

**Comments of the Center for Economic Justice to the
IAIS Implementation Committee**

**Regarding Implementation Monitoring (Agenda 6) and
Future Opportunities for Observer Engagement (Agenda 10)**

At the October 21, 2014 Meeting

The Center for Economic Justice (CEJ), an IAIS Consumer Observer, is a non-profit consumer organization based in the United States that advocates on behalf of insurance consumers before regulatory agencies on fair access to and fair treatment regarding insurance and other financial services. For nearly 20 years, CEJ has provided analysis and testimony on behalf of consumers before U.S. state and federal agencies and legislative policymakers on a wide variety of insurance issues.

We comment today on two agenda items posted for discussion at the Implementation Committee's October 21, 2014 meeting – item 6, Implementation Monitoring and Item 10, Opportunities for Observer Engagement. We suggest there is a link between the two. Our comments are summarized as follows:

1. Implementation of ICPs Should Include Assessment of Market Outcomes for Consumers.

The IAIS Insurance Core Principles (ICPs) represent authorities, capabilities and procedures that the IAIS believes are consistent with effective supervision of regulated entities and which will, consequently, lead to favorable outcomes for and fair treatment of consumers. The Self-Assessment Peer Reviews (SAPRs) are one method used by the IAIS to monitor individual jurisdiction's compliance with the ICP requirements and standards. Since one of the goals of insurance supervision is to ensure that insurers operate in a manner that ensures the promises insurers make to policyholders will be kept, the vast majority of the ICPs focus on supervisory oversight of insurer licensing, governance and risk management. This is logical because insurer financial failures are rare, so there is little empirical evidence from which to develop prudential regulatory practices based on market outcomes. This is not the case for supervisory outcomes related to conduct of business.

We suggest that there must be an assessment of market outcomes for insurance consumers related the wide range of conduct of business issues, including sales and claim settlement practices. It is not only possible to test the effectiveness of ICPs and supervisory approaches by collecting and analyzing data on market outcomes for consumers, but reasonably necessary to ensure that the supervisory principles and application of these principles achieve the

desired outcomes. Just as it is possible and necessary to test a consumer disclosure by testing it with consumers to learn if the disclosure empowers consumers as intended, so it is possible to test other supervisory principles and activities to learn if they are producing the desired outcomes for consumers.

Our recommendation is that Implementation Monitoring expands beyond monitoring adherence to ICPs into standards for data collection regarding market outcomes coupled with evaluation of those market outcomes. Such a data-driven approach will not only confirm the value and effectiveness of ICPs, but will illuminate in what particular circumstances the ICPs are most effective and in what circumstances specific considerations may need to be made in implementing the ICPs. Lastly, collecting data on market outcomes means not only collection of data from insurers and intermediaries on sales and claim settlement outcomes, but formal interaction with consumers in the regulatory process. This formal interaction, as part of implementation monitoring, may take the form of consumer stakeholder meetings, reviews of consumer complaints, testing of consumer information / education / disclosures, testing of consumer understanding of policy forms and mystery shopping / marketplace testing. In an era when insurers utilize Big Data and predictive analytics for virtually all consumer-facing aspects of their business, it is reasonable and necessary for supervisors to complement the standards and procedures of ICPs with data-driven analytics to ensure the linkage between the supervisory standards and procedures and favorable consumer market outcomes is transmitting properly.

2. Implementation Monitoring Should Include Routine Communication Among Supervisors on Conduct of Business Issues. Such Market Conduct Collaboration Should Be Separate From Supervisory College Activities.

It is our observation and conclusion that bad financial products and unfair and deceptive sales practices associated with these harmful financial products not only harms consumers, but can lead to systemic risk to the financial system. We suggest that this is one of the lessons from the recent financial crisis. As a result, a number of jurisdictions have determined that stopping financial products harmful to consumers from entering the market is not only a necessary consumer protection, but the key element of maintaining a stable financial system and have separated prudential regulation from market regulation by creating supervisory agencies devoted to consumer protection and conduct of business.

It is also our observation and conclusion that harmful products and sales migrate from one jurisdiction to the next. We have seen, for example, the same poor value consumer credit insurance / payment protection insurance products sold in an unfair and abusive fashion in many jurisdictions, including the U.S. the U.K., South Africa and Australia.

We also see the spread of life insurance and annuity products guaranteeing investment returns, products which, in our view, raise systemic risk to the financial system. Unlike traditional life insurance and annuity products for which the insurer creates a risk pool to diversify the risk of individuals over the broad pool, the new investment-guaranty products concentrate the risk of investment performance declines with insurers – the opposite of diversification. We cite these products to both point out the linkage between risk products and systemic risk and the need for supervisors to communicate about products and sales practices across jurisdictions.

Based on the above discussion, we recommend that Implementation Monitoring include the creation of one or more cross-jurisdictional Market Analysis Working Groups to enable supervisors most responsible for conduct of business in their jurisdictions to regularly meet with one another to identify emerging conduct of business issues, learn from one another about effective and not-effective actions to address the conduct of business issues and to identify conduct of business issues that may impact prudential oversight and financial stability and to alert their prudential supervisor colleagues of same.

In the U.S., the NAIC has convened both a Financial Analysis Working Group (of chief state prudential examiners) and a Market Analysis Working (of chief market regulation examiners). The FAWG is analogous to a supervisory college among the states. The MAWG is able to address both individual companies with market conduct problems as well as broader market conduct issues. We suggest that the Implementation Committee, as part of Implementation Monitoring, create a Conduct of Business Supervisor Task Force to formalize routine communication and collaboration among insurance market regulators.

3. The Implementation Committee Should Establish a Consumer Stakeholder Committee and Consult with Such Committee At Least As Often as the Implementation Committee Meets.

It is our observation and conclusion that organizations responsible for prudential supervisor of financial service providers interact routinely and often with the regulated entities and rarely with the consumers who are the intended beneficiaries of the prudential supervision. We also observe that when supervisors are responsible for both prudential and conduct of business oversight, the supervisory emphasis falls disproportionately on prudential issues. We suggest that the two outcomes are related. We also suggest that the absence of routine interaction with consumer interests – even on matters of prudential supervision – leads to an overemphasis of the views of the regulated entities compared to the views of consumers.

Our experience, over 20 years of advocacy before insurance and banking regulators, is that we often change the nature of the debate over particular issues and alter the outcome of the regulatory process. In some cases, we bring information to supervisors that is relevant to their consideration, but which would never have otherwise been presented. In other cases, we offer a

perspective that differs from the insurer and which the supervisor would not have encountered without our involvement. We suggest that the Implementation Committee would benefit from such consumer involvement. However, unlike regulated entities which are able to use policyholder-supplied funds to hire government relations specialists and trade associations to pay for the regulated entities' involvement in regulatory processes and proceedings, consumer interests generally do not have the ready resources for such involvement. Consequently, it is necessary for supervisors to reach out to and formalize the involvement of consumer interests. We recommend that the IC accomplish this by establishing a Consumer Stakeholder Committee (CSC) and to interact with the members of the committee at least as often as the IC meets. There are likely other ways to involve a CSC to assist the IC, but the creation of the CSC is the first step.