Strategies for Managing Reputational Risk around the World

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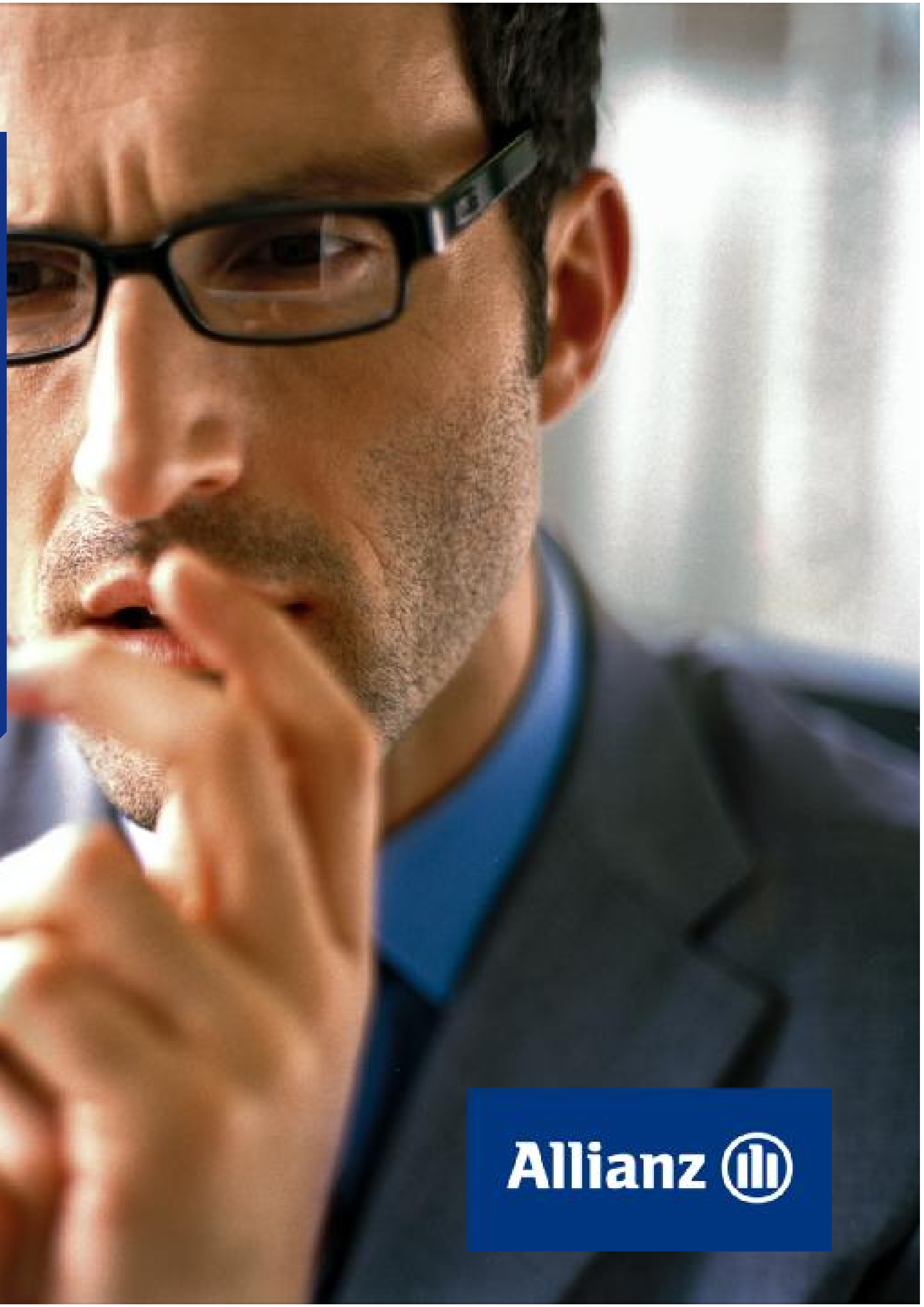

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Agenda

1

Definition of Reputational Risk

Unexpected drop in the value of company share price, value of in-force business or value of future business caused by a decline in the reputation of the organization or one or more of its specific subsidiaries from the perspective of its stakeholders:

Customers, regulators, press, staff, NGOs, pressure groups, shareholders….

Reputational risk events arise from one of two sources

Direct Reputational Risks	Indirect Reputational Risks
…are consciously and actively taken-on during the course of specific business transactions.	…are inherent in the operations of the company and not related to specific business transactions. They normally result from the occurrence of non-reputational risk events (e.g. operational risks)
Examples	**Examples**
…investment in an infrastructure project (i.e. highway) designed to bi-sect a sensitive ecological reserve …providing cargo transport insurance for a shipment of weapons from Ukraine to Sudan	…IT security / data breach …fraudulent financial misstatement … market conduct finding … viral complaint … contagion from other firm in group

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Environmental, Social and Governance

E

Environmental Pollution, Water Use, Renewable Energy, Biodiversity, etc.

S

Child Labor, Health & Safety, Indigenous Rights, etc.

G

Controversial Weapons, Bribery & Corruption, Money Laundering, Tax avoidance, etc

Advocacy groups and NGOs are very interested in ESG!

Case Study – Writing Property and General Liability Cover for a Gold Mine in Africa

Basic Information about the Insured and Insurer	• Mine is written by a locally licensed subsidiary of an international insurance group in an unstable dictatorship in Africa. The country has recently struggled through a civil war and is still subject to civil unrest. • Mine is 70% owned by a mining company headquartered in Australia and 30% by the government.
Coverage Information	• Property cover includes buildings, contents and business interruption with a limit of USD 500 mn and a possible maximum loss (PML) of USD 300 mn. A flat USD 10,000 deductible applies. • Liability cover is USD 100 mn with no deductible. • Parent company, mining company captive, and London market participate in reinsurance.
Key Risk Characteristics	• Loss control reports indicates average controls in place with some significant recommendations for improvement. • The gold is processed using cyanide. The cyanide and other liquid waste is held in “in ground lakes” until it can be disposed. • The mine is upstream from an indigenous religious site and several rural villages. • Government soldiers and a local private contractor hired by the mining company provide security for the mine. • Human rights groups have questioned the employment practices of the mining company.

Case Study 1 – Writing Property and General Liability Cover for a Gold Mine in Africa - Risk Issues

Resettlement of Current Residents	• Does project involve relocation of people? • Does project impact water rights? • Has free informed consent been obtained? • Were relocated people appropriately compensated?
Environmental Issues	• Does project involve mountaintop or hilltop removal? • Have environmental and health impacts been considered (including transportation)? • Are there appropriate plans for de-commissíoning? • Does the project involve disposal of toxic substances (tailings)? • Will cyanide be used? How is the cyanide handled?
Protected Sites and Species	• How far away are environmentally or culturally significant sites? Are they affected? • Are endangered species impacted?
Workforce Rights	• What plans are in place to prevent child/forced labor and substandard working conditions? • Are union/collective bargaining activities tolerated? • What is the reputation of security personnel?
Other Reputational Issues	• What is the reputation of the mining company? Has the mining company been a target of NGOs? • What is the reputation of the government regarding corruption and human rights abuses? • What provisions are in place to prevent corruption or bribery? • Will the profits from the mine be used to violate civil rights (e.g. blood diamonds)? • Are there other reputational risk issues not noted above?

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1 Introduction to Reputational Risk

2 Environment, Social and Governance (ESG)

3 **Conduct Risk**

4 Risk Management Strategies

Conduct Risk

Product design – Are products appropriate for the specific customers?

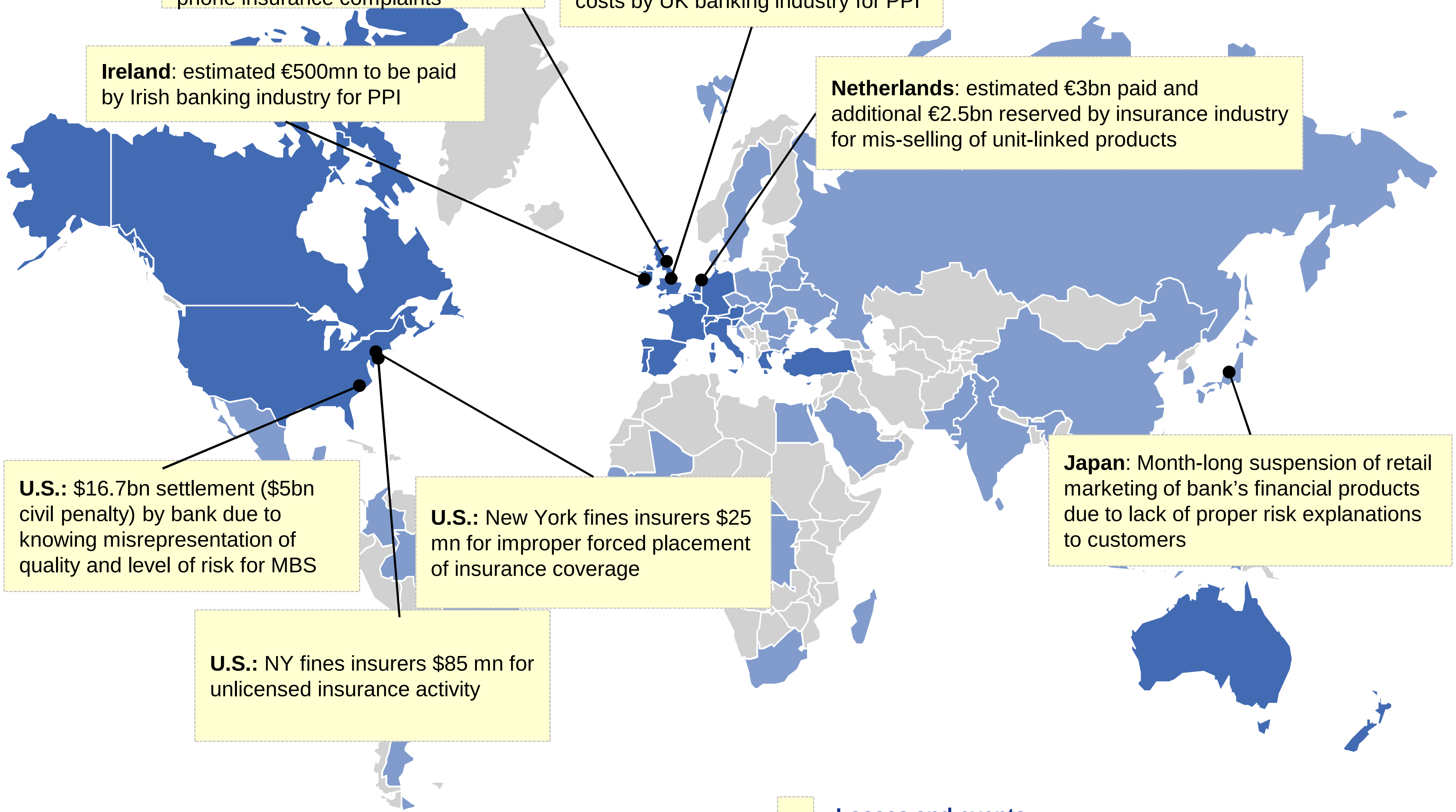
Unfair Discrimination – Are prices, terms & claim pmts. consistent for similar risks?

Sales – Are insureds coerced inappropriately?

This is not new to US insurers who face varied and detailed rate, rule and form regulation.

Recent Wave of Conduct Risk Cases

Big-ticket items focused on banking sector, but insurance will increasingly be targeted



UK - The Financial Conduct Authority in the UK fined one intermediary GBP 2.8 mn for poor handling of cell phone insurance complaints

UK: estimated £26bn compensation costs by UK banking industry for PPI

Ireland: estimated €500mn to be paid by Irish banking industry for PPI

Netherlands: estimated €3bn paid and additional €2.5bn reserved by insurance industry for mis-selling of unit-linked products

Japan: Month-long suspension of retail marketing of bank's financial products due to lack of proper risk explanations to customers

U.S.: $16.7bn settlement ($5bn civil penalty) by bank due to knowing misrepresentation of quality and level of risk for MBS

U.S.: New York fines insurers $25 mn for improper forced placement of insurance coverage

U.S.: NY fines insurers $85 mn for unlicensed insurance activity

Losses and events

Trends in Conduct Risk

- Conduct enforcement has been common in Anglo markets (US, UK, Ireland and Australia) for some time
- Intensity of regulation in these markets has increased since financial crisis
- The UK has been especially active in recent years especially since solvency regulation and conduct regulation has been split into two different entities
- Conduct regulation has become more active on the continent with significant activities in the Netherlands, Germany, Italy and Poland
- The European Insurance and Occupational Pensions Authority (EIOPA) has become more active in this area in the last year
- We expect that conduct regulation will spread to Eastern Europe especially with EIOPA involvement
- Eventually conduct risk will grow in other jurisdictions as well

We want consumers to be able to trust that the firms we regulate have their best interests at heart by providing them with appropriate products and services.

We work to protect consumers from the harm that can be caused by bad conduct in the financial services industry.

We act to ensure that a firm has its customers at the heart of how it does business, giving them appropriate products and services, ***and putting their protection above profits or remuneration.***

An **'approved person**' is an individual who we approve to do one or more activities for an authorised firm. We call these activities 'controlled functions'.

This person has to know and meet our regulatory requirements, as well as understand how we apply them. They must:

- meet the requirements of our 'fit and proper' test and follow its principles
- comply with the Statements of Principle and Code of Practice (these explain the behaviour we expect of people we approve)
- report anything that could affect their ongoing suitability to us and the authorised firm

We can only approve people who we are satisfied are fit and proper to perform the controlled function(s) they apply for.

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Rules

- Am I following the rules?
- Lawyers

Principles

- Do I treat my customers fairly?
- UK Compliance

Outcomes

- Do my customers think I'm being fair?
- Risk management

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A mobile telephone

A mobile jukebox and TV

A mobile library

My life

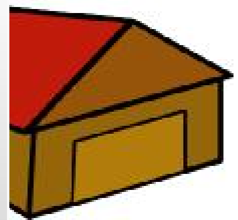
A computer

My friends

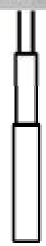
An ATM and charge card

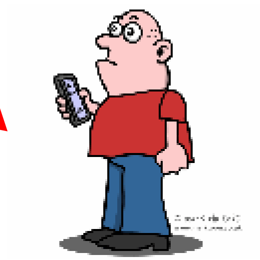
A railway season ticket

Total UK insurance
market size ~£30bn

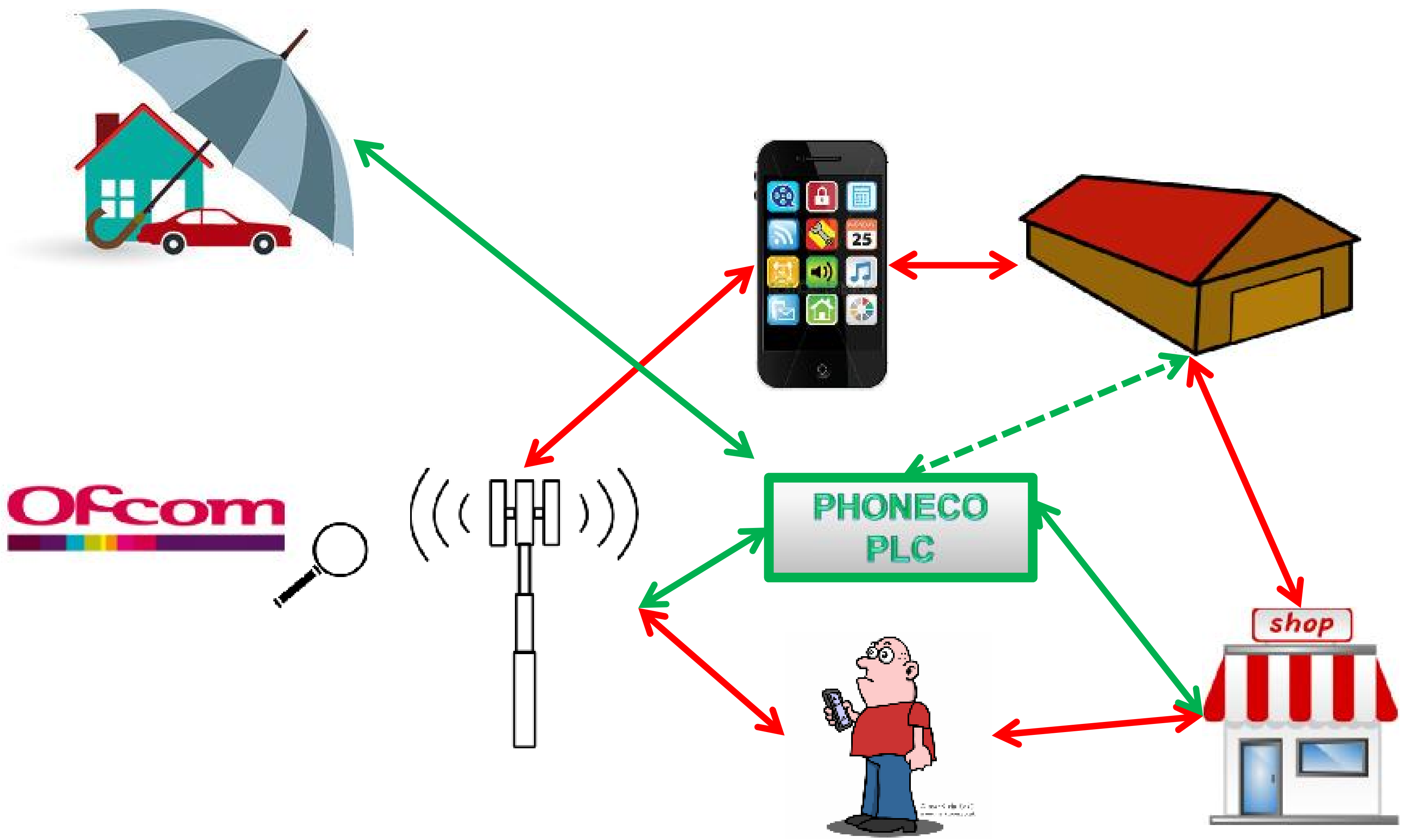


LET'S SELL SOME INSURANCE!





The traditional model



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Risks – distribution controlled by Phoneco

Product design

For the convenience of Phoneco…

…taking advantage of Connected Contract Exemption to insurance sales regulation

High deductible, restrictive terms and conditions

may mitigate anti-selection risk, but is it what the customer expects?

No cover for "my life"

Product pricing

High commission, with profit share for Phoneco **à** low loss ratio, high COR

Product lifecycle

Sales incentives for shop staff, trained to sell phones not insurance **à** mis-selling

Monthly Direct Debit from bank account **à** do customers realise they're insured?

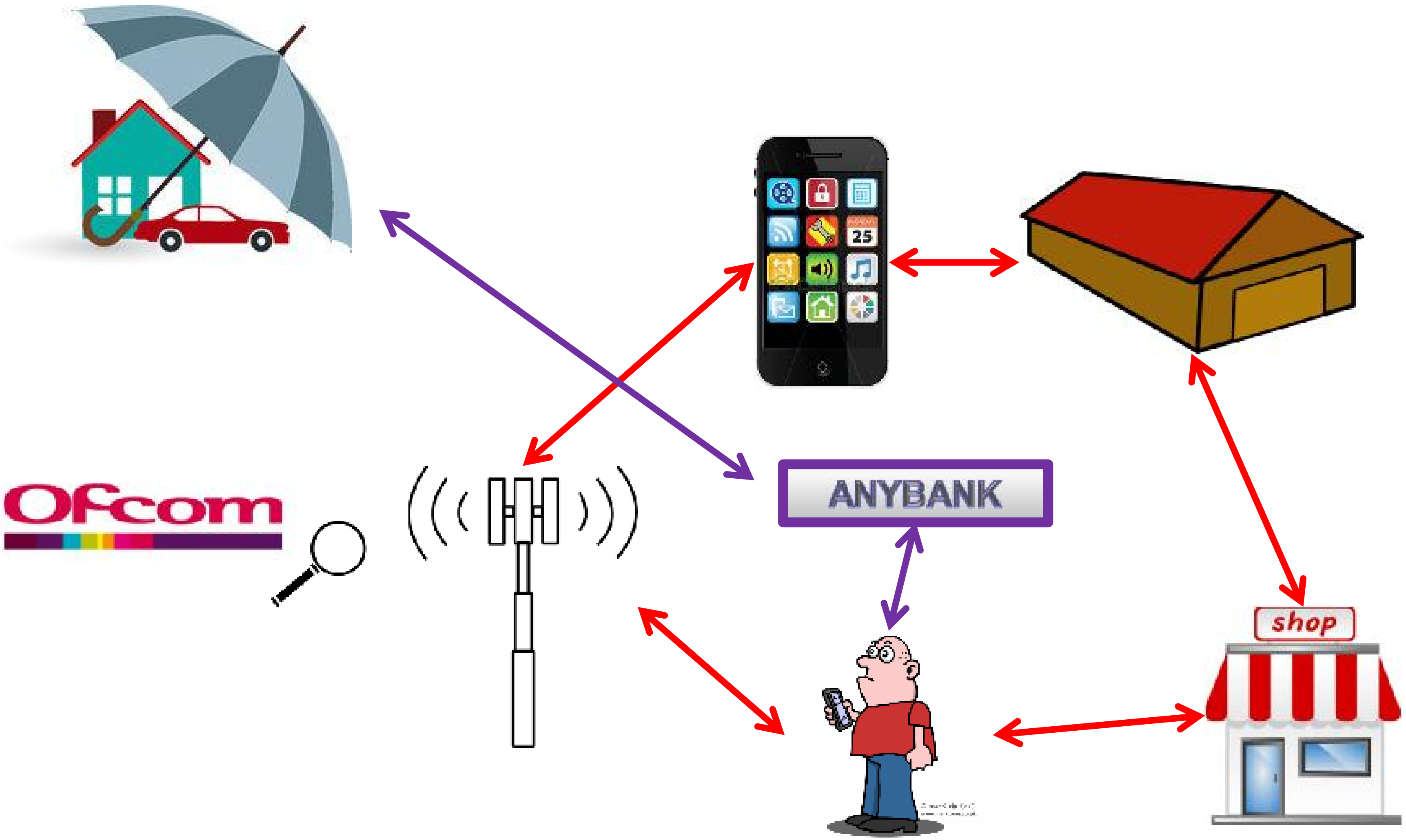
Claims handled by phone administrators and wholesalers, not insurers

Onerous and inconsistent conditions on claim **à** unfair barriers to claim

Some nations' police forces don't accept reports of mobile phone theft

Insurer is at arms-length … but has responsibility for performance of whole life cycle other than point of sale

The banking model



Risks – value added bank account

NB: UK current (checking) account banking is typically free to the customer as long as you stay in credit

à *banks look to sell “value-added” packaged add-ons, like travel and phone insurance and special offers. The market is still small.*

Product design

For the convenience of Anybank … who is FCA regulated … sale is regulated
Anybank wants to protect its reputation with the FCA by offering good quality products

Product pricing

High commission, with profit share for Anybank **à** low loss ratio, high COR

Product lifecycle

Bundled product **à** Risk of dual insurance, insufficient insurance or insurance customer doesn’t know they’ve got
Claim process under control of insurer **à** can be controlled effectively

Insurer controls much of the lifecycle… sharing responsibility with a sophisticated and regulated partner

The future?

- ü Phone and gadget insurance a growing market – around the world
  - ü Big opportunities in developing world
- ü Opportunity for cheaper prices – if you can get to the customer
- ü Opportunity to design a good quality product that customers want
  - ü A phone has a lot of emotion invested in it (like a pet)

- ? Can we insure "my life"? It's what the customer wants
    - ü My contacts. My health records. My money. My vote. My identity

v BUT

- v Mobile phone insurance is fraud-prone and exposed to cyber-risk
- v Customers don't *really* know what they want – it's a very immature market
- v Insurance industry is a follower, playing catch-up in a very rapidly developing technological world

Reputationally, starting from a very weak place

Case Study – Existing Medical Conditions Exclusion

Background

Broad Insurer Risk

- Key value in travel insurance is reimbursement for cancellation due to sick family member
- Definition of “family member” is very broad (e.g., spouse, domestic partner, stepparents, children in the adoption process, in-laws, live-in caregivers, service animals, etc.).

Travel protection is recommended

Peace of mind is only a click away

Yes, add travel protection for a total of $<Total Price> for all travelers in this reservation.

All these benefits for a fraction of the ticket cost:

- **Get reimbursed up to 100%** of non-refundable, prepaid trip costs due to covered injury, illness, or other covered reasons
- 150% trip interruption protection of ticket costs
- Travel delay protection

"It's wise to always consider a travel protection plan to cover your trip costs from the unexpected."
– Frommer's, May 2015

Free Review Period You have at least 10 days to review the policy and cancel for a full refund of insurance fees paid if you have not yet used the coverage or started your trip.

No, I choose not to protect my purchase.

Case Study – Existing Medical Conditions Exclusion

High Risk of Unfavorable Customer Experience

Insurer Risk Managed via Exclusion for “Existing Medical Conditions”

Select Products Include Exception to the Exclusion (“EMC Waiver” or “EMC Coverage”)

Exception Subject to Conditions

Modest Level of Communication Prior to Claim

Denied Claim Can Lead to Reputational Issue

Unfavorable Social Media Post

Insurance Department Complaint

Loss of Future Business

4

Considerations in Establishing Conduct Risk and ESG Standards

Alignment with Brand and Risk Appetite

- Standards vs value proposition to customers and shareholders
- Brand identity
- Alignment with Group appetite
- Alignment with appetite of the individual entities

Conflicting Business Model

- Alignment of underlying business model with appetite
- Relationship between needs of partners vs standards (B2B2C relationships)
- Consistency of standards and producer needs

Regulatory Approaches in Various Jurisdictions

- Differing levels of regulation in different jurisdictions
- Situations where regulatory standards (including market practice) are weaker than the standards
- Retroactive enforcement (e.g. bad press, court or regulatory rulings)
- Evolution of regulatory attitudes (especially in Europe)

Cultural and Market Expectations

- Inconsistency between standards and local market practice
- Evolution of local market practice (e.g. increasing commission rates)
- Appetite of insurer to “lose volume” or upset producers to maintain higher standards

Other Reputational Issues

- Reputational “blowback” (reputational problems for taking a stand that might not be popular with some)
- History of reputational risk or conduct risk problems for the company or competitors

Examples of Potential ESG Indicators for Selected Industries

Mining, Hydro Electric, Infastructure, Oil and Gas

- Environmental risk
- Protection of sites and species
- Forced resettlement
- Workforce issues
- Health related risks
- Governance risks

Ánimal Testing, Animal Welfare

- Animal treatment (e.g. genetic modification, routine mutilation)
- Use of Growth promoting substances
- Slaughtering procedures
- Live transport
- Use of apes
- Ethical review procedures
- Living conditions of the animals
- Use of wild animals

Clinical Trials, Gambling, Sex Industry

- Protection vulnerable people
- Ethical and scientific review procedures
- Insured ties those with criminal backgrounds
- Employee testing
- Prevention of human trafficking
- Workforce issues

Process for ESG Exposure Evaluation

Risk Identification

- Identify industries and account types prone to ESG exposure
- Develop expertise in ESG issues for those account types
- Determine appropriate ESG indicators

Account Evaluation

- Create guidelines and evaluation tools for underwriters
- Underwriters use tools to evaluate risk
- In cases that are not clearly low risk, underwriters consults with ESG experts

Decision

Underwriter and ESG expert work together to determine if the insurer should

- Accept the risk
- Accept the risk subject to specific mitigation actions
- Decline the risk

Appeal

- High level process to review troublesome risks or in cases of disagreement including representatives from
- Risk
- Communications
- ESG
- Underwriting
- Senior management

Examples of Potential Conduct Risk Indicators

Customer Service and Product

- Claims declinations
- Complaints from insureds
- Cancellation, non-renewal, retention ratios
- Regulatory complaint, investigation or discipline
- Judicial or quasi judicial (arbitration or ombudsman) decisions regarding the product

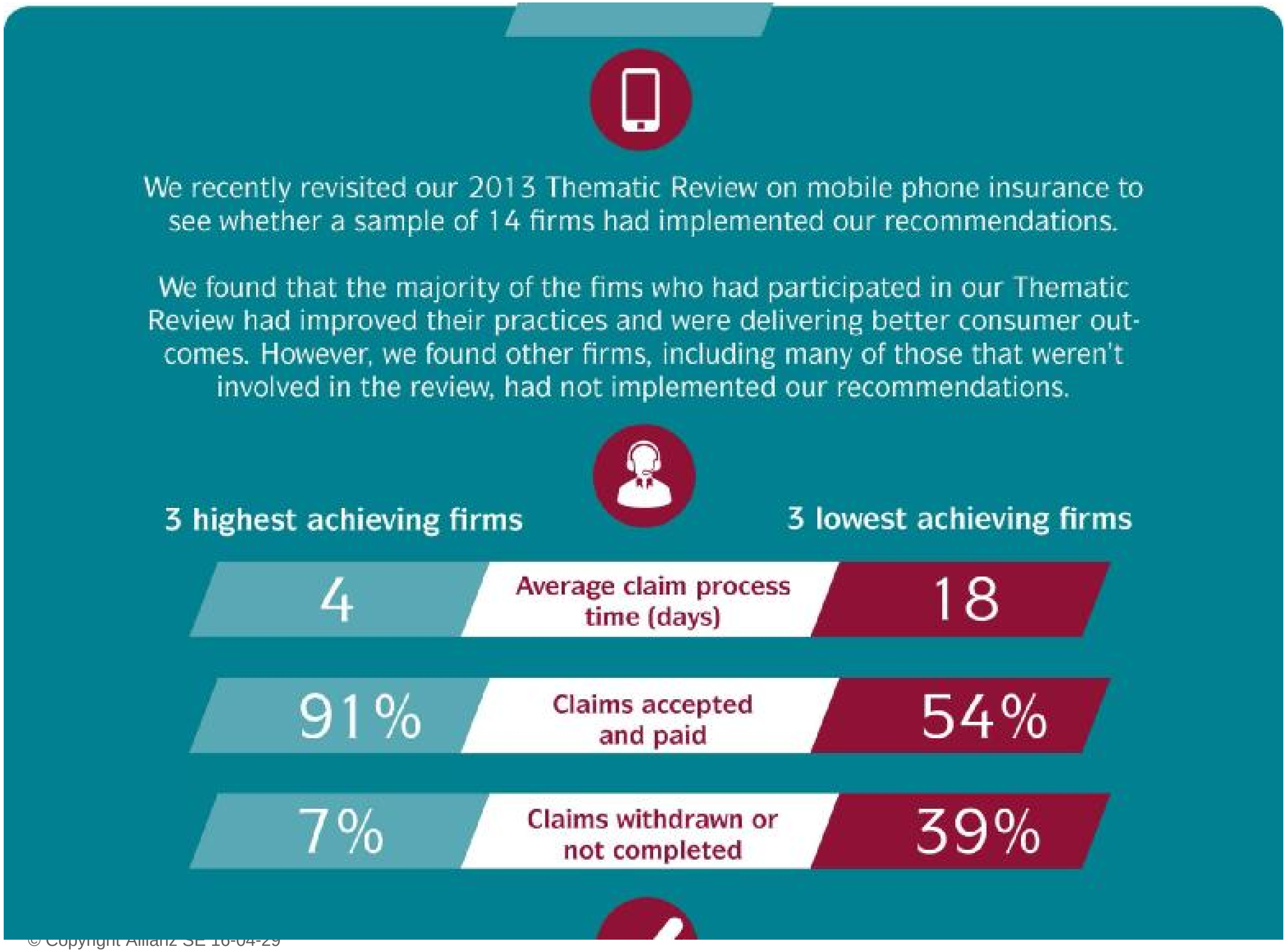
Cost and Efficiency

- Clear disclosure of premium to the insured
- Expected loss ratio or profitability
- Expense ratio

Production

- “Opt-out” vs “Opt-in” (e.g. internet produced products)
- Use of outbound sales calls
- Commissions and incentive compensation
- Producers who sell other products or are not “professional insurance experts”
- Multi-level sales programs
- Insurer right to audit, terminate, discipline and train producers. Insurer ability to enforce standards on producers

FCA 2013 thematic review, 2015 followup – extract



http://www.fca.org.uk/your-fca/documents/thematic-reviews/mobile-phone-insurance-follow-up-review-findings-infographic

AGA US – Conduct Risk Mitigation

Customer Centricity:

Organizational Focus (Dedicated Leader, Cross-functional Integration)

Website Redesign

Enhance Coverage

Clarify Policy Language

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- Protection for existing medical conditions

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AGA US Social Media Engagement

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There are four key steps in AGA US's engagement of online complaints.

Monitor

- Manual review and counting of 31 feedback sites/forums daily
  (e.g. Yelp, TripAdvisor)
- Automated alerts from Hootsuite Enterprise for Facebook and

Engage

- 24-hour reply to all posts
- Cross-divisional resolution
- Positive comment capture and promotion

Analyze

- Social media customer trends (volume and content)
- Message board posts
- Surveys

Improve

- New marketing initiatives
- New service initiatives
- New product initiatives

AGA US – Social Media Engagement

AGA social media responses are designed with three communication objectives.

Humanize

- Begin and end with introduction and name of team member
- Showcase support, empathy
- Deliver customized responses
- Change the conversation

Clarification and Education

- Document comments for customer experience purposes
- Explain covered reasons and exclusions
- Highlight 95% customer satisfaction, A+ rating with Better Business Bureau
- Explain travel insurance concept of unforeseen vs. foreseeable

Fulfill Customers' Service Needs

- 10-day Satisfaction Guarantee
- 24/7/365 customer service availability

Questions