protect consumers by seeking information about a particular practice across a range of insurers, or the practices of a particular insurer. One risk consumers face is being sold inappropriate financial products, and it can be very difficult to establish what the insurer said to the "genuine" consumer in the sales discussions. By recording what the insurer says in discussions with a "mystery shopper", however, the supervisor can establish the insurer's normal practices in a way which would not be possible by other means.

47. Typically, these associations ensure that their materials and views are publicised and accessible to consumers. Some jurisdictional legislative frameworks permit them to sue insurers in model cases or “class actions” on behalf of customers or groups of customers.

48. With the expanding role of the internet, other players have emerged that, while not identifying themselves as consumer protection associations, can be helpful in providing the consumer with comparative information on-line. They compare the insurance providers and insurance products available in the marketplace. Particularly when these services are insurer or product neutral and independent, website platforms can complement information available from other sources, thus helping the consumer make a more informed decision on price, product features, and disclosures.<sup>14</sup> Whilst comparison websites may provide helpful information to consumers, COB supervisors should be mindful of whether such websites may take on an intermediary function and therefore potentially require appropriate supervision.

### **2.4.3 Role of industry associations**

49. Effective and sufficiently representative industry associations can play a useful role in supporting the COB supervision objectives of the insurance supervisor. For example, in jurisdictions where product approval by the supervisor is not required, certain industry associations issue “model contracts”. These provide their members with guidance on fair and appropriate contractual terms.

50. Industry associations typically play a role in co-ordinating industry input into regulatory developments, keeping members informed of such developments and ensuring there is a shared understanding of the supervisor’s expectations. Sometimes they provide public information that is useful for consumers. Industry associations may also issue guidelines on specific COB matters that support their members.

51. In some jurisdictions industry associations provide insurers and policyholders with IDR options to resolve conflicts arising out of insurance transactions.

### **2.4.4 Role and accessibility of the court system**

52. Courts serve as a last resort for consumers when disputes with an insurer cannot be resolved elsewhere. This approach entails legal costs which may not be fully recoverable, even if the consumer wins. To improve accessibility to the court system, many jurisdictions provide legal aid if the consumer cannot afford the costs but has a reasonable case.

## **2.5. Principles-based vs. rules-based approaches to COB supervision**

53. As pointed out in ICP 19.2.3, balancing principles-based and rules-based supervisory approaches depends to a large degree on the jurisdiction’s legal framework and supervisory approach, as well as taking into account factors such as the protection needs of vulnerable consumers and benefits to consumers that arise through product innovation. While varying from jurisdiction to jurisdiction, most supervisory approaches use a spectrum of principles-based and rules-based provisions. In some cases, the approach is described as “outcomes-based”, with the supervisor determining the most appropriate mix of principles and rules to achieve the desired supervisory outcomes.

54. COB supervision, in particular, requires a considerable focus on principles, outcomes and governance frameworks over and above compliance with specific rules. This is because it encompasses:

- a broad range of insurer activities throughout the insurance product life cycle<sup>15</sup>

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14 See EIOPA report on comparison websites (as listed in annex I).

15 The structure of section 4 of this paper follows the product life cycle sequence of ICP 19.

- a broad range of insurer activities across the insurance value chain<sup>16</sup>
- assessment of the insurer’s customer treatment culture.

55. Factors that supervisors may consider in determining the optimal balance between rules-based and principles-based requirements, include the following:

- rules-based provisions support regulatory certainty and predictability, but can also result in insurers and supervisors adopting a “tick box” approach to ensuring compliance with specific rules rather than designing their business practices or supervisory frameworks to achieve broader or fairer outcomes. Rules-based provisions could be at risk of becoming outdated and no longer “fit for purpose” if market innovation occurs or new conduct risks emerge.
- Principles-based provisions allow greater flexibility for insurers to design business processes that suit their business models and strategies. They also allow greater flexibility for supervisors to tailor their supervisory approach to a range of business models. On the other hand, principles-based provisions may raise concerns that the supervisor’s expectations are unclear. Principles-based provisions provide greater scope for innovation in product and process design, and for regulatory and supervisory frameworks to respond to potential new risks from these innovations, without necessarily having to introduce new rules.

### **COB Survey responses**

*Respondents were asked whether they would describe their approach to COB requirements imposed on insurers as mainly rules-based, mainly principles-based, or a fairly balanced mix of rules-based and principles-based requirements.*

The largest proportion of responses indicated a fairly balanced mix, albeit with a considerable number of respondents indicating that their approach is mainly rules-based. Very few respondents indicated a mainly principles-based approach. Some respondents explained that the balance between rules and principles differed for different regulated activities. For example, one supervisor adopts a mainly rules-based approach to intermediary supervision but a more principles-based approach to insurers, while another adopts a rules-based approach to product design but a more principles-based approach to other phases of the product life cycle. Some survey respondents indicated that although their current approach is largely rules-based, they are in the process of shifting to a more principles-based approach.

### **2.6. Features of COB supervision**

56. Subject to the jurisdiction-specific context and supervisory approach, COB supervisory frameworks will typically include some or all of the following underlying features:

- comprehensive and consistent supervision
- intensive and intrusive supervision
- risk-based and proportional supervision
- pre-emptive and proactive supervision
- credible deterrence.

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<sup>16</sup> The insurance value chain includes the relationship between the insurer itself and the various parties and processes involved in providing and servicing the insurance product, such as reinsurers, investment or underwriting managers, other outsourced service providers, intermediaries, etc.

57. These features are inter-related, and in some cases the COB supervisor will need to find the right balance between them. For example, comprehensive and consistent supervision needs to be balanced against risk-based and proportional supervision to ensure that minimising the scope for arbitrage does not result in an inflexible “one size fits all” approach. Similarly, a remedial approach to mitigating risk through pre-emptive supervision should not compromise the application of credible deterrence where misconduct has occurred, or vice versa.

### **2.6.1 Comprehensive and consistent supervision**

58. The regulatory and supervisory framework should aim to close gaps in the coverage of COB activities of insurers and, where relevant, other entities forming part of the insurance value chain. The framework should also limit opportunities for regulatory arbitrage between insurers and other supervised financial entities.

59. The supervisory approach should also aim for consistent coverage and intensity, with due regard to relevant COB risks.<sup>17</sup>

60. In principles-based frameworks, principles for fair treatment of customers should apply to all relevant supervised entities. Similarly in rules-based frameworks, rules-based elements of the framework should be as consistent as possible across comparable activities.

### **2.6.2 Intensive and intrusive supervision**

61. To enable the supervisor to make fair and informed judgments regarding COB risks in a particular insurer, the COB supervisor will need a clear and deep insight into the insurer’s culture, governance structures, business model and business practices. This may require more intensive on-site inspection and off-site monitoring than would be the case if a “lighter touch” approach was adopted.

62. Once risks have been identified, the COB supervisor may require a more intrusive form of engagement with the insurer to rectify the situation and pre-empt consumer harm, or seek redress where harm has occurred.

### **2.6.3 Risk-based and proportional supervision**

63. As is emphasised throughout the ICPs,<sup>18</sup> the supervisor should conduct its activities taking into account:

- nature, scale and complexity of the insurer and its business model
- nature of the customer
- type of insurance provided
- potential risks posed to customers.

64. This is equally true of COB supervision and the assessment of COB risks. As a result, those insurers who satisfy the supervisor that they consistently treat customers fairly and comply with other COB obligations set out in ICP 19 will typically attract proportionally less supervisory scrutiny. Jurisdictions where the focus of insurance supervision has been primarily on prudential risks, will need to review the current risk-based models (used by the supervisor and/or insurers) to determine if they are appropriate for identifying and managing COB risks.<sup>19</sup>

## ***COB Survey responses***

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17 See also the ICP standard 2.5 which provides, inter alia, that the supervisor should apply regulatory requirements and supervisory procedures “consistently and equitably”.

18 See in particular paragraph 8 of the Introduction to the ICP’s and ICP standard 2.5.

19 See also section 2.3 above.

*Respondents were asked whether they would describe their approach to COB supervision as risk-based (i.e. taking into account the nature, scale and complexity of the risks posed by insurers and to which insurers may be exposed).*

Almost all survey respondents answered 'Yes' to this question, which is unsurprising given the risk-based emphasis of the ICPs and other international standards and best practices.

#### **2.6.4 Pre-emptive and proactive supervision**

65. Any supervisory framework has reactive elements, requiring the supervisor to respond to risks or events that have already crystallised. Preferably, however, the supervisor will identify COB risks early enough to intervene and prevent negative customer outcomes before material damage is done, or at least to mitigate further damage. The supervisor should develop processes to identify COB risks early, including by obtaining access to suitable insurer and third party information sources that will help identify emerging trends affecting financial consumers and insurers.

66. The ability to identify proactively potential COB issues with a view to pre-empting negative customer outcomes is an important goal of supervision. This proactive approach should cover emerging risks within specific insurers, as well as concerns at industry, market, or business model levels.

67. With a pre-emptive approach to supervision, the COB supervisor takes proactive steps, where appropriate. Where industry-wide COB risks are concerned, the supervisor's response should achieve a consistent, industry-wide change in conduct. Where COB risks are identified in specific insurers or groups, the supervisor would need to take pre-emptive action to prevent or minimise harm to the particular insurer's policyholders.<sup>20</sup>

68. The supervisor needs to strike a balance between corrective action and enforcement action, adopting a consistent approach in this regard (for example by dealing consistently with similar offences by different insurers).

69. Supervisors who take a proactive and pre-emptive approach to conduct risks increasingly need to make forward-looking judgements regarding the likelihood of conduct risks crystallising and the most effective supervisory response to pre-empt consumer prejudice. There are risks attached to this judgement-based supervisory approach. It requires supervisors to strike a careful balance between the need for certainty in the market and the need to use their discretion to address identified risks. The risk of a supervisor getting a prediction of potential future prejudice wrong is greater than the risk of incorrectly assessing the impact of prejudice that has already crystallised. However, the risk of a reactive approach is that it will often not be possible to secure adequate redress for customers that have already suffered harm once misconduct is proved. The benefits of proactive supervisory action are typically not visible to the market, so it can expose supervisors to criticisms of overreaction or inconsistency. On the other hand, a more visible but reactive approach exposes supervisors to accusations of lack of foresight and of having done "too little too late".

#### **COB Survey responses**

*Respondents were asked whether they would describe their approach to COB supervision as mainly proactive, mainly reactive, or a fairly balanced mix.*

The majority of survey respondents described their approach as "a fairly balanced mix", with a relatively small minority seeing themselves as mainly reactive and a still smaller group as mainly proactive.

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<sup>20</sup> See also ICP Standards 9.2.4, 9.3.3 and 9.7.1.

Various respondents cited the following as proactive supervisory tools: On-site inspections (including the process of prioritising these); examining the industry environment; testing concerns, issues and practices; product approval requirements; the process of developing rules and regulations; monitoring financial innovation, press releases and contracts; issuing regulatory guidance and recommendations; mystery shopping; data collection and analysis to identify potential trends; financial education.

The following were viewed as reactive tools: Responding to complaints or other intelligence; breach handling.

Some respondents pointed out that, although the approach is mainly reactive, the findings of a reactive supervisory intervention are used proactively to assess whether a similar problem could or has occurred. Some jurisdictions indicated that although their current approach is mainly reactive, they are in the process of moving to a more proactive approach.

### **2.6.5 Credible deterrence**

70. Effective COB supervision requires both insurers and consumers to have a high degree of confidence that the supervisor will detect and take meaningful action against misconduct and unfair consumer treatment. Supervisory frameworks will need to take into account jurisdiction specific rules in relation to enforcement powers and confidentiality. However, to have a deterrent effect (as opposed to merely a punitive effect), meaningful consequences of material misconduct should be visible to consumers and other industry participants.

### **2.7. Resourcing and capacity implications**

71. The legal authority with respect to COB needs to be clear and well understood by supervisory staff and market participants. Staff need to be properly trained and have appropriate levels of experience and seniority. COB supervision requires a different set of knowledge, skills and abilities to prudential supervision, including a strong understanding of:

- insurance law and regulations
- general consumer protection practices
- insurance business models, products and practices
- best practices and risks related to fair treatment of consumers.

72. Care should be taken to ensure that both on-site inspection and off-site monitoring programs are adequately resourced from a COB perspective and that COB supervision is given equal priority to other supervisory work.

73. Resourcing the COB supervisory function will depend on the approach taken. For example, an “intensive and intrusive” approach will require supervisory staff with significant insurance industry, product and business model knowledge, over and above legal and regulatory knowledge. A “pre-emptive and proactive” approach may require economic and market analysis skills to identify emerging industry-wide risks.

74. COB supervisors need the skills necessary to “follow the money”. They should not underestimate the level of quantitative financial expertise (such as actuarial, auditing, and accounting expertise) required. It is not only a skill set required by prudential supervision. In order to understand the drivers of culture and behaviour in organisations, it is important to understand drivers of profit and cost.

75. COB supervisors may wish to consider supplementary sources of expertise. Options include:

- expert “wise person” advisory panels

- partnerships with academics, economists, relevant non-governmental organisations, professional associations and the media
- the use of “think tanks”
- inviting expert input to discussion documents
- temporary secondments of relevant insurer staff to the supervisor or vice versa.

### **3. Aspects of COB supervision with reference to ICP 9**

#### **3.1. Risk-based supervisory framework<sup>21</sup>**

76. One of the key features of ICP 9 is the requirement that the supervisor should take a “risk-based approach to supervision”. From a COB supervision perspective, this means that the supervisor is required to have insight into COB risks and how they interact with other (particularly prudential) risks, in order to form a holistic view of the risks faced by and posed by insurers.

77. As with prudential supervision, COB supervision should be systematic, risk-based and proactive, and conducted within a documented framework. The framework should not be overly burdensome on the regulated industry and will usually employ a mix of tools.

78. In establishing a COB supervisory framework, supervisors need to recognise the full range and scale of COB risks, focusing particularly on risks to the fair treatment of customers at all stages of the insurance product life cycle. The indicators supervisors consider to determine these risks may therefore differ from those used to assess prudential or financial risks.

79. Supervisors, taking a risk-based approach, usually assess each insurer to determine its risk profile and/or allocate it to a risk category. The extent of supervision, the supervisory instruments used and the interaction between supervisor and insurers can then be determined based on the insurer’s risk profile or category.

80. Supervisors use different methodologies to ensure that their supervisory frameworks are proportionate to the nature, scale and complexity of the risks posed by insurers and of risks to which insurers may be exposed. Examples include:

- developing a set of risk categories (for example high risk, moderate risk, low risk) and allocating each insurer to a risk category
- developing a risk scorecard or “points” system and allocating a risk rating or “score” to each insurer
- combinations of the above

81. When assessing risk profiles and developing risk profiling methodologies, supervisors may consider COB risk factors such as size of market, customer base, insurance lines, ownership structure, and number of consumer complaints. For example, companies typically prioritised for more intensive COB supervision (for example more frequent on-site inspection or more detailed off-site reporting) may:

- have the greatest number of customers
- be involved in personal lines of business (versus commercial lines)
- be active in the small business market (versus commercial markets)
- have an unsophisticated or vulnerable customer base
- offer complex or high risk products
- be in a difficult financial position
- have products or business practices that the supervisor has previously identified as posing a risk to customers.<sup>22</sup>

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21 Other relevant ICP’s are ICP 8 and 9 (which discuss models and assessment), ICP 7 (governance) ICP 21 (fraud), ICP 22 (AML/CFT) and ICP 23 (group supervision).

22 ICP 9, Guidance 9.8.6.

82. Where the supervisor has assessed an insurer as lower risk, for instance as a result of having demonstrated a lower risk business model, a good business and governance culture, and good customer outcomes in respect of COB matters, it may determine that the insurer merits a less intensive supervisory approach than an insurer assessed as higher risk.

83. Similarly, the supervisor recognises that the incidence of unlawful or harmful market practices may vary by line of business, class of risk, marketing approach and geographical area.

84. In order that COB supervision reflects the evolving nature, scale and complexity of risk which may be posed by insurers and of risks to which insurers may be exposed, the COB supervisory framework should not only take account of the risk profile of the individual insurer concerned, but also reflect the nature, scale and complexity of the market and broader environment in which insurers operate. Therefore, when developing COB supervisory frameworks and plans, supervisors can benefit from regular market analysis.

85. Items considered in an analysis of the market typically include:

- general economic conditions
- rate of market growth
- the size, structure, product mix of the insurance sector
- distribution models
- types of consumer complaints
- types of customers
- changes in laws or regulations
- other underlying trends in the sector, including consumer trends.

86. Supervisors can enhance the use of market conduct data analysing as a supervisory tool. Collected data can be used to review market activity of the entire insurance marketplace in a consistent manner and to compare the performance of insurers and identify those whose practices are outside normal ranges.<sup>23</sup>

87. Data elements collected can include claims, premiums, policies in force, new policies written, non-renewals and cancellations, replacement-related activity, lawsuits and complaints on an industry-wide basis. If a company's performance appears to be unusual as compared to the industry, this can prompt the supervisor to undertake further review of that insurer. The additional review may be as simple as calling the company for further information or clarification or conducting further analysis.

### **COB Survey responses**

*Respondents were asked whether they analyse market or consumer trends.*

A majority of respondents indicated that they analyse trends. Respondents analyse a variety of information, such as:

- industry reports and analysis
- consumer organisations
- financial reports
- media monitoring

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23 In the United States, the state insurance supervisors, through the NAIC, have implemented a Market Conduct Annual Statement (MCAS) to collect and analyse market conduct data from insurers. The MCAS was initially designed as an aid in targeting inspections, as well as an alternative to on-site COB inspections.

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|--|
| <ul style="list-style-type: none"><li>• consumer complaints</li><li>• sales volume of specific lines of insurance.</li></ul> |
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88. Information learned from market analysis or consumer trends can help a jurisdiction shape a COB supervisory approach that is appropriate for its circumstances. For example, a market characterised largely by complex retail products provided by many insurers is likely to require a different supervisory approach from one characterised by standard retail products provided by a few insurers. The supervisory approach is also likely to differ depending on economic factors, with a different approach being adopted in markets where the economy is strong and consumers are, in general, relatively financially secure, as opposed to markets with a weak economy where many consumers are financially constrained.

89. In addition supervisors try to find the appropriate balance between assessing COB related risk at an insurer specific level and at an industry or sub-sector level (sometimes referred to as micro conduct supervision vs. macro conduct supervision). The COB work may therefore include a combination of:

- insurer specific supervision, involving reviews of codes of conduct, strategic plans, policies and procedures and internal controls with respect to COB risks to ascertain whether the insurer's policy and internal controls effectively mitigate COB risks and to determine whether or not supervisory requirements are being adhered to
- thematic reviews and investigations, relating to the examination of specific types of insurers, insurance business, or business functions to ascertain potential COB risks. An example might include the examination of the sale of specific types of credit insurance products
- product review and approval processes
- individual case reviews and complaint investigations.

90. Importantly, the supervisor should ensure that the risk profile or risk categorisation of an insurer is kept up to date. All pertinent findings from off-site monitoring, on-site inspections, market analyses and other relevant information sources should therefore be used to inform and update the insurer's risk profile on an ongoing basis.

91. Regardless of the structure of the COB framework, it is important that the framework is well documented for internal and external users.

### **3.2. Supervisory cooperation**

92. In some jurisdictions responsibility for supervision of insurers is shared between more than one authority. Where this is the case, the relevant authorities should co-operate when applying ICP 9 to ensure an understanding of all risks that might be relevant to supervisory review and reporting.<sup>24</sup>

93. From the COB supervision perspective, co-ordination and information sharing mechanisms need to be structured to enable an understanding of all relevant COB related risks where:

- COB supervision and prudential supervision are split between two authorities (such as in "twin peaks" regulatory models) or within a jurisdiction (such as between federal and provincial levels)

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<sup>24</sup> See paragraph 10 of introduction to the ICPs.

- more than one supervisor, or more than one department within the same supervisor, is responsible for COB supervision (either for different parts of a group or for different activities carried out by the same entity)
- a general consumer protection authority also has some degree of oversight over the insurer
- a separate authority is responsible for oversight of systemic stability of the financial sector.

94. Different forms of inter-agency cooperation and information sharing<sup>25</sup> mechanisms could be considered, including:

- prescriptive and/or principles-based legislated mechanisms
- formal memorandums of understanding (MOUs)
- informal mechanisms.

95. In addition to cooperating with related authorities within the jurisdiction, supervisors need to take into consideration how to cooperate with supervisory authorities, both COB and prudential supervisors, in other jurisdictions, where similar COB issues may arise or otherwise have impact across one or more entities of a group across jurisdictions. Cooperation on COB matters at international level needs to be fully explored given that the market in one jurisdiction can have an impact on the market in another from a COB perspective as well as a prudential perspective.

96. Supervisors also need to take steps to put in place adequate coordination arrangements to deal with COB issues arising in cross-border business conducted by groups or other means, such as passporting. For example, involved supervisors could establish a memorandum of understanding (MOU), or use supervisory colleges to raise and address COB cross-border issues.<sup>26</sup>

### **3.3. Supervisory Powers**

97. The powers supervisors have to perform off-site monitoring and conduct on-site inspections are usually not confined to the insurer itself, but are broad based and extend to services and activities outsourced by the insurer. Subject to applicable legal and confidentiality constraints, the supervisor may have powers to conduct inspections of and collect information from outsource parties such as:

- intermediaries
- third party administrators
- investment managers
- pension fund administrators
- banks (in respect of bancassurance activities)
- joint venture partners
- other service providers to the insurer.

#### ***COB Survey responses***

*Respondents were asked whether they have access to COB related information from non-insurer third parties to whom the insurer has outsourced any customer facing activities.*

<sup>25</sup> Primarily addressed in ICPs 3 (info exchange and confidentiality) and 25 (cross border).

<sup>26</sup> See ICP 25.1 and 25.1.2

Almost all survey respondents indicated that they had the authority to access this type of information directly. One jurisdiction indicated that while it did not have the power to access the information directly, it could access the information through the insurer.

98. Agreements between the insurer and entities providing outsourced activities – in particular, non-insurer third parties to whom the insurer has outsourced any customer facing activities – should ideally recognise the role of the supervisor in COB supervision and ensure that the supervisor’s ability to collect, analyse and rely on information is facilitated. Clear recognition in such agreements assists supervisory oversight, ensuring that the standards that apply to these entities are no less rigorous than those that would apply to the insurer if the activities had not been outsourced.

99. As with outsourced activities, the supervisor should have the ability to access information relevant to COB activities within corporate groups, either directly or indirectly.<sup>27</sup>

### 3.4. Sources of information

100. When supervisors seek information or request documents, they expect insurers to be open and cooperative. Sources of information relevant to COB supervision tend to be broader than those used in other insurance supervisory work and include insurer COB data and data from sources other than the insurer itself, such as:

- consumer complaints
- ombudsman services or other alternative dispute resolution structures
- consumer bodies
- industry associations
- industry or consumer media
- other COB/consumer protection regulatory or supervisory agencies
- intermediaries
- whistle-blowers
- court cases
- data on general economic and environmental factors impacting on consumer behaviour and expectations.

101. Depending on the nature, scale and complexity of the market, other information sources could be used such as consumer surveys and “mystery shopping”, or similar techniques.

102. At all times supervisors need to be aware of any legal or confidentiality constraints and appropriately address them.<sup>28</sup>

### **COB Survey responses**

*Respondents were asked whether they obtain information regarding the COB of insurers from sources other than the insurer itself, and if so, what type and on what basis. Information sources include:*

27 In accordance with ICP 9.1.2 “Services or activities that are outsourced by the insurer should be subject to the same level of supervisory review and reporting as the services or activities that are not outsourced and are performed by the insurer itself. The supervisor can do this through the insurer itself but should also have the ability to obtain information from, and conduct on-site inspections of, entities engaged in providing outsourced services or activities to the insurer, where necessary.”

28 Subject to relevant laws, supervisors may consider reporting any data security breaches to the affected parties.

- ombudsman schemes or other alternative dispute resolution structures: many jurisdictions responded that they receive information from ombudsman schemes or alternative dispute resolution structures. Some jurisdictions responded that they do not obtain information from such bodies, a few noting that no such bodies exist in their jurisdiction currently.
- consumer or industry associations: many jurisdictions indicated that they receive information either informally or formally from consumer or industry associations including self-regulatory organisations. The frequency and range of information exchange varies considerably between jurisdictions.
- consumer media: many jurisdictions indicated that they receive information either informally or formally from consumer media. Some jurisdictions indicated they maintain systematic media monitoring while others did so on an ad hoc, informal basis.
- other COB regulatory or supervisory agencies: many jurisdictions indicated that they obtain information from other COB regulatory or supervisory authorities. The other agencies providing information appeared to be quite broad, ranging from other insurance supervisors to securities and pensions regulators to other agencies engaged in finance, fair trade and consumer affairs.
- intermediaries: many jurisdictions indicated that they receive information either informally or formally from intermediaries.
- whistle-blowers: some jurisdictions indicated that they receive information from whistleblowers. Several of these jurisdictions noted, however, receipt of such information as an infrequent occurrence.
- Any others (e.g. investment managers, third party administrators): some jurisdictions indicated that they receive information either informally or formally from other groups. Some of the sources mentioned include actuaries, investment managers, third party administrators, arbitration courts, judges and elected officials.
- mystery shopping: some jurisdictions indicated that they conduct mystery shopping techniques to test treatment of consumers by insurers and/or intermediaries. The form and frequency of mystery shopping varies between jurisdictions.

### **3.5. Supervisory reporting and off-site monitoring**

103. Off-site monitoring is generally based on review of a combination of routine or regular supervisory reports required to be submitted by insurers, and other ad hoc or thematic information obtained from insurers or third party information sources.

104. The frequency, type and level of detail of regular reports should be consistent with the risk profile assessment discussed in paragraph 75. Regular reports should be more frequent and/or require greater levels of detail in higher risk situations such as those outlined in paragraph 78.

105. Jurisdictions have different systems in place for collecting COB information through regular reports. Supervisory reporting requirements should be designed to provide indicators of fair treatment of customers at various stages of the product life cycle and other information on COB related risks. Regular reporting enables the supervisor to build up over time a picture of insurers' circumstances and behaviour, in order to inform and update the insurer's risk profile on an ongoing basis.

106. When considering what information should routinely be reported, supervisors normally consider known COB risks as well as recent developments in the insurance markets and set reporting requirements in an anticipatory manner, focusing on market conduct issues that could affect the insurers and policyholders now and at some future time.

107. The supervisor may also consider requiring a mix of qualitative and quantitative information. Qualitative information may be helpful in assessing compliance with more principles based requirements such as the extent to which a fair treatment culture is embedded or the effectiveness of governance processes, whereas quantitative statistics may not provide full insight.

108. Section 4 of this paper discusses in more detail some possible fair treatment and COB risk indicators that may be monitored through regular reporting. Broadly speaking, information included in regular reporting will typically cover:

- corporate governance arrangements, and any significant changes to them
- material outsourced functions and activities
- organisational structures including whether an insurer has close links with other entities, and the nature of the relationship
- a wide range of compliance and other statistical and operational reports in regard to the insurer's products and services, to help the supervisor to determine whether an insurer is complying with relevant supervisory requirements and fair treatment standards.

109. The above regular reports should include trend analysis, where feasible, over prescribed periods to enable the supervisor to identify and query noticeable trends or deviations in customer treatment indicators. These analyses should supplement prudential or financial data to inform the overall risk profile of the insurer.

110. In addition to regular supervisory reporting, the supervisor may request insurers or a sample of insurers, on a market-wide or sector-specific basis, to provide ad hoc information relating to existing COB practices or new developments. Examples of events triggering such thematic information requests could include:<sup>29</sup>

- a particular serious complaint or an increase in complaints of a specific type
- a shift in consumer or intermediary behaviour
- economic or regulatory developments affecting consumer or insurer behaviour
- emergence of a new type of product or service
- at individual insurer level, changes in an insurer's governance or management structures or changes in product, service, target market or distribution strategies
- a significant change or trend, either at insurer or industry level.

111. By analysing information in a timely manner, supervisors can deepen their understanding of developing trends. By reviewing information on a "horizontal" basis – i.e. comparing information from different insurers - the supervisor can identify companies that may require additional attention.

112. Over and above regular or thematic off-site reports, the supervisor usually has the power to approach an individual insurer on an ad hoc basis with specific information requests (sometimes referred to as an "interrogatory"). Such a request typically takes the form of a set of questions used to evaluate an insurer's handling of compliance or processing issues. These can be tailored to a very specific need for information and are a useful option to determine compliance with a particular rule or law. This type of information request is also a tool that can be used by the supervisor in preparing for an on-site inspection. Examples include:

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<sup>29</sup> See ICP 9.5.

- sending a questionnaire to an insurer, asking about a specific business practice, e.g. specific aspects of claim handling practices
- sending a questionnaire to an insurer about its plan of action to comply with a particular new statute
- sending a questionnaire to an insurer about compliance with product suitability requirements.

113. Financial statement data is also used in COB off-site monitoring. For example, the supervisor will be concerned when the financial statements indicate financial stress because financial problems are often accompanied by COB problems, such as delayed claims payments and neglect of customer service. Claims-related information is of particular relevance to market performance and spikes in claim reserves might signal COB problems. The supervisor should investigate the reason for such spikes within an insurer and check complaints made against the insurer, trends over time and reserving levels for comparable companies in the market.

114. A review of financial data is also important to enable the COB supervisor to “follow the money” in order to identify: sources of profit and loss to the insurer; incentives payable to management, intermediaries and other parties; general spending priorities; and/or intra-group cash flows – all of which may be valuable indicators of COB risks in an organisation.

115. In addition to regular and ad hoc information requested by the supervisor, the supervisor may also consider requiring insurers themselves to proactively report to the supervisor (i.e. not only at the supervisor’s request) on matters that may be of interest to the supervisor. Possible matters insurers could be required to report as they arise include:

- changes or new strategies for target markets, product or service design, distribution models or other business changes that could materially impact on customers
- material litigation, complaints, adverse ombudsman rulings, or negative publicity
- identified legislative or regulatory contraventions.

### **COB Survey responses**

*Respondents were asked what type of information they require insurers to report. Information required includes:*

- Changes/new strategies for target markets, product or service design, distribution models or other business changes that could impact customers: many jurisdictions indicated that there are general requirements for insurers to notify the regulator of significant/material events. Some jurisdictions enumerate the notification duties of insurers (such as changes in or amendments to the actuarial bases used for the calculation of premiums, acquisition or transfer of insurance business, engaging in non-insurance business etc.). In some jurisdictions insurers are required to get prior approval from the supervisor for some or any changes to or introduction of new products/services and distribution channels. In some jurisdictions there are no formal, general reporting obligations, however in many cases material changes would be evident from financial, statistical and risk information submitted as part of prudential reporting requirements.
- Material litigation: there was an even split amongst those jurisdictions which have a requirement to report material litigation and those who do not. The extent of information required by the supervisor varies between jurisdictions; reports may be required on a regular basis or on the supervisor’s instigation. Several of the jurisdictions which reported no requirement indicated that such information might be captured through broader requirements (e.g. a requirement to report significant events). Others indicated such information could be obtained through special request, regular on-site inspection or is required to be included in the insurer’s annual report.

- Serious complaints or an increase in specific complaints: some jurisdictions indicated that there have or will have in the near future a requirement to report such complaints. Some respondents indicated such information might be captured through broader requirements (e.g. a requirement to report an increase in risk). Others indicated such information could be obtained through special request, regular on-site inspection or was required to be included in the insurer's annual report.
- Adverse ombudsman rulings: a small number of jurisdictions indicated that they have such a requirement. Several of the jurisdictions with no such requirement indicated that an ombudsman service did not exist or had only recently been introduced. In jurisdictions with a requirement, either insurers notify the supervisor of adverse ombudsman's rulings or the supervisor directly interacts with the ombudsman and exchanges information. In jurisdictions with no specific reporting obligation, insurers may be required to report on their most significant risks, including operational risks and legal & regulatory risks – material adverse ombudsman rulings could therefore be reported, if applicable, through this mechanism.
- Negative publicity: a small number of jurisdictions indicated that they have a requirement to report negative publicity. Some of the jurisdictions with no such requirement indicated that this type of information could be obtained through special request or through general information from the market. Some jurisdictions require insurers to report on a variety of matters which arise out of their general reporting obligations. Even if there is no specific reporting obligation in relation to negative publicity, insurers may be required to report on their most significant risks, including operational risks and legal & regulatory risks. Reputation risk is typically classified under one of these headings. Material negative publicity could therefore be reported, if applicable, through such mechanism.
- Risk and compliance reports that include COB matters: many jurisdictions indicated that there was such a requirement. Some of the jurisdictions without such a requirement indicated that this type of information could be obtained through special request. Others indicated that it may be required as part of new COB requirements being developed. In some jurisdictions insurers are required, as part of their regular prudential reporting requirements, to report on their risk management processes in general as well as on identified material risks outside of their risk appetite.
- Any other COB-related matters: some jurisdictions indicated that they have some additional reporting requirements. Some of these included: licensing information (including records of disciplinary actions or terminations), development of new products, internal audit reports relating to COB, general legislative disclosure requirements, annual questionnaires on business practices, information on outsourced activities, and an annual market conduct statement that provides information on key market performance data.

### 3.6. On-site inspection<sup>30</sup>

116. On-site inspections provide information that supplements the analysis from off-site monitoring and gives the supervisor the opportunity to verify information it has received. On-site inspection may also help detect problems that may not be apparent through off-site monitoring.<sup>31</sup> On-site inspections, enabling face-to-face engagement with senior management and other levels of an insurer's staff, are also generally better suited to assessing qualitative aspects of the insurer's culture than off-site monitoring tools

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30 Other relevant ICP's include ICPs 1 and 2 (which deal with supervisory powers and the mandate), ICP 7 (which addresses corporate governance), and ICP 18 (Intermediaries).

31 ICP 9, Guidance 9.8.1.

117. Normally on-site inspections are tailored to the particular insurer and its risk profile.<sup>32</sup> The frequency, scope and depth of on-site inspections are likely to take account of the insurer's business model, the nature, size and sophistication of its customer base and its relative importance in the market.

118. On-site inspections should be more frequent and more in-depth in higher risk situations such as those outlined in paragraph 78.

119. COB focused on-site inspections assess the insurer's fair treatment of customers, including observance of COB requirements and consumer protection regulations.<sup>33</sup> They can be either full-scale or limited/thematic, and can involve investigations, no-knock inspections<sup>34</sup> or scheduled targeted inspections.

120. Full-scale inspections involve a review of all or most of the insurer's lines of business and operation. In some jurisdictions, comprehensive inspections, unless statutorily required, are only conducted if deemed necessary as a result of the off-site analysis.

121. Limited or thematic inspections often occur when the off-site monitoring or broader market analysis work has identified the need to review either a specific line of business or specific business practices. Examples of areas that may be targeted through such thematic reviews are:

- underwriting and rating
- product development processes
- marketing and sales
- complaint handling
- operations/management
- advertising materials
- compliance with any licensing conditions
- policyholder services
- claims handling
- compliance with a particular legislative or regulatory requirement (for example a new requirement)
- form filings.

122. Where feasible, the supervisor should aim to co-ordinate on-site inspections (particularly full-scale inspections) of the same insurer by different supervisors or different departments within the supervisor.

123. The supervisor typically gives the insurer notice of an on-site inspection and its scope, although most jurisdictions also allow for "no-knock" inspections, without advance notice, in certain circumstances. The type and extent of notice provided will usually depend on the nature of the supervisor's specific concerns (if any) regarding the insurer's conduct, and the need to strike an appropriate balance between allowing the insurer a reasonable opportunity to prepare meaningful input and the risk of "rehearsed" responses or opportunities to hide or manipulate information.

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32 ICP 9, Guidance 9.8.2.

33 ICP 9, Guidance 9.8.7.

34 Inspections conducted without advance notice.

124. Supervisory staff participating in an on-site inspection need to have appropriate competence and seniority to effectively engage members of the Board and Senior Management so as to:

- assess organisational culture, leadership and governance quality and commitment to fair treatment of customers, as opposed to focussing on rules-based compliance monitoring
- appreciate the COB risks arising from “big picture” elements of the insurer’s business model, group structure, overall value chain and inter-relationships with suppliers, intermediaries and other third parties
- challenge or query the rationale for decisions, strategies or company policies
- discuss identified weaknesses in the insurer’s governance or control functions from a COB perspective
- persuade the Board or senior management to take action regarding current or emerging problems, and engage in meaningful dialogue regarding possible acceptable solutions
- provide management with forward looking insight and guidance and respond appropriately to questions on the supervisor’s expectations, planned future focus areas, and the impact of pending legislation.

125. The supervisor should have appropriate confidentiality and competency safeguards in place if it delegates any aspect of on-site inspection to independent experts.

### **3.7. Supervisory feedback and follow-up**

#### **3.7.1 Forms of feedback and follow-up**

126. Following an on-site inspection, supervisors provide feedback to insurers, including following up to clarify matters, request additional information, or verify information provided by the insurer. This can take several forms and often depends on the seriousness of the issue and the level of insurer cooperation.

- Correspondence - this can be focused upon a potential or fully identified problem to be addressed quickly by the insurer. It also serves as a record of an insurer’s intentions regarding regulatory compliance, in the event the problem is not subsequently corrected. Examples include:
  - sending a letter to an insurer reminding it of a specific regulatory requirement after the supervisor has noted cases of noncompliance
  - sending a letter to an insurer advising of increasing complaint ratios noted during the supervisory review process
  - following up with the insurer to ensure that required actions have been taken by the insurer.
- Interviews with the insurer - in the form of a face-to-face meeting or conference call, interviews with the insurer are useful when there is a need for open dialogue, discussion or clarification. It provides both the supervisor and the supervised entity an opportunity to ask questions, provide clarification and verbalise each other’s point of view about compliance matters. Interviews with the insurer’s personnel can be useful for obtaining information about specific divisions or functions, and confirm findings from the on-site inspection. Examples include:
  - making a phone call to an insurer’s management to discuss concerns relating to the insurer’s change in marketing strategy

- requesting a meeting with an underwriting manager to learn first-hand how the insurer uses loss history information
- setting up a recorded statement to ask a claims examiner about policies and procedures relating to the handling of problematic claims.
- Follow-up contact with other stakeholders – at times the supervisor feels that input is necessary beyond what is gained from the insurer’s officers, and decides to contact specified members of the public, such as current or past policyholders and claimants, independent experts or the insurer’s intermediaries to verify information provided by the insurer. Typically these contacts are intended to uncover very specific information about the insurer and potentially harmful behaviour under investigation. Examples include:
  - contacting intermediaries to ask for their perspective about training provided by the insurer
  - contacting consumers who purchased a specific insurance product to ask how the product was presented and sold to them
  - consulting independent experts to obtain their views on opinions expressed or concerns raised by the insurer.

### **COB Survey responses**

*Respondents were asked to describe how they verify information received from insurers, through follow-up with the insurer or through independent experts?*

All respondents indicated that they follow up directly to verify information received from insurers. This includes a wide range of supervisory practices including off-site monitoring and on-site inspections, special inspections and meetings, through general follow-up with the insurer and communications with Board and Senior Management. Some jurisdictions indicated that they use outside experts to follow up, but many do not.

### **3.7.2 Preventive or corrective action**

127. Depending on the jurisdiction’s legal regime there is a range of possibilities when preventive or corrective action is needed. Typically, a supervisor will opt for a more interventionist response the more severe the breach or contravention by the insurer is. The following are examples of preventive or corrective action in order from less to more severe; such actions are not necessarily mutually exclusive and could be applied in combination with one another where appropriate:

- Informal agreements - An informal agreement to change practices or implement procedures can be either written or verbal. Such an agreement would be most appropriate for situations involving non-compliance with technical regulatory issues and where no significant harm has occurred to consumers or other stakeholders. It could include amendment of business practices, promotional material or other documents, for example.
- Negotiated settlement agreements/consent orders/enforceable undertakings - A negotiated settlement may be used to arrive at a mutually agreeable conclusion to a matter of concern. Such a settlement is typically negotiated and recorded in the form of a written consent order. The agreed-upon settlement may include such components as remediation/restitution, voluntary forfeitures (fines), agreements to cease and desist, agreements to implement action plans, self-reviews and possibly reporting back to the supervisor after an agreed-upon period of time. The settlement agreement may or may not lack an administrative determination that a specific violation has occurred and may or may not also indicate that the supervised entity

neither affirms nor denies the specific allegations. The agreement is made as a means to resolve the conflict.

- Administrative complaints and hearings - An administrative complaint is filed when the supervisor has reason to believe that a supervised entity is engaging in non-compliant behaviour. The complaint document will allege that a violation of insurance law has occurred or may occur, and provide for an administrative hearing where both parties are allowed to present evidence and testimony about the allegations.

Typically, an administrative hearing would follow the filing of a formal administrative complaint against the supervised entity, starting with setting a time and place for an administrative hearing. The supervised entity would be provided an opportunity to offer testimony and evidence before a hearing officer, who would decide the outcome of the action. Likewise, the supervisory representative would present evidence and request a finding or determination along with a request for resolution. Sometimes, a voluntary compliance plan or consent agreement may be entered into prior to an administrative hearing. The nature of the finding of the administrative hearing or sanction imposed will depend on the legal and supervisory regime concerned, but may include one or more of the types of interventions described in this section.

- Administrative fines or penalties – A supervised entity could be required to pay an administrative fine or penalty as “punishment” for a breach of legislation or other misconduct. In some cases such a fine or penalty may only be imposed after an administrative hearing, whereas in other cases the supervisor has the power to impose fines or penalties at its own instance. The imposition of a fine or penalty will often be combined with a remediation or restitution order, or other forms of action discussed in this section.
- Cease and desist or “undesirable business practice” orders - An order can be issued by the supervisor to an insurer to prohibit a person or business from continuing all operations or certain targeted operations or violations of law. Such an order would be issued when harm to consumers is considered imminent and quick action is perceived to be necessary. The supervisor may then set up an administrative hearing to determine future action.
- Ongoing monitoring/internal audit - If a systematic compliance error has been identified, the supervisor may request that the insurer conduct a targeted COB internal audit. This permits an insurer to take corrective action and to report its findings to the supervisor. Additionally, as part of settlement agreements or after final inspection reports, an insurer may be required to submit regular audits covering the areas of concern. The audits would be submitted to the supervisor over a period of one or more years to help demonstrate continued compliance in the area of concern.
- Remediation or Restitution Plans - In cases where harm can be measured and corrected, remediation may take such forms as premium refunds, supplemental claim payments, removal of unapproved or incorrectly administered restrictive endorsements or policy change options. The goal is to obtain remediation or restitution for policyholders, claimants and parties affected by an adverse situation, aiming to put them in the position they would have been in had the error or misconduct concerned not occurred.
- Compensation - When an insurer’s actions or omissions have done harm to policyholders or claimants, the jurisdiction may require that compensation is made for that harm. Compensation is made for actual loss or damage that was sustained. It differs from remediation or restitution, which usually require some form of reversal of an error, but not necessarily full compensation for the consequences of the error or misconduct.

- Post-investigation or follow-up examinations - There may be instances when a supervised entity modifies procedures in response to a finding. In some cases, the supervisor may schedule a series of targeted investigation to monitor the procedures over an extended period of time to satisfy itself that the changes stay in effect.
- Probation, suspension, revocation of licence - Depending on the severity and frequency of specific violations, or the variety of violations, the supervisor may revoke, suspend or limit an insurer's authorisation to operate in the jurisdiction. Probation is often ordered for entities guilty of more minor violations or first offences, which allows them to continue the business of insurance under surveillance. For more serious charges, the license may be suspended usually for a specified period of time. If the violations are severe or pervasive in nature, or if probation or suspension has not resulted in a remedy to the issues, the license or authority to conduct the business of insurance may be revoked.

### **3.7.3 Communicating the supervisor's position**

128. Supervisory concerns are generally recorded in a report following the on-site inspection. In some cases a closing letter to management may be appropriate.

129. Where the issue may be of wider concern than a specific insurer, the supervisor may want to convey its position more broadly. The use of targeted mailings, newsletter articles, bulletins and website notices allow supervisors to address a concern or provide information relative to new issues, interpretations, relevant case law, implementation policies for new laws, or discussion of new industry practices or technologies. Sometimes education (in the form of supervisor communication or proactive outreach) can be used to provide information to the insurance industry.

130. Practical examples of supervisory communications include:

- issuing warning notices to consumers
- issuing a formal communication to clarify the supervisory authority's interpretation of a specific law and supervisory expectations
- posting an advisory communication letter to respond to multiple requests for information about a specific compliance issue
- providing access to insurance laws and regulations through the supervisory authority's website
- providing answers to "frequently asked questions" from insurers on the supervisory authority's website
- discussing specific supervisory concerns in a supervisory authority's quarterly newsletter or similar communication.

### **3.8. Other responses to issues identified**

131. The supervisory process may result in lessons learned or prompt other responses and/or actions which are not limited to insurers or the supervisor itself. The ability to take other responsive actions based on issues identified may depend on the supervisor's mandate and/or authority.

#### **3.8.1 Providing information to intermediaries**

132. The supervisor may wish to convey information to intermediaries. In addition to the possible use of mailings and notices, the supervisor may choose a more proactive type of outreach. Outreach mediums include speaking engagements, supervisor-sponsored seminars and training events, press releases, interviews with the media, articles for publication, billboards and advertisements, brochures and radio spots. Identifying the target

audience and tailoring the delivery to that audience are keys to a successful outreach campaign.

133. Practical examples of proactive outreach to intermediaries include:

- hosting or sponsoring a seminar aimed at insurance compliance professionals to discuss changes to specific laws or regulations
- participating in an industry or supervisor-sponsored trade organisation seminar to share information about a new rule affecting COB supervision
- requesting that trade organisations place periodic reminders in their publications about the importance of specific lines of insurance for consumers.

### **3.8.2 Initiating consumer outreach or education**

134. The supervisor has a unique opportunity for determining which insurance related issues are confusing or unclear to consumers. Newspaper and magazine articles, press releases, outreach at public events and speaking engagements can help provide consumers with tips on how to be more “savvy” about insurance and can help prevent abusive sales techniques and unsuitable sales.

135. Practical examples of consumer outreach or education initiatives include:

- initiating a campaign to inform consumers about the danger of fraudulent and unauthorised insurers
- publishing a brochure explaining a certain confusing insurance product and requiring its distribution at point of sale
- developing media news releases to teach consumers how to best file insurance claims after a natural disaster
- using billboards to remind the public that insurance fraud is a crime.

### **3.8.3 Referral to other agencies**

136. Occasionally, issues or concerns cross boundaries between authorities within a jurisdiction. Supervisory agencies may wish to establish channels of communication with other applicable agencies, and understand the functions of those agencies and how they might apply to insurance.

### **3.8.4 Requesting legislative or regulatory changes<sup>35</sup>**

137. A COB issue may be discovered for which no regulatory or supervisory authority exists to address the concern, or where the law has not kept pace with changing market conditions. Sometimes a practice is identified that is technically legal, but is causing harm to consumers or disrupting the marketplace. In other cases, supervisory work may highlight differences in interpretation of legislation or unclear provisions. Although in some cases insurers may be willing to change the practice voluntarily as long as they can be assured of a level playing field, at other times problems need to be addressed on a broader and more certain basis through rulemaking, legislative changes, etc.

138. Practical examples of requesting legislative or regulatory rule changes include:

- addressing COB risks arising from new technologies, such as the need for advertising regulations in relation to internet sales, “crowd funding”, virtual currencies, etc.

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<sup>35</sup> When it comes to legislative or regulatory changes, supervisors need to consider which approaches – principles-based, rules-based or a combination – are most appropriate in enhancing consumer protection (refer to the Section 2.5).

- addressing the need to amend existing insurance statutes to capture new types of insurance or marketing arrangements or clarify unclear provisions.

## 4. ICP 19 and approaches to off-site monitoring and on-site inspection

139. This section discusses possible approaches to both off-site monitoring and on-site inspections that supervisors could consider when supervising an insurer's conduct in relation to the way it treats its customers. The section broadly follows the structure of ICP19, considering supervisory approaches to insurer conduct at various stages of the insurance product life cycle. For each product life cycle stage, the discussion distinguishes between the following (where applicable):

- *Supervisory requirements*: Specific requirements that may be set by the supervisor;
- *Governance monitoring*: The governance processes within insurers that supervisors may monitor to determine whether their supervisory requirements are being met;
- *Activity monitoring*: Specific insurer activities that supervisors may monitor in determining whether their supervisory requirements are being met.

### 4.1. Fair treatment policies, procedures and culture

#### *Supervisory requirements*

140. In accordance with ICP 19, the supervisor sets requirements for the conduct of the business of insurance to ensure customers are treated fairly, both before a contract is entered into and through to the point at which all obligations under a contract have been satisfied.<sup>36</sup>

141. The supervisor should require insurers to act with due skill, care and diligence when dealing with customers, and also to establish and implement policies and procedures on the fair treatment of customers that are an integral part of their business culture.<sup>37</sup>

142. The requirements reflect the jurisdiction's tradition, culture, legal regime and the degree of development of the insurance sector.<sup>38</sup> For example, the needs of customers in developing countries, with regard to fair treatment and especially in the field of micro-insurance, may be substantially different from the needs of customers in developed countries. See also the discussion in section 2.4.

#### *Governance monitoring*

143. The supervisor may review whether insurers have a "fair treatment of customers" or similar policy that incorporates a culture of fair treatment at each stage of the life cycle of a product, from its design to after-sales service and from the moment obligations arise until they expire. In reviewing the adherence to and effectiveness of such a policy, the supervisor would assess whether the policy is adequately embedded in the insurer's structure and processes from strategic planning to decision-making and from governance structures to operations.

144. The supervisor may review the extent to which fair treatment of customers is implemented in relevant areas of the insurer's operations, including performance management and reward processes, by concerted action, a firm commitment and strong leadership at decision-making levels.

145. When the insurer is part of a group, it is important for the insurance supervisor to understand the dynamics between policies and procedures applied at the group and entity levels. In some instances, group-level governance, risk management and internal control

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36 ICP 19.

37 ICP 19.1 and ICP 19.2.

38 See ICP 19.0.2.

functions can promote a group-wide policy for the fair treatment of customers.<sup>39</sup> However, the insurance supervisor would wish to be satisfied that responsibility for handling insurance COB matters is appropriately allocated within the insurance entity.

146. In evaluating an insurer's approach to COB, the supervisor typically assesses:

- the extent to which policyholder interests are included in the insurer's strategy. In particular, do the insurer's risk strategy, appetite and enterprise risk management (ERM) frameworks<sup>40</sup> take into account COB related risks, and not solely solvency risks?<sup>41</sup>
- how accountability for COB matters is assigned within the insurer's Board and Senior Management. In particular, who is accountable, how is this accountability reflected in the insurer's performance management and incentive and reward structures, and to what extent is commitment to fair treatment of customers reflected in the insurer's strategic planning process and any applicable codes of ethics or corporate policies?<sup>42</sup>
- what controls are in place to identify, address and mitigate conflicts of interest? In particular, the board of directors should be under an obligation to establish code of conduct and ethical rules in order to manage conflicts of interest.
- the extent to which management information systems and other control structures enable insight into customer experience and conduct related risks. This includes a review of:
  - risk management and internal control
  - compliance
  - internal audit
  - any specific customer related governance structures such as a "policyholder protection committee" or "customer affairs committee" of the board
  - controls in place to ensure fair treatment of customers where any functions impacting on customers are outsourced
  - any other measures, controls and management information the insurer has put in place to monitor COB matters – including the quality of reporting on these matters to the Board and Senior Management
  - controls in place to ensure fairness of advice and distribution models.

### **COB Survey responses**

*Respondents were asked whether they assess the organisational culture, governance and commitment to fair treatment of customers.*

More than half the respondents indicated that they assess these factors and the assessment appears to range from informal approaches to more systematic approaches involving general risk assessment, and evaluation of governance and internal controls in relation to

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39 ICP 19.0.6 "Where insurers participate in an insurance group or financial conglomerate, the application of appropriate policies and procedures on conduct of business across the group should result in the fair treatment of customers on a group-wide basis, even if legal provisions in some jurisdictions set requirements that are potentially lower than those used by the group".

40 ICP 16 and 17 discuss ERM from a solvency capital perspective.

41 Refer to ICP 16.

42 See also ICP 9.2.6.

COB. The respondents also stated that they challenge the rationale for COB related decisions, strategies and policies of insurers.

*Respondents were asked about the ranges of supervisory monitoring on COB matters.*

Many respondents indicated that they monitor the following areas:

- How responsibility for COB matters is assigned within the Board and Senior Management; these are assessed by on-site inspection and/or off-site reporting. In some respondents this monitoring is undertaken within the overall risk assessment
- How fair treatment of customers is reflected in strategic planning and codes of conduct; however, in most cases respondents indicated that this is a part of the overall risk assessment rather than focusing specifically on COB matters
- The quality of control measures and management information regarding COB matters in general; monitoring, usually as a part of the internal control framework review, is conducted by on-site and/or off-site inspection.

#### *Activity monitoring*

147. In addition to monitoring the insurer's governance structures in relation to fair customer treatment, the COB supervisor may review evidence-based indicators of the effectiveness of these structures, such as any self-assessments, reports or survey results in relation to customer satisfaction or customer treatment. Such a review should include a review of the extent to which any findings have been acted upon to improve identified weaknesses.

## **4.2. Product development**

### *Supervisory requirements*

148. The supervisors should require insurers to take customer interests into account in the development of products and marketing of insurance products.<sup>43</sup> Jurisdictions use different approaches to accomplish this, ranging from pre-approving products, monitoring the insurer's own product governance, and intervening when they are not satisfied.

149. Product standards: Many supervisors put requirements on terms of insurance contracts to ensure information given to the consumer is clear, correct, and not likely to mislead the consumer. Also in many jurisdictions the law and/or regulation establishes standards that insurance products shall meet. Such requirements can set mandatory clauses or guarantees for some products and/or prohibit undesirable or unfair contractual clauses, for instance clauses restricting the rights of the consumer, clauses written in foreign language, clauses not specifying the terms of payment or the interest rate, etc.

150. Product development governance: In some cases supervisors will prescribe product development procedures and policies which insurers must have in place to ensure customer needs are taken into account. For example, the procedures and policies may require insurers to:

- establish a formal approval process that takes into account the interests of different types of customers
- establish clear approval procedures for marketing materials associated with new products
- train marketing personnel and/or intermediaries so they understand for whom the product is suitable and all the product's features, especially in respect of legal requirements

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43 ICP 19.3.

- if the development or marketing of a product is outsourced, conclude an outsourcing agreement that has regard to customers' rights.

151. Product pre-approval: Some supervisors may pre-approve some or all products. Practices range with respect to pre-approval from:

- requiring pre-approval of all new (or substantially modified) insurance products before they are issued
- requiring pre-approval depending on the product type
- preferring not to pre-approve products
- explicitly prohibiting pre-approval of products.

152. Product intervention: In the event that product features or product disclosure material do not comply with supervisory requirements, or are generally considered undesirable, some supervisors have powers to order the withdrawal or temporary suspension of the product. This allows the supervisor to ascertain whether insurers have taken into account the interests of different types of customers. In some countries, the supervisor's decisions may be published.

#### *Governance monitoring*

153. Even where the supervisor does not specifically prescribe product development governance requirements as discussed in paragraph 143 the COB supervisor will usually review the effectiveness of the insurer's product approval processes from the perspective of ensuring fair treatment of customers. Such a review will typically consider the extent to which the insurer's product approval processes address the factors set out in paragraph 143.

#### *Activity monitoring*

154. The supervisor can monitor a variety of indicators to determine whether insurers adequately take into account consumer interests in their product development and marketing, for instance by receiving and assessing:

- detailed information on new or modified products including the terms and conditions of contracts
- statistics/reports on new product development, including any consumer product testing carried out
- sales volumes/market share data
- target market/customer demographic information
- policy lapse, termination, and retention data
- product-related complaints data.

155. Even when there is no product prior approval, supervisors typically keep an eye on new product launches, particularly for products involving financial innovation, so that they can assess whether the product could potentially be detrimental to the customer.

#### **COB Survey responses**

*Respondents were asked whether they monitor insurers in relation to how customer interests are taken into account in the development of products and services.*

A majority of respondents indicated that they do consider this factor through various approaches. Some jurisdictions require insurers to have a product development process which takes into account the interests of different types of customers and clear approval procedures for any marketing materials for insurance products. Other jurisdictions review the tariffs and general insurance conditions which will be used for the insurance of specific lines

of business such as occupational pension plans for employed persons and for supplementary insurance to mandatory health care insurance. Some respondents stated that insurers define their product target in order to help ensure that the product is distributed to the right population, and that it is reviewed on a regular basis to make sure it continues to reach the target market.

### **4.3 Product promotion and disclosure**

156. In accordance with ICP 19 the supervisor requires insurers to promote products and services in a manner that is clear, fair and not misleading and to set requirements for insurers with regard to the timing, delivery, and content of information provided to customers at point of sale.<sup>44</sup>

157. The supervisor should make sure that the insurer's quality control over product promotion and disclosure to customers, including both pre-publication controls and controls to rectify incorrect information, can allow customers to make informed decisions regarding products, before, during and after their purchase. In its supervisory review of insurers the supervisor will assess whether insurers have adequate policies and procedures in place regarding product promotion and disclosure to customers, and that these policies and procedures are implemented in an effective and on-going manner.

158. The supervisor may look at samples of insurer documentation to assess the fairness, clarity and quality of insurance product promotion and disclosure of information, to determine whether that this is sufficient to enable customers to understand the characteristics of the product they are buying and help them understand whether and why it meets their requirements.<sup>45</sup> This would include reviewing samples of advertising material, pre-contractual information, product information provided to customers and sales-supporting documents provided to intermediaries by insurers. The supervisor might also evaluate consumer understanding of disclosures and other documents, for example through testing and focus groups.

#### **4.3.1 Advertising**

##### *Supervisory requirements*

159. Given that advertisements are often the first, and sometimes the only, document the consumer will look at before making a decision, the supervisor may seek to set principle-based requirements that advertisements are:

- fair and do not provide any dishonest and misleading information
- verifiable (in respect of technical information or data provided)
- identifiable as advertising, by a clear mention of its nature and as separate material with their own features
- distinguished from pre-contractual and contractual information
- clear so that the reader can readily understand the meaning of the information provided.

160. The supervisor may also set specific requirements regarding the content of advertisements, usually taking into account the nature and complexity of the product sold. Subject to the type of product, requirements may include:

- clearly displaying the name of the institution

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44 ICP 19.4 and ICP 19.5.

45 ICP 19.5.9.

- stating the nature of the product that is promoted, its potential advantages with the corresponding potential risks
- when there is a mention of past performance (particularly for life insurance investment products), including a disclaimer that past performance of this product is not necessarily an indicator of future performance. Past performance should not be the central argument in advertising material<sup>46</sup>
- specific requirements relating to providing investment performance data and investment management fees
- specific requirements relating to disclosing information on various types of guarantees.

#### *Governance monitoring*

161. The supervisor will usually monitor the effectiveness of an insurer's formal processes for reviewing advertising material before its publication to make sure that it fulfils consumer protection requirements and that staff working in this area (or relevant people in the compliance function) are properly trained, especially in respect of relevant legal requirements. The supervisor may review, amongst other things, controls aimed at ensuring that:

- prior to being disseminated, advertising material regarding the insurer's products is reviewed independently of the person that prepared or designed it for the insurer
- any product advertising that is misleading, unclear or inaccurate is immediately modified and/or withdrawn
- adequate and appropriate product information is provided to intermediaries marketing the insurer's products
- information concerning issues such as consumers' rights granted by the law is not presented in such a way as to appear to be an offer from the insurer or insurance professional.

#### *Activity monitoring*

162. Monitoring advertising of insurance products by the supervisor is of paramount importance. For the supervisor, this monitoring has three main objectives:

- to detect and seek remedies for infringements of legislation or supervisory requirements
- to identify changes in business practices and spot new products, and to ensure these comply with the legislative and regulatory rules
- to highlight good practices.

163. Usually the supervisor monitors advertising on a regular basis and carries out inspections on a sample basis. Optimally monitoring would apply to all media, including television, radio, press, billboards, and on-line advertising. It should also encompass non-media promotion such as street marketing activities, communication campaigns or events. Monitoring may also include monitoring the insurer's advertising and marketing expenditure, to identify trends and focus areas.

164. The supervisor may choose to focus on specific themes (e.g. rates of return) or on specific categories (e.g. types of product, types of insurer). Other factors that could impact the scope of the supervisor's work include:

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<sup>46</sup> ICP 19.5.2.

- the number of market players
- the duration, volume or recurrence of the advertisement
- the identity of the advertiser
- the seriousness of any infringements (and the risks they represent for the consumer)
- the consumer population targeted (especially in the case of vulnerable consumers)
- consumer complaints relating to the advertising material or other product information concerned.

165. Moreover, the supervisor may need to pay special attention to specific issues in a short period of time. Indeed, the temporary nature of advertising requires the supervisor to respond quickly in terms of monitoring, intervention and sanctions.

#### **4.3.2 Understandable pre-contractual information**

##### *Supervisory requirements*

166. The supervisor may consider setting specific standards or issuing guidelines regarding pre-contractual information.

167. Pre-contractual information should be provided to the consumer prior to the purchase of the insurance product. The supervisor may set requirements regarding the specific timing of pre-contractual information and requirements that pre-contractual information (as well as final policy documentation) should be:

- provided to consumers free of charge
- prepared in written format or, at least, in a durable and accessible medium (electronic for instance)
- written in plain language, so that the consumer can easily understand the product features
- in prescribed language(s).

168. The supervisor could require insurers to disclose defined pre-contractual information to potential policyholders, such as:

- the insurer's contact details
- the product's main features
- the risks covered
- complaint handling policies
- the insurance cover's limitations
- the term of the contract.

##### *Governance monitoring*

169. Similar to approaches used in respect of product promotion and disclosure (see section 4.3), the supervisor may monitor the effectiveness of the quality and controls the insurer has in place regarding the production and dissemination of contractual and pre-contractual information. This may include a review of controls the insurer uses to ensure that information is in "plain language" and appropriate to its target market.

##### *Activity monitoring*

170. To prevent inappropriate sales, the supervisor may consider reviewing the quality of information provided to the customer either before a contract is concluded or on a sample basis thereafter.

### 4.3.3 Mandatory contract forms and standardised disclosure documents

#### *Supervisory requirements*

171. In some jurisdictions, the supervisor adopts specific mandatory contract formats. The objectives of a mandatory format are threefold: to standardise the drafting, to simplify the information given to the customer, and to make it easier for the customer to compare products. They can be mandatory either because of the needs of the target population or because of the nature of the contract.

172. Many insurance products are complex, making it difficult for consumers to understand the product characteristics. This has led some supervisors to introduce standardised disclosure documents (sometimes called a “Key Information Document”, or “KID”), or to call for such templates to be developed. A KID contains information such as the key features of the product, its risks, costs and benefits.

#### **COB Survey responses**

*Respondents were asked whether they monitor insurers in relation to the fairness, clarity and quality of product promotions and disclosures.*

A vast majority of respondents indicated that they actively monitor the fairness and quality of product promotions and disclosures. Different approaches applied from jurisdiction to jurisdiction, including the following:

- using an on-site inspection to verify that insurers give sufficient information to the customers in the prescribed form, if any. Other jurisdictions prefer to use only an off-site monitoring, for example, using periodic reporting by insurers. However, it is noted that many jurisdictions combine both approaches to cover as much potential source of consumer detriment as possible
- carrying out mystery shopping programmes in this regard
- relevant legislation stipulating that all advertising, promotion and offering services provided by insurers must be based on good faith and truthful facts, that is, advertising must be consistent with what is being offered to users
- the supervisor issuing guidelines regarding pre-contractual information to insurers.

### 4.4. Advice and conflicts of interest

#### *Supervisory requirements*

173. The supervisor requires that insurers have controls in place to ensure that, where customers receive advice before concluding an insurance contract, such advice is appropriate, taking into account the customer’s disclosed circumstances, and that any potential conflicts of interest are properly managed.<sup>47</sup>

174. Moreover, the supervisor usually requires insurers and intermediaries to have appropriate knowledge of the legal environment applicable to the insurance market, including legal provisions applying to insurance products, market participants, and consumer protection. Insurers and intermediaries should act ethically and professionally and their professional knowledge has to be appropriate and current. The supervisor may set principles-based requirements and / or specific rules in this regard.

175. In some jurisdictions, the supervisor prescribes specific governance requirements regarding the management and disclosure of conflicts of interest between intermediaries, insurers and customers – for example, by requiring insurers to have a “conflict of interest management policy” in place, meeting certain minimum standards. In some cases this may

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<sup>47</sup> ICP 19.6 and ICP 19.7.

include prohibitions of particular types of incentives or benefits which the supervisor regards as an unacceptable conflict.

176. Some jurisdictions may prescribe the amount, type or frequency of commission or other remuneration or incentives that insurers may provide to intermediaries.

177. Additional requirements imposed by some supervisors in relation to advice and conflicts of interest include requiring insurers to:

- have processes to verify whether the intermediary has gathered the necessary information on the consumer before the sale of an insurance product. One way of doing this is to have the intermediary use a standard form detailed questionnaire. Again, requirements may differ depending on the intermediary's status
- provide training or accreditation in relation to the insurer's products to intermediaries before allowing the intermediary to market the insurer's products.
- disclose to policyholders the status of the intermediary
- have processes to ensure that the distribution model used in a particular case is appropriate to the type of product and / or customer group concerned. For example, insurers may be required to determine whether it is appropriate to market particular types of products without advice, and to put appropriate controls in place to ensure fair treatment of customers.

### **COB Survey responses**

*Respondents were asked whether they monitor insurers in relation to the controls in place to ensure fairness of advice and distribution models.*

The majority of respondents indicated that they monitor this through a diverse range of tools including sophisticated ones utilising thematic reviews, mystery shopping and on-site inspections that are largely driven by complaints.

In some jurisdictions all distributors have to give comprehensive and key information on the insurance policy, to identify the requirements and needs of the consumer, to formalise in writing the advice given, and to maintain a client file.

Other respondents stated that they make sure, through COB reviews, that controls are in place to ensure fairness of advice and distribution models.

*Respondents were asked whether they monitor insurers in relation to the controls in place to mitigate conflicts of interest*

A vast majority of respondents indicated that they require insurers and intermediaries to set principles and establish internal mechanisms to identify, prevent and manage conflicts of interests, ensuring that when a conflict of interest does arise, the customer is treated fairly.

Some respondents stated that they require insurers to put in place a fire-wall between operational activities and compliance functions. They encourage or require insurance entities to adopt codes of conduct or ethical rules (in addition to more formal legislation/regulation). These rules vary depending on the complexity of the product sold. For example, codes of conduct may be more rigorous with regards to sales of investment-linked insurance products.

Some jurisdictions approve codes of conduct which are proposed by industry associations. A number of supervisors assess the internal control framework in respect of fair treatment of customers. On the other hand, some jurisdictions follow a more indirect approach because of varying business structures and resources, supervisors apply general principles of conduct but do not dictate specific management decisions within insurance companies. For example, supervisors can require the fair treatment of customers but do not explicitly require such standards be reflected in a company's strategic plan or code of conduct.

Some respondents pointed out that they also set rules on intermediaries' training to ensure that intermediaries are well aware of rules concerning the prevention of conflicts of interest.

#### *Governance monitoring*

178. Even where the supervisor does not specifically prescribe controls in relation to advice and conflicts of interest as discussed above, the supervisor will usually review the effectiveness of the insurer's own controls and processes from the perspective of ensuring suitable advice to customers. Typically, the supervisor will review mechanisms to identify, prevent, disclose and manage conflicts of interest. Such a review may also consider the extent to which the insurer's processes address the factors set out in paragraphs 166 to 170 under "supervisory requirements" above, even where these factors are not specifically prescribed.

179. Supervisors may review the manner of remuneration for those selling or providing advice to customers to ensure it does not jeopardise customer interests. The supervisor may determine the extent of disclosure (e.g. the manner and/or detail) that is required. Even where not specifically prescribed, remuneration and sales incentives should not influence the advice given to the customer.

#### *Activity monitoring*

180. The supervisor can monitor a variety of indicators to assess the fairness of the insurer's distribution and advice practices, such as:

- sales, termination and lapse data per type of distribution channel
- the types and amounts of remuneration paid to intermediaries
- distribution force data such as number of intermediaries recruited/contracted, retention of intermediaries, etc.
- advice related complaints data.

181. Additionally, the supervisor may require the insurer to notify it of any significant changes in distribution models or intermediary remuneration practices

### **4.5. Post-sale servicing and information**

#### *Supervisory requirements*

182. The supervisor requires insurers to service policies appropriately through to the point at which all obligations under the policy have been satisfied. The supervisor also requires insurers to disclose to the policyholder information on any contractual changes during the life of the contract, as well as other relevant information depending on the type of insurance product.<sup>48</sup>

183. Supervisors may require insurers to inform policyholders after a contract has been concluded about various specific matters, such as:

- any changes in the contract's supporting data or terms
- additional requirements
- in the case of savings or investment related contracts, details of investment performance from time to time (e.g. portfolio performance, profits, bonus amounts, the value of the units allocated to the policyholder, substantial modification of the assessment of an investment fund's risk).

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48 ICP 19.8.

184. Supervisors may also prescribe the timing of ongoing disclosures, for example requiring insurers to provide an updated benefit statement at least annually.

185. In some jurisdictions, supervisors require insurers to have controls in place regarding any outsourced services, to ensure that customer service is not compromised and that the outsourced service provider meets relevant service standards.

#### *Governance monitoring*

186. Supervisors may monitor the effectiveness of the controls an insurer has in place to monitor the quality of ongoing post-sale policy servicing and information, including services or information provided by outsourced service providers. In particular, the supervisor may monitor the insurer's disclosure systems that allow consumers to determine whether the product continues to suit their needs and expectations. Items typically reviewed include disclosures relating to:

- after-sales transactions
- performance
- contract amendments during the term of the contract
- if applicable, the rights and obligations of customers in connection with the changes
- substitution or replacement of a product
- portfolio transfers
- changes in the environment, such as legislative amendments that have an impact on the products customers hold
- organisational or operational changes involving the insurer that have an impact on customers, products or related services.

#### *Activity monitoring*

187. Most supervisors assess the quality of insurers' post-sale policies and procedures to determine whether these promote the fair treatment of the policyholder, insured, beneficiary or injured third party. They may also assess whether the insurer is acting responsibly in cases where information provided by a customer prior to the conclusion of the contract subsequently changes. The supervisor may also assess the insurer's procedures to support customers wishing to replace or substitute a product or change suppliers and the associated risks.

188. Other indicators of the quality of post-sale servicing that supervisors may review include:

- samples of post-sale servicing documentation, such as standard letters, annual benefit statements, etc.
- reports on adherence to/deviations from internal service standards and service levels of outsourced service providers
- service related complaints data
- customer satisfaction survey data.

## **COB Survey responses**

*Respondents were asked whether they monitor the quality of on-going post sale policy servicing and information.*

More than half of respondents indicated that this is included in the COB monitoring process and in general through on-site inspections. Monitoring approaches include:

- off-site monitoring
- via complaints handling
- COB thematic reviews
- post sale calls to policyholders (for investment-linked products)
- indications of large impact
- regular (random) testing to identify whether the information given by the insurer is correct.

Some respondents pointed out they also use mystery shopping techniques or programs to monitor the fair treatment of customers by insurers.

### **4.6. Claims**

#### *Supervisory requirements*

189. Supervisors require insurers to handle claims efficiently and fairly, and have claims handling procedures that are simple, transparent and accessible.<sup>49</sup> When purchasing an insurance product (i.e. in arranging the contract), and again later if a claim is made, supervisors usually require insurers to make the customer aware of:

- what is covered and what is not
- what the claims process involves, including what documentation is required, who to contact, etc.
- turnaround times for claims processing
- who to contact in the event of a claims dispute.

190. In some jurisdictions, specific timelines are prescribed for claims handling, such as maximum periods within which a claim decision must be communicated to the claimant, periods within which the claimant may dispute a decision, etc.

191. Supervisors may also prescribe various aspects of the governance processes insurers should have in place in relation to claims handling, such as requiring insurers to:

- develop and maintain a claims procedure manual
- have a dedicated claims handling function with adequate resources and suitably qualified/trained staff
- on receipt of a claim, provide the claimant with full details of all claim requirements and next steps. This should include details of the role of third party service providers such as surveyors, loss adjusters, repair services, etc. It should also include details of any relevant excesses, co-payments, subrogation or averaging processes
- keep the claimant informed of the progress of a claim (including reasons for any delay) and/or advise them how to track such progress
- provide adequate reasons for any rejection of a claim, including partial rejections

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49 ICP 19.9.

- provide contact and process details regarding how to appeal or dispute a claim decision (including any relevant alternative dispute resolution mechanisms)
- maintain certain minimum claims related records
- establish controls for combating fraud and money laundering appropriate to their exposure and vulnerabilities. These may include: making the policyholder / claimant aware of the consequences of submitting a false statement or incomplete statement; providing claims department staff with adequate training on fraud indicators; carrying out public awareness programmes on claims management and documentation; where legally possible, participating in relevant databases where claims susceptible to fraud would be reported.

192. In addition to claims handling governance requirements, supervisors may also set requirements or provide guidance in relation to fair claims handling standards. These may for example include prohibiting the insurer from:

- concealing any provisions of an insurance policy when they are pertinent to a claim
- dissuading policyholders, claimants, or beneficiaries from obtaining the services of an attorney or surveyor
- attempting to settle claims for less than the amount the claimant would be entitled to receive according to any written or printed advertising material accompanying the application forms
- denying a claim without reasonable investigation
- transferring responsibility for a claim to others (for e.g. third party service providers such as surveyors, loss adjusters, repair services, etc.), except as may be expressly provided for in the policy conditions.

#### *Governance monitoring*

193. Even where the supervisor does not specifically prescribe governance processes in relation to claims handling as discussed above, the supervisor will usually review the effectiveness of the insurer's own controls and processes from the perspective of ensuring fair claims handling practices. Such a review may consider the extent to which the insurer's processes address the factors set out in paragraphs 182 to 185, even where these factors are not specifically prescribed.

194. Supervisors usually analyse insurers' claim reserves. A spike in reserves can occur for a number of reasons, some of which might signal COB problems. A spike in reserves without a corresponding change in losses paid should be investigated.

#### *Activity monitoring*

195. Supervisors monitor, and in some jurisdictions make public, claims handling statistics, such as:

- claims/loss ratios
- average (median) turnaround times for disposal of claims
- settlements
- number and value of rejected claims, including reasons for rejections
- number and value of claims resulting in litigation
- number and cause of complaints relating to claims
- number, age and value of outstanding claims.

196. Loss ratio information identifies companies with greater claims. Significant deviations from the norm could indicate financial stress if the loss ratio is too high—or highlight the potential concerns about claim-handling or underwriting practices, if the loss ratio is unusually low. It must be kept in mind, however, that what is a “normal” loss ratio, consistent with profitable operations, may vary significantly depending on the line of business and, especially for “long-tail” lines of business, on changes in general economic conditions.

197. Supervisors usually also review (typically through an on-site inspection) the operational effectiveness of the claims handling function, including adherence to internal and outsource service standards and the competency of claims handling staff.

### **COB Survey responses**

*Respondents were asked whether they monitor claims handling processes and whether complaints data and claims ratios indicators are included in supervisory review.*

The majority of respondents indicated that the monitoring of claims/complaints handling processes within insurers is a high priority area in the supervisory review process through various means including on-site inspection, reporting requirements through regulations or guidelines; quantitative and qualitative assessment of corporate governance; COB-focused risk assessment; or in the course of performance evaluation of insurers.

In the same vein, most respondents stated that complaints data and claims ratios are reviewed and analysed on a regular basis in the course of off-site monitoring as COB related indicators and further investigated, where necessary, through on-site inspection in specific areas.

## **4.7. Complaints**

### *Supervisory requirements*

198. The supervisor requires insurers and intermediaries to have policies and processes in place to handle complaints in a timely and fair manner.<sup>50</sup> Complaints are a product of any normally functioning insurance market and insurers are generally required to have systems for handling them. Supervisors track trends in complaints, as they could point to broader problems.

199. In some jurisdictions the supervisor plays a role in relation to the establishment or operation of alternative dispute resolution structures. In other cases, supervisors themselves have a direct complaints handling role. See discussion in paragraph 2.2.6.

200. In some jurisdictions, specific timelines are prescribed for complaints handling by insurers, such as maximum periods within which a complaint must be resolved or responded to.

201. It is common for supervisors to prescribe various aspects of the governance processes insurers should have in place in relation to complaints handling, such as requiring insurers to:

- implement and maintain a complaints management policy that is usually required to be approved by the Board or Senior Management. The supervisor may also prescribe minimum matters to be addressed in the complaints management policy, including: that customers should be able to lodge a complaint through various channels free of charge; acknowledging and handling complaints received; the turnaround times involved in the various processes from acknowledgement to final disposal; when a complaint is considered finally disposed of; proper treatment of

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50 ICP 19.10.

complainant's information and personal data, according to applicable legal frameworks.

- have a dedicated complaints management function headed by a senior manager or Senior Management structure who reports at a senior executive level. The supervisor may also require the function to be protected from conflicts of interest (for example by having control over its own budget).
- maintain a register of complaints, containing minimum details such as: the subject of the complaint; data on the complainant; date of receiving and answering the complaint; result/outcome of the complaints; category of complaint e.g. class of insurance concerned, subject matter of the complaint, etc.
- keep complainants informed of progress of a complaint and reasons for any delays or decisions, including possible appeals.
- communicate details of and co-operate with relevant alternative dispute resolution forums.
- categorise and analyse complaints to identify and address any recurring or systemic problems and potential legal and operational risks.
- submit prescribed complaints data to the supervisor, including details of identified trends or recurring or systemic problems. In some jurisdictions public reporting of complaints data is also prescribed.

### **COB Survey responses**

*Respondents were asked whether they require insurers to report on serious complaints or an increase in specific complaints.*

Some respondents indicated that they require insurers to report on serious complaints/claims or an increase in specific complaints on a regular basis to identify the most common or potential problems in the marketplace. In addition, some jurisdictions require insurers to maintain a complaints registry to track all consumer complaints and make such registry available to supervisors upon request. Other jurisdictions, although they currently have no explicit requirement, also indicated that granular complaints/claims reporting requirements would be developed and implemented in the near future.

### *Governance monitoring*

202. Even where the supervisor does not specifically prescribe governance processes in relation to complaints handling as discussed above, the supervisor will usually review the effectiveness of the insurer's own controls and processes from the perspective of ensuring fair complaints handling practices. Such a review may consider the extent to which the insurer's processes address the factors set out in paragraphs 1911 to 194 above, even where these factors are not specifically prescribed.

203. The supervisor may also review the complaints handling culture of the insurer as an indicator of its general fair treatment culture. For example, the supervisor may assess whether complaints are handled strictly with reference to the terms of the insurance contract concerned, or whether the insurer also considers the general reasonable expectations of the complainant and the complainant's particular circumstances to arrive at a fair outcome.

### **COB Survey responses**

*Respondents were asked whether they handle complaints from policyholders and beneficiaries.*

The vast majority of respondents indicated that they handle complaints from policyholders and beneficiaries directly and indirectly with expectation of the following supervisory benefits:

- being able to identify and monitor abusive market practices or signals about COB related breaches of insurance regulation
- considering whether to take proactive supervisory action for consumer protection
- providing the public with a general recommendation based on deep analysis of complaints collected
- carrying out on-site inspection with respect to COB in a more effective and efficient manner.

Even in cases where the complaints against insurers are handled by self-regulatory bodies, supervisory authorities maintain a monitoring role to ensure that the complaints are properly managed in accordance with the rules and regulations within the self-regulatory framework established.

In some jurisdictions insurers publish details of their complaints handling process including:

- how to complain (the type of information to be provided by the complainant)
- the identity and contact details of the person or department to whom the complaint should be directed
- the process that will be followed when handling a complaint (e.g. when it will be acknowledged, indicative handling timelines)
- the availability of a competent authority, an ombudsman or alternative dispute resolution scheme.

#### *Activity monitoring*

204. Supervisors should review complaint information. This can include both quantitative data (such as complaints volumes, resolution rates, escalations, etc.) and qualitative complaints related information (such as samples of complaints related correspondence and reviews of the insurer's complaints analysis findings). From an efficient complaints analysis the supervisor can detect potential problems on both individual company and industry-wide levels. Complaint information can serve as an early warning system to detect problems (including potential risk mitigation problems) and to provide a basis for further COB review.

205. Despite the obvious correlations between consumer complaints and COB concerns, supervisors should be careful not to jump to conclusions purely on the basis of complaints data, nor should they conclude that the absence of complaints means an absence of COB problems. An exclusive focus on consumer complaints cannot be used as a substitute for a more thorough inquiry into an insurer's activities.

206. Nevertheless, complaint information is typically the single most useful source of data for COB supervisory review purposes. Complaints provide a great deal of information about the industry, individual insurers and real-time consumer concerns, including emerging issues in the marketplace.

207. Complaint information is one of the factors that should be considered in determining an insurer's risk categorisation, in the selection of insurers for further review and in determining the nature and scope of that review. Identifying insurers with consistently high levels of complaint activity can be a first step toward corrective action.

208. Complaints data should be reviewed as frequently as possible, such as quarterly or monthly, to spot trends in a timely manner. The supervisor can readily detect problems by comparing past statistical information on an industry-wide level, by product line or type of complaints, or on an individual company level.

209. Although the focus of analysis is on patterns and trends, some individual complaints by their nature will raise serious questions about an insurer's conduct, which call for follow-up even if the insurer's complaint trends are otherwise unremarkable. The supervisor usually

establishes criteria for complaint analysts to identify complaints which should be reviewed further. These could include inquiries from intermediaries or consumers about particular business practices.

210. Typically supervisors monitor the resolution of complaints off-site, using indicators such as:

- number of complaints
- number escalated to the supervisor, alternative dispute resolution forums, or other channels
- turnaround times for resolution
- number of complaints that have resulted in litigation.

211. The supervisor carries out on-site inspection, as required, of the effectiveness of the insurer's complaint handling procedures, and of specific complaints or thematic issues through a focused approach. Other approaches include:

- mystery shopping
- surveys of customers and intermediaries
- input from alternative dispute resolution schemes, other regulators, consumer organisations and the media.

#### **4.8. Privacy protection**

##### *Supervisory requirements*

212. Supervisors require insurers and intermediaries to have policies and procedures for the protection of private information on customers, including policies and procedures in place to prevent the theft, loss or inappropriate use of private customer information.<sup>51</sup> This is required because of the risk to customers and the threat to the reputation of insurers.

213. Even when outsourced, all activities related to receipt, storage and the processing of personal information remain the ultimate responsibility of the insurer. Supervisors therefore typically require insurers to have sufficient safeguards in place, in the outsourcing contract and in the insurer's internal processes, to prevent the misuse or inappropriate use of personal information through appropriate measures to protect the confidentiality and security of personal information.

214. Legislation identifies provisions relating to privacy protection under which insurers and intermediaries are allowed to collect, hold, use or communicate personal information of customers to third parties.<sup>52</sup>

215. Where the insurance supervisor is not the sole agency responsible for the protection of personal information, there should be clear channels of communication, through MOUs or administrative means, for the appropriate exchange of information on topics such as:

- misuse or the inappropriate communication of personal information
- breaches of laws, regulations, rules or guidelines
- sanctions, penal or criminal procedures or decisions, etc.

##### *Governance monitoring*

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51 ICP 19.12.

52 ICP 19.11.

216. The supervisor will usually review the effectiveness of the insurer's measures to protect consumer privacy such as:

- policies and procedures relating to privacy protection in order to ensure compliance with legal provisions and industry best practices
- quality of necessary training of employees at all levels of the organisation, in order to promote awareness of privacy protection requirements
- internal control mechanisms that meet the objectives of privacy protection and support the achievement of those objectives
- whether the appropriate technology is available and in place to manage adequately the financial, medical and personal information an insurer is holding on a customer
- policies and procedures relating to managing risks pertaining to security breaches
- ensuring that group structures are not used to circumvent prohibitions on the sharing of personal information.

217. In addition, the supervisor may review controls aimed at ensuring that:

- consumers are notified, on a timely basis, of any breach in confidentiality liable to jeopardise their interests or rights
- supervisors are notified of any violation of the protection of private information liable to jeopardise the interests or rights of consumers and the insurer's reputation
- responsible individuals within the insurer are informed of any breach in confidentiality on a timely basis.

#### *Activity monitoring*

218. Supervisors assess insurers' procedures and safeguards, and their observance of data protection laws, by on-site inspection or off-site monitoring. This should include data protection procedures and controls where aspects of the business are outsourced.

#### **COB Survey responses**

*Respondents were asked whether they monitor controls to ensure the protection of confidential customer information.*

In many jurisdictions, the protection of personal information is dealt with in legislation other than the insurance legislation. A different authority might therefore be solely responsible for compliance by insurers with obligations on the protection of personal information. This responsibility may also be shared with the insurance supervisor.

However, even if another authority is involved, some insurance supervisors nevertheless require insurers to have appropriate controls, safeguards and procedures for protecting the personal information of policyholders.

Most supervisors monitor this through on-site inspection. However, in some jurisdictions, it is monitored through off-site monitoring, disclosure by the insurer via its annual reporting requirements, or in connection with the handling of customer complaints.

## 5. Other supervisory tools and approaches to COB supervision

### 5.1 Behavioural economics

219. The use of “nudges” to influence consumer behaviour and gently push them towards a purchasing decision has become a familiar concept – for example, supermarkets are not laid out as they are by accident. In some sectors, including financial services, however, such influences are not so easy to spot. As a consequence, some supervisors are turning to behavioural economics to help them understand consumers’ choices. For various reasons people may make errors when choosing and using financial products, and can suffer considerable losses as a result. By using behavioural economics, supervisors have an additional tool to help them understand how these errors arise and why they persist. This in turn may help inform decisions on what can be done to mitigate them.

220. The growing literature on behavioural economics shows that some errors made by consumers are persistent and predictable. This raises the prospect of firms designing business models to exploit these behaviours, rather than competing on price and quality. Understanding behavioural economics enables supervisors to determine how best to counter such business models and secure better outcomes for consumers.

221. While it is common sense that people make mistakes, behavioural economics goes beyond intuition and aids in detecting, understanding, and remedying problems that arise from consumer mistakes. Supervisors can take a closer look at the biases that have the most harmful effects on the decisions that consumers make, and what can be done to mitigate these effects. The findings can be incorporated into supervisory strategy, including integrating behavioural economics into conduct of business regulation and supervision to enhance regulatory and supervisory effectiveness.

### 5.2 Communication with industry and consumers

#### *Publication of forward-looking risk assessments*

222. Some supervisors are taking a more forward-looking approach to COB risks. This involves setting out an assessment of the risks foreseen as developing in the near future, typically over the next 12 or 18 months, together with the likely supervisory action should those risks crystallise. The assessment may also include an explicit message concerning the supervisor’s expectations of how firms should engage with and react to the analysis contained in such a risk assessment.<sup>53</sup> Such risk assessments could include both risks arising from the business models and practices of insurers and other financial institutions, as well as risks arising from broader economic, regulatory or other external developments.

223. Communicating such risk assessments can encourage insurers to be mindful of mid- to long-term risk, and to take these risks into account in their current and future business plans and strategies and product development. In addition, where there are issues that supervisors are unable to tackle alone when it comes to the root cause of some of the COB risks identified, proactively highlighting such issues of concern can help to stop the issues from becoming major problems.

#### *Dialogue*

224. Supervisors can utilise regular communication events that are designed to discuss topics related to customer fair treatment. Through such dialogue the supervisor can take the opportunity of sharing a clear and common understanding of what is meant by this principle, as well as of promoting and discussing ways in which the industry can reach the goal of treating customers fairly. Such dialogues can take place through various forums, including

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<sup>53</sup> See for example the UK Financial Conduct Authority’s Risk Outlook 2014.

events hosted by the supervisor itself, industry or professional association events, consumer events or, where appropriate, events hosted by specific institutions.

#### *Public disclosure*

225. Some supervisors publish data related to business conduct, which could include information such as

- warnings
- performance by the industry in relation to conduct indicators or against conduct-related benchmarks (for example data reflecting performance in respect of customer complaints or insurance claims data)
- progress by the industry or individual firms in addressing particular weaknesses or in undertaking specific remedial action
- supervisory action taken (including enforcement action).

226. Public reporting of such data by the supervisor can:

- contribute significantly in encouraging progress by the industry in addressing potential market conduct issues, in a proactive and transparent manner
- influence market conduct behaviour by the industry in dealing with consumers and customers
- influence the culture and financial awareness of consumers in purchasing insurance
- reinforce and enhance the awareness on market conduct issues by providing multi-channel feedback from broad range of stakeholders.

227. Some supervisors also publish, or require insurers themselves to publish, data on individual insurers' performance in relation to appropriate conduct indicators or benchmarks – such as complaints or claims related data. The reputational impact of such public disclosure can act as a deterrent to unfair customer treatment, and an incentive for insurers to compete over the quality of the customer experiences they deliver.

#### *Regulatory guidance*

228. Some supervisors publish guidance to the industry regarding conduct of business requirements, to supplement formal conduct of business requirements. The legal status of such guidance will depend on the jurisdiction's legal regime, varying from non-binding guidance in some cases to other cases where the guidance is binding but not necessarily subject to the same enforcement processes as explicit rules-based requirements. Guidance can take the form of setting out the supervisor's expectations on particular conduct requirements; an indication of how the supervisor interprets or intends to supervise a particular conduct requirement; or examples of what the supervisor considers good or poor conduct practices. Such guidance, even where it is non-binding, can be a useful tool for avoiding disputes as to the regulator's expectations in the event that formal enforcement action is required, particularly in the case of principles-based requirements. Where a supervisor raises concerns with an insurer regarding its compliance with a principles-based requirement, it is more difficult for the insurer to argue that the supervisor's expectations regarding compliance with the principle were unclear, where guidance has been provided.

### **5.3 Other approaches**

#### *Complementary risk identification*

229. Some supervisors have in place a central system for collecting indicators related to financial consumer protection. All such indicators come in to a central point for analysis that

takes into account other relevant internal and public information and are then referred for action, where relevant.

230. The sources of such indicators can include:

- consumers
- insurers
- other government and consumer agencies
- cross-border and international supervisory authorities.

231. The supervisor could also share the results of such analysis with these organisations when it concerns risks to consumer protection outside their own remit.

232. The findings of such analysis would also typically be used to inform the content of published risk assessments, as discussed in section 5.2 above, where these are produced.

#### *Internal changes to enhance consumer protection*

233. Supervisors sometimes require insurers to make internal structural changes in seeking to ensure that they give sufficient attention to the interests of customers. Where this takes place, the supervisors can assess the impact of such plans on customer treatment. Such an assessment can focus on both the scope and structure of the change plans as well as on the speed of their implementation. The supervisor can consider how organisations are steered in a comprehensive way, including whether top management leads by example, how the principle of the fair treatment of customers is communicated to staff, and how a culture is embedded within the insurer that promotes relevant factors such as customer involvement, conduciveness of people to change, attitude to feedback and effective governance on consumer protection matters by the Board.

#### *Changes to the supervisory structure*

234. Some jurisdictions have reviewed their supervisory structure and made, or are planning to make, changes to ensure that conduct supervision receives appropriate resources and attention.

#### *"Dashboards" or similar rating tools*

235. Supervisors may develop market conduct "dashboards" or other assessment tools that are based on customer treatment indicators to measure the extent to which insurers are prioritising customer interests and delivering fair outcomes for customers. These measurements can be translated into a score or ranking, and be used to identify trends (whether positive or negative) or areas of concern.

236. Individual discussions with different companies about the results of these assessments enable the supervisor to benchmark different companies, as well as identify good practices and areas for further improvements. In addition, the general assessment findings can be shared (without identifying individual insurers) with industry more broadly, to create shared understanding of good and poor practices, and help insurers benchmark their own assessment ratings against those of their peers.

#### *Self-assessment*

237. Some supervisors encourage insurers to assess their own compliance with conduct of business requirements, and share the results with the supervisor. Sometimes such self-assessments are used in combination with other information gathered and analysed by the supervisor. The additional information helps the supervisor to judge the credibility of the self-assessment, engage in further interaction with the insurer for validation purposes, and then take the self-assessment into account its own assessment of the insurer. The self-assessment thus contributes to, but does not alone determine the supervisor's assessment

of the insurer. Where weaknesses are identified these can be used to influence the degree of supervisory intensity needed, as well as to require improvements to be made.

238. Such self-assessments can take the form of “dashboards” or other self-assessment tools as described in paragraph 228 above. The self-assessment tool can either be developed by the insurer itself, or in some cases the supervisor may develop a self-assessment tool which insurers may use or adapt voluntarily. Again, discussing self-assessment results with the insurer will assist the supervisor in understanding the challenges and successes the insurer is experiencing in relation to fair customer treatment, and identify and agree action to be taken.

### **COB Survey responses**

*Survey respondents were asked whether they had made recent changes to their approach to COB supervision, or whether such changes were planned in the near future.*

Responses to this question highlighted an increasing supervisory focus on COB matters. Nearly half the respondents provided details of recent or pending initiatives to intensify COB supervision practices, including:

- new insurance legislation and/or regulatory guidance with enhanced COB provisions
- strengthening of the supervisor’s mandate in relation to market conduct/business practices
- focusing on unfair contract terms
- a growing trend toward COB related data collection and analysis
- moving to a Twin Peaks model, with prudential supervision and market conduct supervision carried out by separate regulators, with dedicated focus on COB supervision.

**Selected reference to international standards or material on COB supervision**

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- AMF, Quebec: Sound Commercial Practices Guideline (June 2013)
- EIOPA: Guidelines on Complaints Handling by Insurance Undertakings (June 2012)
- EIOPA: Report on Best Practices by Insurance Undertakings in handling complaints (June 2012)
- EIOPA: Report on Good Practices on Comparison Websites (January 2014) FCA, UK: Journey to the FCA (October 2010)
- FCA, UK: Applying behavioural economics at the Financial Conduct Authority (April 2013)
- FSA, UK: Mystery Shopping Guide (November 2006)
- FSA, South Africa: Implementing a twin peaks model of financial regulation in South Africa (February 2013)
- NAIC: Market Regulation Handbook (2013)
- OECD: G20 High-level Principles on Financial Consumer Protection (October 2011)