

The Financial Regulator's Perspective on the Changing Customer
Landscape

Insurance Institute Conference

Patrick Neary, Chief Executive, Financial Regulator

8 September 2006

Good morning and thank you for inviting me here today to share some thoughts with you on the changing customer landscape.

Certainly the customer and regulatory landscape has evolved enormously in recent years and continues to change at a fast pace. If we were sitting here in this same room ten years ago – I think we might well have been debating different issues and certainly I welcome your interest today in the consumer agenda, this is very much to the fore in today's regulatory environment.

Stepping back in time to 1995, almost 400 insurance firms were entitled to operate in the Irish market, comprising Irish head offices, branches of non-Irish firms and those notifying to do business cross border. In that year - a total of €4.6 billion in premium income was taken in by the sector. At that time, insurers were subject to prudential supervision by the then regulator, the Department of Enterprise and Employment and any consumer protection at the time, was largely driven by voluntary codes of conduct developed by insurance representative bodies.

Comparing that with today's insurance landscape - the most recent Insurance Statistical Review for last year, 2005, showed that Gross Premium Income written in Ireland totalled €31.1 billion – six times the gross premium income of 1995. Today, over 900 insurance firms are entitled to operate in the Irish market.

While some consumer protections were in place 10 years ago through voluntary codes of compliance, consumer protection was not enshrined in legislation and the regulatory framework. It is possible that in that environment shareholder returns may have been a more significant priority for boards than ensuring consumers were sold the most suitable and appropriate product.

A key driving force behind the establishment of the Financial Regulator was a determination to put the consumer at the heart of financial services regulation. Our overall function is to help consumers to make informed decisions in a market which is both safe and fair. This includes monitoring the solvency of Irish financial firms, strengthening consumer protection rules and considerably enhancing and developing consumer information. We believe strongly in transparency, competition and choice for the consumer.

I believe that within this changing environment, an unconditional commitment by boards and management to good corporate governance, combined with the new consumer focused regulation can bring benefits for consumers and provide winning strategies for insurance companies in the Irish market.

The Changing Environment: the factors

So, how and why has the environment changed? All of you attending here today will have experience and views on how the customer landscape has changed, but I see that it has been the result of three factors:

- Changes in the regulatory landscape – both domestically and from Europe;
- Changing consumer behaviour; and
- The advent of the new Consumer Protection Code

Regulatory Landscape

With the establishment of the new regulator, the move to the Euro and towards a single market in financial services, the landscape has changed exponentially as the growth in the size of the sector in the last decade demonstrates.

At the same time as these developments other factors have contributed to changes in the way insurance activity is carried out. In addition to developments on the regulatory side, major reviews of the sector have been carried out by the Joint Oireachtas Committee on Enterprise and Small Business, the Competition Authority as well as the work of the Motor Insurance Advisory Board. In turn these have all impacted on how firms conduct their business. In response to MIAB recommendations, we have published statistical analysis of motor premiums and claims costs to improve public policy and market intelligence for insurers. The establishment of the Personal Injuries Assessment Board led to the introduction of a book of quantum for damages, a reduction in litigation

costs and has improved the speed of claims resolution. Likewise the Financial Regulator has worked with the Oireachtas committee and Competition Authority to implement their recommendations, with many of their proposals incorporated into the consumer protection code, with which firms will be expected to comply.

Competition can come to the market in many ways. Authorised EU & EEA insurance companies can sell cross border or through a sales operation set up in Ireland and we always respond quickly and positively to any such notifications from other EU supervisors.

Having a solvency requirement for authorising insurance companies in Ireland is fundamentally about protecting consumers and this is the sole principle guiding the Financial Regulator's approach to solvency standards. We are alive to the competition implications that any solvency regime can have. I would point out that there is no evidence that our solvency regime impacts negatively on competition and all of the major international insurance groups and many of the next line of insurers are active in the Irish market. Indeed we are currently processing six applications from new insurers who are seeking authorisation.

You will all be aware that the European Commission and the Member States are engaged in work to develop a new prudential regime for insurance companies which will apply a more comprehensive approach to risk, commonly referred to as the Solvency II project. The objectives of Solvency II are:

- To maintain policyholder protection;
- To establish a solvency capital requirement that is better matched to the risks of an insurance company;
- To avoid undue complexity;
- To accommodate market developments and innovation;

The Financial Regulator is actively involved in all Solvency II working groups established under the auspices of CEIOPS (Committee of European Insurance and Occupational Pension Supervisors). In order to assist us with this work, we have established a Solvency II Consultative Group comprising industry representatives and other interested parties. Although Solvency II implementation is not expected until 2010, a draft Directive is expected within the next 12 months.

A great deal of work remains to be done, particularly in relation to assessing the potential impact of any proposals. This work involves all of us. It should be recognised that the completion of the Solvency II project may reduce the scope that Ireland will have in the future to determine how the solvency rules are practically applied. We welcome the commitment from industry as we work together in partnership so as to ensure that Irish positions are clear in EU fora as issues of importance to Irish firms are negotiated in the forthcoming directive. We strongly encourage Irish insurers to actively engage in our Quantitative Impact Studies so that an accurate picture can be painted of the potential impact of the Solvency II proposals on the Irish market.

Changing consumer behaviour

In addition to changes in the regulatory environment, we are seeing changes in consumer behaviour and changes in the way the industry interacts with its customers, particularly with the introduction of the new Consumer Protection Code. This code replaces previous interim codes. We recognise that all this poses considerable challenges for the insurance industry. Changes in consumer behaviour have manifested themselves in many ways, but fundamentally consumers are now:

- More informed than they were;
- More likely to shop around and switch; and
- More likely to complain

The forces that had led to these changes in consumer behaviour are numerous. I feel that the Financial Regulator has played a significant part in this, having put considerable time and resources into helping consumers make informed decisions. We have a statutory role to protect consumers and inform consumers and part of our stated mission is to help them to make informed financial decisions in a safe and fair market. Consumer information initiatives have helped people understand financial services and better equip them to ask for the information they need.

Shopping around for financial products is now well established. In 2005, we produced 13 different cost surveys on financial products and over 80,000 copies of these surveys were sought by consumers. Surveys on insurance products proved particularly popular, with demand for motor insurance surveys, home insurance and life insurance totaling 38,000.

Consumers also showed us that they want to find out more about how financial products work - not just the cost of products. Demand for our

various insurance guides last year was over 30,000. This demand continues to grow, demonstrating a consumer appetite for information that will help them make better informed financial decisions.

The establishment of the Financial Regulator and the Financial Services Ombudsman have given consumers the resources and the confidence to deal with the industry in a more assertive way. Consumers are now more vocal and less intimidated by institutions, financial or otherwise. Statutory footing allows consumers to have full confidence in the Ombudsman and his decisions. In the first half of 2006, the Ombudsman has dealt with 960 insurance complaints and in 2005, handled a total of 1,734 complaints.

Consumers demonstrated a measure of apathy in the past because they perceived all financial institutions to be the same, with the same products, same prices and same levels of customer service. Market changes combined with more consumer awareness mean consumers are now far more active in seeking out the best products and service.

Consumer code

One of the other ways we seek to protect consumers is by fostering a safe and fair market. A major milestone in this task was the recent publication of the Consumer Protection Code. The aim of the Code is well known at this stage – it is fundamentally about creating transparency for the consumer and a level playing field for the industry. It sets out the information that customers are to be given before, during and after the sales process. We fully recognise the fact that some of the new provisions in the Code will require system changes and intensive staff training.

Some confusion seems to have arisen about the apparent exclusion of basic banking products from the Code requirements and claims from some in the insurance industry that basic insurance products should also be excluded.

I want to correct any misinformation by explaining clearly here today the Financial Regulator's position: First of all any perception that the Code does not apply to banking products is wrong – the Code covers banking products and all of the general principles apply to all regulated firms including banks in their dealings with consumers.

It is true that certain basic banking products are not subject to the “Knowing your Customer” and “Suitability” Requirements of the Code. The basic products involved are current accounts including overdrafts, ordinary deposit accounts and term deposit accounts with a term of less than one year. These are basic generic products designed to have a general suitability and not to require tailoring to individual circumstances. We do not want to put any barriers in the way of consumers accessing the basic banking products they need.

But it is important to note that the banks must always act in their customers best interests and must, for example, assess the holding of funds on deposit on this basis and both advise customers of any restrictions on these basic accounts such as notice periods for withdrawals and of any lower cost alternatives.

With regard to insurance products, I am not aware of any basic generic insurance products, which would not be influenced by the particular circumstances of the consumers. Therefore it makes sense that a full ‘Know your Customer’ and ‘Suitability’ assessment is carried out to ensure the appropriate product is sold to the consumer. In terms of ‘know your customer’ requirements we believe firms should take a reasonable and proportionate approach to the amount of information required which depends on the type of product sold.

Winning strategies

So, in this changed environment, with all the challenges that it brings, what will the winning strategies be for the industry? I believe that successful firms will be financially sound, will treat their customers fairly, be well managed and perhaps most importantly, embody the very best principles of corporate governance.

Governance of an insurance undertaking should

- Contribute to a sound and prudent management of the insurance undertaking, strengthening the protection of policyholders and beneficiaries; and
- Assist the Board of Directors in setting and, on an ongoing basis, adjusting the undertaking’s overall risk profile to match its financial strength.

Through our supervisory oversight, we encourage insurance companies to adopt sound standards in this area. In particular, we ensure that there are

independent non-executive directors on Boards, that independent Boards are setting the direction of the firm and that Directors are satisfying themselves that the firm is managed in accordance with their direction.

We are about to issue Corporate Governance Guidelines for Reinsurance Undertakings. We will extend this to the wider insurance sector at a later date. Our approach to development of this corporate governance regime has been guided by two principles. Firstly, to devise a regulatory framework for corporate governance that is robust, credible and competitive and secondly to develop the regime transparently, with extensive consultation. This process will also be followed for the wider proposals.

Challenges on the horizon

For the industry, we recognise the challenge involved in full implementation of the Consumer Code. We are actively engaging with industry in the rollout of the code and I am confident that it will bring benefits for consumers, for companies and for the standing of the financial services industry as a whole.

The investment market in the post-SSIA environment poses concern for the Financial Regulator. There is potential that in an effort to secure higher returns, people will ignore the risk element of potential investments. The challenge for the Financial Regulator is to make sure that consumers get the information they need to make suitable financial decisions. The challenge for the industry is to deliver the products that consumers want through the right channels.

Intermediaries play a vital role in the insurance sector particularly in providing product choice for consumers. We are proposing to undertake a review of the intermediaries sector next year which amongst other things will review the names or classifications applied to insurance market intermediaries. We accept that these classifications – ‘multi-agency intermediary’ (MAI), formerly Restricted Activity Investment Product Intermediary (RAIPI), and Authorised Adviser (AA) - may be confusing for consumers and may be over bureaucratic for the brokers themselves. We are considering what changes could be made to improve the position for all stakeholders.

Conclusion

As part of our regulatory process in a continuously changing landscape for consumers, we aim to engage with all our stakeholders, both nationally and internationally, on a continuous basis.

It is worth repeating the need for good governance within insurance undertakings. I am quite clear that the winning companies of the future will be those who operate a good governance regime, make a return for their shareholders while looking after their customers by pricing and selling products properly and settling claims quickly and apply proper financial principles based on the measurement and monitoring of risk and understand the regulatory environment. This formula will result in companies that consumers will trust and will want to do business with.

Finally, I would like to conclude by thanking you again for inviting me to your conference and look forward to maintaining a positive and

constructive relationship with you as we jointly work towards further enhancing Irelands reputation as a financial services location that protects consumers.

-ends-