RESPONSE TO FEEDBACK RECEIVED - CONSULTATION PAPER ON THE PROPOSED RISK MANAGEMENT GUIDELINES FOR INSURANCE BUSINESS

1 INTRODUCTION

1.1 MAS issued a consultation paper on 7 June 2007 inviting comments on the proposed risk management guidelines for insurance business. The consultation period closed on 9 July 2007. MAS would like to thank all respondents for their contributions. The respondents are listed in Appendix A.

1.2 We have considered the comments received and incorporated the relevant feedback into the final risk management guidelines. Comments that are of wider interest, together with MAS' responses, are set out below. The final risk management guidelines can be found on the MAS website.

2 NATURE AND STRUCTURE OF THE GUIDELINES

2.1 High level principles versus detailed practices

2.1.1 The respondents preferred the guidelines to be drafted more broadly in order to give insurers flexibility when it comes to implementing the guidelines. Of particular concern to the respondents was the use of examples in the guidelines. As many respondents viewed the risk management practices set out in the guidelines to be mandatory requirements, they felt that the examples given would place constraints on insurers' implementation of these guidelines. Some respondents were also worried about the potential increase in compliance costs arising from these guidelines.

MAS' Response

2.1.2 As indicated in the consultation paper, the purpose of the guidelines is to articulate the broad principles that should be embedded in an insurer's risk management framework. The examples given are meant as illustrations of how the principles may be applied in practice so as to provide greater clarity to help insurers incorporate the principles into their risk management systems. These examples are not intended to be exhaustive or to prescribe a set of risk management practices that all insurers must uniformly adopt. As explained in the "Classification of Instruments Issued By MAS" on the MAS website, guidelines set out principles or "best practice standards" that govern the conduct of specified institutions or persons. While contravention of guidelines is not a criminal offence and does not attract civil penalties, institutions or persons are encouraged to observe the spirit of these guidelines. The degree of observance with guidelines by an institution or person may have an impact on MAS' overall risk assessment of that institution or person.

2.1.3 Insurers will continue to have the flexibility to implement risk management frameworks which are commensurate with the nature, size and complexity of their operations. However, insurers should have good justifications where they have decided not to implement risk management practices that are widely implemented by their peers of similar size and risk profile.

2.2 Separate guidelines for life and general insurance businesses

2.2.1 The proposed guidelines cover both life and general insurance businesses. One respondent suggested that the two classes of insurance businesses should each have their own set of guidelines as the respondent felt that some recommendations in the proposed guidelines were clearly more relevant to one class of insurance business than the other.

MAS' Response

2.2.2 We have chosen to cover the risk management practices for both life and general insurance businesses in a single document as most of the recommended risk management principles can be applied to both classes of insurance business. Where there could be differences in application of the principles, we have tried to illustrate these for clarity.

3 RISK MANAGEMENT FRAMEWORK

3.1 Core activities versus fraud risk chapters

3.1.1 Two respondents noted some differences in the manner in which the two chapters, namely the proposed guidelines on managing risks arising from core activities and fraud risk, described a risk management framework. For example, the proposed guidelines on fraud risk expect an insurer's risk management strategy to include a mission statement and that the strategy should facilitate development of risk limits. Similar details were not found in the proposed guidelines on core activities.

MAS' Response

3.1.2 We have made the necessary amendments to improve the consistency between the two sets of guidelines with respect to how they describe a risk management framework.

3.1.3 With regard to the level of detail that each chapter goes into, it should be recognised that an insurer is exposed to an array of different risks inherent in its core activities. As the guidelines on fraud risk focus on only one particular risk, it is possible to provide more specific guidance compared to the guidelines on core activities which are broader in scope.

3.2 Application to branch operations

3.2.1 The proposed guidelines described the role of the Board of Directors and senior management in a risk management framework. One respondent sought clarification on how would the terms "Board of Directors" and "senior management" apply in the context of a branch of an insurer that is not incorporated in Singapore.

MAS' Response

3.2.2 In the case of a branch of an insurer not incorporated in Singapore, we expect the head office to provide the necessary strategic direction and oversight, and for the senior management in the Singapore branch to operationalise the risk policies conveyed by head office personnel.

4 GUIDELINES ON CORE ACTIVITIES

4.1 Risk indicators and performance measures

4.1.1 Two respondents commented that for the risk identification and monitoring processes to be effective, insurers ought to develop some form of risk indicators or performance measures. They have therefore suggested enhancing the guidelines by including examples of key risk indicators and performance measures for the five core activities.

MAS' Response

4.1.2 We agree with the suggestion and have included examples of risk indicators and performance measures in the final guidelines on core activities. We would, however, like to reiterate that these examples are not meant to be exhaustive. Insurers should develop their own risk indicators and performance measures that are consistent with their risk management philosophy and risk profiles.

4.2 Potential conflicts of interest

4.2.1 Two respondents commented on the examples of potential conflicts of interest given in the proposed guidelines. For the example highlighting that the member of senior management approving the base premium rate should not have marketing responsibilities, one respondent highlighted that it is common for general insurers to be managed along business lines where underwriters are also involved in business development work. This respondent opined that the risks arising from the potential conflicts of interest can be effectively mitigated by measures such as having regular reviews of portfolio performance by an independent member of the senior management; and establishing underwriting guidelines and authority levels.

4.2.2 On the example of the segregation of the underwriting and claims functions, another respondent felt that when the claims department is short-handed, it is preferable that a claim arising from a particular product type be assessed by an underwriter who is familiar with that product type rather than a claims staff that specialises in a different product type. The respondent felt that as long as fraud risk is properly controlled, such an arrangement should be acceptable.

MAS' Response

4.2.3 The rationale for ensuring proper segregation of duties is not solely to minimise fraud. It is also to avoid putting employees in situations that may compromise the objectivity of their decisions because of the competing objectives of the different responsibilities that they are asked to assume. Where such segregation of duties is not feasible, the insurer has to ensure that there are adequate controls in place to mitigate the potential conflict of interests.

4.3 Independent risk management function

4.3.1 The proposed guidelines recommended that insurers establish independent risk management functions if warranted by the size and complexity of their operations. Some respondents sought clarification on what constitutes independence while others questioned the need for independent risk management functions when they have in place risk committees comprising mainly members of the senior management.

MAS' Response

4.3.2 A risk management function is responsible for the development of and ensuring compliance with an insurer's risk management policies and procedures. As the risk management function provides the necessary checks and balances to an insurer's operational processes, it should preferably be independent from the operational processes.

4.3.3 A proper risk management function should consist not just of decision-making bodies (e.g. risk committees). It should also be adequately staffed to develop policies and procedures and oversee the implementation of the approved policies and procedures.

4.4 Stress testing and scenario analysis

4.4.1 The proposed guidelines suggested the use of stress testing and scenario analysis to assess the potential impact of probable adverse events. Two respondents suggested including in the guidelines details about stress testing and scenario analysis methodologies and related governance issues.

MAS' Response

4.4.2 The proposed risk management guidelines are meant to provide high-level guidance. It is therefore not appropriate to incorporate details about stress testing or scenario analysis methodologies in this document.

4.4.3 Life insurers may wish to refer to MAS Notice 312 which contains some guidance on how stress tests are to be conducted. We will review whether similar guidance is necessary for general insurance business.

4.5 Creditworthiness of policyholders

4.5.1 In relation to the guidance that insurers should consider the creditworthiness of their counterparties, two respondents commented that it is difficult to investigate the creditworthiness of policyholders who are not body corporates. Both respondents also concluded that the creditworthiness of policyholders pose little credit risk to insurers as insurance policies are generally worded such that no claims are payable when premiums are not paid.

MAS' Response

4.5.2 Creditworthiness of policyholders can be relevant in some instances. In performance bond insurance business, an insurer may be obliged to pay legitimate claims filed by the principal holding the bond even if the policyholder has not paid the premiums. In addition, the insurer would still want to recover the amount of claims paid from the policyholder. Insurers are therefore advised to conduct their own analysis to determine if there is any credit risk exposure to policyholders inherent in their business and implement risk management measures that are commensurate with the level of risk.

4.6 Addressing risks that arise from ambiguous and inconsistent contract wordings

4.6.1 In one of the examples given in the proposed guidelines, it was suggested that insurers should explain in their product development proposals what efforts have been made to ensure clarity in the scope and level of coverage. This is to address the risk that may arise from contract wordings being ambiguous or inconsistent with the intended coverage. One respondent found that such explanation in every product proposal is unnecessary if an insurer already has in place a process to address this risk and the process is monitored under the risk management framework.

MAS' Response

4.6.2 We agree that the focus should be on encouraging insurers to rely on their risk management frameworks to address the potential risks identified in the product development process. Nevertheless, where such a framework is not in place, an insurer should ensure that the product proposal itself discusses how the relevant risks have been or should be addressed. The risk management guidelines have been amended to reflect this position.

5 GUIDELINES ON INSURANCE FRAUD RISK

5.1 Risk control measures

5.1.1 The proposed guidelines recommended that insurers establish control measures to mitigate fraud risk. One respondent felt that such measures to mitigate fraud risk are already embedded in the various functions of insurers. Policy contract clauses also provide clear position of insurers on insurance fraud for which insurers would not have an obligation to pay fraudulent claims.

MAS' Response

5.1.2 We agree that policy contract clauses can be used to mitigate insurers' exposure to fraud risk. However, insurers would be able to rely on such clauses to void the policies when fraud is involved only if they have the necessary fraud risk management policies and procedures to identify, detect and investigate fraud cases. These policies and procedures can be embedded within relevant functions of insurers.

5.2 Independent fraud management function

5.2.1 The proposed guidelines recommended that an insurer establish an independent fraud risk management function if warranted by its own risk assessment. Some respondents felt that such an independent function was unnecessary for insurers.

MAS' Response

5.2.2 An independent fraud management function can help facilitate the execution of the insurer's fraud risk management and control processes. Insurers have to decide whether such a specialised function is justified by its own risk assessment.

5.3 Informing policyholders of anti-fraud strategy and policies

5.3.1 The proposed guidelines recommended that an insurer inform its policyholders of its anti-fraud strategy and policies. One respondent felt that such measures would not be effective in deterring policyholder fraud. Some respondents also expressed concerns that policyholders might be offended by such measures and hence have a negative impression of the insurer.

5.3.2 Some respondents also wanted to know if it would be sufficient for the insurer to highlight to the policyholder that no payment would be made for any policyholder and claims fraud.

MAS' Response

5.3.3 We have taken note of the comments given and would amend the proposed guidelines by removing reference to insurers' anti-fraud strategy and policies. Nevertheless, we would like to emphasise the need for concerted efforts by insurers to combat insurance fraud so that consumers at large are not penalised through higher premiums because of the fraudulent activities of some. Insurers should therefore educate their policyholders by highlighting the consequences of committing fraud against the insurer which includes the forfeiting of all benefits under the policy to possible prosecution by the relevant law enforcement agencies.

5.4 Intermediary fraud – monitoring intermediary and related party transactions

5.4.1 The proposed guidelines suggested that an insurer should monitor its intermediary's own insurance policies and those of his family members and relatives in order to minimise intermediary fraud. Respondents either questioned the practicality of monitoring these policies or sought clarifications on the definition of family members and relatives.

5.4.2 One respondent also queried the relevance of this guidance in relation to the general insurance business.

<u>MAS' Response</u>

5.4.3 We acknowledge the difficulty in monitoring transactions involving all of the intermediary's family members and relatives. In this regard, the guidelines have been amended to recommend such monitoring for the intermediary's own insurance policies and those of his immediate family members when there are grounds for suspicion. However, we encourage insurers to extend such monitoring to other related parties, where feasible and when there are reasons for suspicion.

5.4.4 For general insurance business, the risk of intermediary fraud involving the intermediary's own insurance policies and related parties is generally lower than in life insurance. Notwithstanding this, it is still possible for such fraud to occur for general insurance policies. One example is whereby the intermediary uses cheques issued by other policyholders which have not been clearly identified for the purpose of settlement of their own policies, to pay for premiums of other policies under the intermediary's control.

5.5 Intermediary fraud – separate notification to policyholders

5.5.1 In order to minimise intermediary fraud, the proposed guidelines recommended that insurers send policies and documents as well as payments directly to policyholders rather than through intermediaries. If this is not possible, insurers should, at a minimum, send a separate notification to the policyholders if policies and documents as well as payments are dispatched via the intermediaries. One respondent felt that such separate notification would result in additional administrative costs especially for businesses that are highly intermediated and where contact with the policyholder is preferred via intermediary groups. Instead, the respondent felt that subsequent servicing document sent to customers directly would serve as a trigger for alert.

MAS' Response

5.5.2 As part of good risk management practices, insurers should send separate notifications to policyholders if policy documents and payments are dispatched via intermediaries. Such an additional measure will help to guard against incidents of documents and monies given to the intermediaries not reaching the policyholders and not being detected for a long time, especially if reliance is placed only on subsequent servicing documents being sent to the policyholders. We would therefore like to emphasise that insurers should take into account the fraud risk when deciding on the appropriate measures to adopt. The additional administrative costs involved in implementing the proposed measure may be worthwhile when compared with the potential financial and reputational losses that an insurer could incur, especially in highly intermediated businesses.

5.6 Centralised database

5.6.1 The proposed guidelines suggested some indicators to facilitate insurers' identification of possible policyholder, claims and intermediary fraud. Such indicators included situations where the policyholder had been declined coverage by other insurers due to material non-disclosure or there were evidence of churning of policies across several insurers. Two respondents commented that there would be a need for a centralised database available to the industry in order to identify policyholders who have been declined coverage due to non-disclosure of material information. With regard to intermediary fraud, one respondent commented that evidence of churning of policies across several product providers is difficult to obtain because insurers are currently unable to furnish client's details to other insurers without the client's prior consent under the "Guidelines on Standards of Conduct for Financial Advisers (FAA-G04)".

MAS' Response

5.6.2 We will review the merits and feasibility of a centralised database with the relevant industry associations. In the meanwhile, insurers should rely on information that is available, such as information obtained during the fact find process, reference checks or through its own internal database to identify policyholders who had been previously declined coverage or had recently made a product switch.

Appendix A

List of Respondents to the Consultation Paper on the Proposed Risk Management Guidelines for Insurance Business

1. Allianz Insurance Company of Singapore Pte. Ltd.
2. American Home Assurance Co.
3. American International Assurance Co. Ltd.
4. Aviva Ltd.
5. HSBC Insurance (Singapore) Pte. Ltd.
6. Institute of Certified Public Accountants of Singapore.
7. MSIG Insurance (Singapore) Pte. Ltd.
8. Prudential Assurance Co. (S) Pte. Ltd.
9. QBE Insurance International Ltd.