Treating Customers Fairly

The self-assessment pilot

Feedback report: December 2011

In the Treating Customers Fairly Roadmap, published on 31 March 2011, the FSB undertook to develop a TCF self-assessment tool, which FSB regulated firms can use to gauge their success levels in achieving the TCF fairness outcomes and culture framework requirements. A draft version of the tool was prepared and piloted with a sample group of different types of financial services firms, during the period July to November 2011. This report provides feedback to the financial services industry on the pilot and key areas requiring further guidance from the FSB.

The FSB takes this opportunity to thank the pilot participants for the extensive work undertaken in participating in the pilot process and their invaluable contribution to the development of the TCF framework.

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1. BACKGROUND, METHOD AND SCOPE

1.1 The TCF Roadmap

In the Treating Customers Fairly Roadmap, published on 31 March 2011, the FSB explained that:

> *TCF is a regulatory approach that seeks to ensure that specific, clearly articulated fairness outcomes for financial services customers are demonstrably delivered by regulated financial institutions.*
>
> *TCF will require regulated firms to consider their treatment of customers at all stages of their relationship with the customer, from product design and marketing, through to the advice, point-of-sale and after-sale stages. Firms will ultimately be required to demonstrate - through management behaviours and monitoring - that they are consistently treating customers fairly throughout the stages of the product life cycle to which they contribute.1*

The FSB undertook to provide a TCF self-assessment tool as part of an on-going regulatory guidance process designed to ensure that the fairness outcomes are clearly articulated and understood by regulated firms. The self-assessment may be used by regulated firms to gauge their success levels in achieving the TCF fairness outcomes and culture framework requirements.

A draft version of the tool was prepared and piloted with a sample group of different types of financial services firms, during the period July to November 2011. This report provides feedback to the financial services industry on the pilot exercise and key TCF lessons and observations drawn from the pilot participants' responses.

1.2 The purpose of self-assessment and the pilot process

The purpose of developing – and piloting - a self-assessment tool is to:

- Provide firms with insight as to how ready they are to demonstrate to the FSB and other stakeholders, through management behaviours and monitoring, that they are consistently treating customers fairly.
- Provide a high level indication to firms of the kinds of factors the FSB may in future take into account in monitoring and assessing TCF delivery.

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[1] TCF Roadmap, 31 March 2011, p 7 and 8
[2] In most cases these are groups of companies.
[3] Typically these were licences held within larger product supplier groups. As explained in the TCF

- Use the tool (or an appropriate variation of the tool) to conduct a TCF baseline exercise, against which the financial services industry's future progress in delivering TCF outcomes can be measured.
- Use the insights obtained from the pilot and baseline exercises to inform the development of the TCF regulatory, supervisory and enforcement frameworks.

1.3 The method and structure of the pilot questionnaire

The method of the pilot was to design a questionnaire template, to submit this to participating firms for completion and to subsequently conduct an in-depth interview with each firm after the questionnaire was completed and returned.

The questionnaire was structured around each of the six fairness outcomes, with particular emphasis on Outcome 1 and the elements of the TCF cultural framework. The questions were linked to identifiable risks to the achievement of each outcome, which are set out at the beginning of each set of questions.

The questionnaire comprised three Parts:

- Part A: Open-ended qualitative questions

  These questions were designed to obtain insights into the processes participating firms have in place to achieve their TCF objectives and commitments, and to identify and mitigate TCF risks.

- Part B: TCF implementation actions

  This section set out lists of possible actions that firms may use – or in future consider using – to deliver the TCF outcomes. Participants were asked to indicate, on a "Yes", "No", or "Partially" basis, whether they currently use these actions. It was explained that the list of actions in Part B should be seen as indicative, rather than comprehensive.

- Part C: Evaluating the questionnaire

  This section asked for an evaluation of the usefulness of the self-assessment questionnaire and process. It also asked for suggestions regarding future TCF benchmarking, reporting and management information approaches.

Identifying and inviting the participants

The FSB invited organisations to participate in the pilot exercise. Invited participants ranged from large conglomerates to smaller "niche" firms. Types of firms included long-term and short-term insurers, collective investment scheme management companies, pension fund administrators, and financial services providers (including discretionary and administrative FSP's). The sample also included a few banks (primarily in their capacity as FSP's) and underwriting managers.

The basis for selecting participants in the pilot exercise was to:

- ensure an appropriate mix of participants to provide insight into the suitability of the tool for different industry sectors and different firm sizes; and
- identify participants who would be potentially able to provide meaningful, practical input into the effectiveness of the tool, based on TCF preparation work they may already have carried out.

The Association for Savings and Investments in South Africa (ASISA) and the South African Insurance Association (SAIA), who had both established TCF committees prior to commencement of the pilot, offered to canvass their members to identify volunteers to participate in the process. The majority of the firms participating in the pilot were volunteers identified in this way. In addition to the ASISA and SAIA volunteers, a few firms pro-actively approached the FSB to request participation and a few were approached directly by the FSB, and agreed to participate. Two firms declined the FSB's invitation to participate.

Once the pilot participants had been identified and accepted a formal invitation to participate, the questionnaires were issued to them together with completion instructions. Where the participating organisation comprised a number of financial services subsidiaries and / or lines of business, agreement was reached with each participant as to how best to structure their response to maximise the quality and scope of their input. An initial period of approximately one month was granted within which to complete and submit the questionnaire. The majority of participants requested further time, and extensions of between one and three weeks were granted, on a case-by-case basis.

Number and types of participants

Twenty organisations participated in the TCF self-assessment pilot. In almost all cases, the participating organisations comprised multiple subsidiary entities and/or lines of business, usually holding multiple FSB licences in different sectors. Most participants submitted a number of completed questionnaires, representing different parts of their businesses. In some cases, responses for different parts of the business were combined in a single questionnaire, where the firm concerned felt similar responses applied. In many instances, the organisation's legal structure did not mirror its operational structure, and often a single entity would hold more than one FSB licence in respect of different regulated activities. As such, the number of questionnaires submitted does not correlate to the number of licenced entities or the number of organisations participating.

A total of 54 completed questionnaires were received, representing some 255 licences in various regulated financial services activities.

The table below sets out further detail of the number and types of participants:

Table 1 Overview of participating firms

Total number of organisations[2]	20
Total number of completed questionnaires	54
Total number of licensed entities	255
Licenced entities per sector:	
Long-term insurers	29
Short-term insurers	22
CIS management companies	12
Pension fund benefit administrators	30
Category I FSP's[3]	115
Category II and IIA FSP's	34
Category III FSP's	10
Category IV FSP's	3
Underwriting managers	5
Other[4]	7

The in-depth interviews

Pilot participants were required to complete all parts (A to C) of the self-assessment questionnaire and make themselves available for a follow-up interview of up to 3 hours.

After the written responses to the pilot questionnaire were received and reviewed by the FSB, an in-depth follow-up interview was held with members of the executive and senior

[2] In most cases these are groups of companies.
[3] Typically these were licences held within larger product supplier groups. As explained in the TCF Roadmap, small and medium sized Category 1 FSP's were not included in the pilot, mainly for capacity reasons.
[4] Refers to entities within groups who participated in the pilot in respect of additional services they provide in conjunction with financial products and services, where their activities are not directly regulated by the FSB.

management of each participant. Firms arranged for high-level delegations of the executive management (and sometimes, board members) to be available to answer questions. In some cases, multiple follow-up meetings were held with senior management teams from different parts of the participant's business. The FSB was represented in each case by the Head: Treating Customers Fairly and also, in some cases, by an independent consultant who is assisting the FSB with aspects of the TCF roll-out, Dr Penny Hawkins of Feasibilty Pty Ltd, and FSB supervisory staff members from the Insurance and FAIS Departments.

The purpose of the follow-up visits was to have a relatively high level discussion, probing elements of participants' responses to the self-assessment questionnaire with a view to:

- Clarifying any responses the FSB did not fully understand
- Getting further information on practices or processes the FSB found interesting from a TCF perspective
- Obtaining insight into firms' views on what impact TCF will have in their businesses, in view of their experiences in completing the pilot process
- Providing participants with the FSB's perspective on main aspects of their responses
- Discussing any suggestions or recommendations regarding the TCF self-assessment process or the implementation of TCF in general
- Answering, as far as possible at this stage, any questions and discussing any concerns participants had regarding TCF.

A primary focus of the follow-up discussions was on responses regarding TCF Outcome 1 (embedding a TCF culture in the business).

Pilot participants indicated that they found the follow-up meetings useful in providing further guidance regarding the FSB's developing TCF expectations.

The FSB values the effort made by pilot participants in making senior executives available for these discussions in most instances, and for the frank and constructive manner in which the discussions were held.

1.4 The general nature of the feedback report

The report prepared here sets out the general trends and common responses from the firms, and highlights good practice and areas of concern, at an industry level.

A generic analysis is necessary given the early stage of the implementation of the TCF programme. TCF is not yet specifically enforced by explicit legislation: the legislative and regulatory gap analysis is still on-going. Moreover, FSB supervisors have not yet fully incorporated TCF in their assessment processes. In spite of this, the firms were prepared to submit to the process and receive critical feedback.

Given that we have sought to maintain the confidentiality we promised the participating firms, the feedback is at a high level. No firms are mentioned specifically, although occasionally responses are quoted verbatim - although not attributed - where their illustrative value is exceptional.

In completing the questionnaire, firms were asked not to submit supporting documentation as evidence of their responses. Although firms were advised that such evidence should be available on request, supporting material was only requested in a very few instances. This approach was consistent with the fact that participation was voluntary. Any "examples of good practice" referred to are based purely on the written and verbal feedback provided by participating firms and the extent of their actual application or practical effectiveness has not been tested. The examples of good practice should therefore not be viewed as practices recommended by the FSB, and firms should critically evaluate their suitability for delivering TCF outcomes against the firm's own business model, type of customer base and resources.

The work involved in completing the assessment and in preparation for the in-depth interview was considerable in every case, and the FSB is most grateful for the co-operation displayed by these firms in contributing to the success of the process.

2. FIRM RESPONSES TO THE TCF OUTCOMES:

The discussion below deals with the firms' responses to Parts A and B of the questionnaire, which were divided into sections according the six TCF outcomes.

Much of the discussion focuses on Outcome 1: *Customers are confident that they are dealing with firms where the fair treatment of customers is central to the firm culture*.

There is good reason for this: Where firms can demonstrate they deliver Outcome 1, the other TCF outcomes tend to follow. For this reason, Outcome 1 was the most discussed at the in-depth interviews. One firm pointed out that, in completing the pilot questionnaire, it had found the questions regarding Outcome 1 considerably more challenging than those for Outcomes 2 to 5, as it required a focus on the firm's strategy rather than its operations.

2.1 Responses for Outcome 1

Customers are confident that they are dealing with firms where the fair treatment of customers is central to the firm culture

General trend: Customer orientation

Virtually without exception, the responses from firms emphasised their customer orientation – sometimes expressed as customer centricity, customer service focus or client satisfaction - including such aspects as improving service, obtaining a better understanding of client's needs, and emphasising the longevity or sustainability of their relationship. The customer orientation was reflected in the firm's philosophy, value statements, vision or mission – or any combination of these.

While customer orientation may in many ways overlap with TCF, it should not be assumed that a customer centric approach converges with TCF in every way. Moreover, for firms that have a customer oriented approach in place, it may lead to a sense of complacency that nothing needs to be adjusted, without critically examining the business in relation to the TCF outcomes. This danger is particularly apparent where the firm's existing "client service" programme is assumed to align seamlessly with TCF.

One of the common misperceptions, for example, is to assume that fairness aligns with satisfaction. Many firms are proud of their satisfaction indices, and customer satisfaction is indeed a desirable result. However, while a client may be impressed with effective sales and efficient administrative processes – and hence express satisfaction – if the product is mis-sold then fairness has not been achieved, and the client may only become aware of this sometime in the future.

General trend: Definitions vs. outcomes.

The approach of the FSB in setting out its expectations for TCF has been to emphasise the manifestation of fairness through six outcomes. In was not unexpected however that certain firms sought to clarify and justify their specific definition of fairness. The problem with this approach, as those that have "Fair Practice Committees" can testify – is that definitions of fairness vary widely – even within organisations. In one case, for example, "fairness" appeared to be defined as non-discrimination: "*Being fair to consumers: We should treat all customers impartially and apply policies appropriately regardless of gender, race, etc*…"

Where firms focussed on their ability to show measurable proof of each TCF outcome, rather than justify their *ex ante* approach to fairness, the discussion was more fruitful for all concerned. One firm positioned this by saying that one of the lessons learnt from the pilot process was that, although they felt the TCF elements were *"there"* in their organisation, they realised they needed to do much more to be able to demonstrate this.

One firm made the useful observation that, although TCF related management information (MI) cannot in itself establish a TCF culture, it could be used to provide evidence that such a culture does exist within the firm. Other firms recognised that communicating relevant TCF MI to staff could help to foster a TCF culture by demonstrating management's commitment to TCF and celebrating TCF successes.

General trend: Waiting for further guidance

A number of firms indicated that they would address TCF once regulatory guidance had been received from the regulator. This was expressed in a number of ways: Firms said they had no need for a gap analysis of their existing practices or their MI and they indicated that they were waiting for further guidance from the FSB. Others said that the TCF regulatory framework is still too uncertain to enable them to develop TCF implementation plans. It was also apparent that some firms were waiting on "regulatory requirements" to be published prior to revising their MI.

While further guidance will be forthcoming from the FSB, firms are advised to consider critically how they can evaluate themselves against the six TCF outcomes and what MI they would need to have to demonstrate to themselves (and the regulator) whether they have met the outcomes.

Regardless of the scope or timing of future guidance, the FSB's main expectation of firms will still be to demonstrate delivery – or at least progress towards delivery – of the six TCF outcomes. There is no reason in the FSB's view for firms to delay taking steps towards ensuring their readiness to deliver these outcomes.

Risks related to Outcome 1

- *Lack of board and senior management appreciation of strategic implications of TCF for costs, reward and profitability*
- *An absence of TCF leadership in the organisation*
- *Inability to assess or provide appropriate evidence of how the firm meets TCF obligations*
- *Conflicts of interest between the firm's commitments to TCF and other business goals are not adequately identified, analysed or managed*
- *No progress with TCF*

The questionnaire responses and the interview discussions have highlighted that in the vast majority of cases, the TCF leadership has been identified. However, in spite of this, in some firms it is clear that the board and senior management remained mere observers to the process. For this reason, there was little engagement of the board. In some firms there was a sense that the assessment of how the firm meets its TCF obligations had been glossed over. From this perspective, it seemed that there was a likelihood of some of the above risks occurring in some of the piloted firms. These points will be discussed in turn.

Risk: Lack of board appreciation of strategic implications for costs, reward and profitability

In most firms surveyed, the board had yet to fully engage with the concept of TCF. While most firms had ensured that board members had had a presentation on TCF- typically as part of their regulatory compliance function - TCF was not part of the regular agenda on board and other executive meetings.

This lack of involvement by the board was particularly apparent in firms which had multiple licensed entities, where a wide range of awareness and understanding levels was apparent. In such firms, it was not unusual to have one entity that described itself as almost fully able to demonstrate its ability to deliver the TCF outcomes reporting to the same board as another entity that was clearly only embarking on the journey.

Some firms have established TCF related committees (although not necessarily branded "TCF") at board level or senior executive level. However, these firms acknowledged that more needed to be done to align the focus of such forums with customer initiatives across the breadth and depth of their organisations. In some cases, it was apparent from the responses that some parts of the business had little or no insight into the role or activities of the board level structures.

The situation where the functional and operational structure of the group does not mirror its legal structure (and hence its board structure), was flagged as a challenge by some firms in regard to board involvement in TCF. However, a similar challenge must presumably apply to other group strategic initiatives besides TCF implementation and the FSB therefore trusts this will not stand in the way of firms ensuring appropriate board level involvement. Firms

are reminded that, in future, they can expect the FSB to engage with both executive and non-executive directors to gauge their TCF awareness and commitment.

For the majority of firms, there was little evidence of board consideration of the impact of TCF on costs, reward and profitability. This lack of engagement by the firm at the highest level was sometimes manifest in a "business as usual" approach by firms, typically reflected in a response that indicated that TCF would have limited implications for the firm and its processes. For example, the existing product approval process and – particularly for long-term insurers - the role of statutory actuary was emphasised as the key method of ensuring TCF outcomes in more than one survey. The FSB was at pains to point out that while the statutory actuary has a role to play in achieving TCF outcomes, the responsibility cannot vest in this role. Moreover, the analysis by the statutory actuary of customer benefit expectations is typically based on the perspective of the firm (i.e. whether it is financially able to meet the expectations it has created), not necessarily the consumer, and so may not deliver on the required TCF outcomes.

Nearly all product supplier firms stated that they used "value for money" for customers as a product approval standard, but few were in a position to describe what measures they would use to determine if this aim had been achieved from the customer's perspective. Others stated that their product approval process balanced profitability drivers against fair treatment of customers, but most were not in a position to describe how they went about achieving this balance. A small number of firms stated that they have explicit profitability criteria built into their product approval processes – but even in these cases it was not always clear to what extent TCF considerations were used in setting the criteria.

Risk: An absence of TCF leadership in the organisation

In some cases, although firms accepted that responsibility for TCF delivery needed to be carried by the board and senior management generally, leadership of the TCF implementation had been allocated to compliance, risk, or other support functions. Although the FSB does not intend to prescribe to firms what governance structures they should adopt for TCF delivery, we caution firms to ensure that TCF accountability is allocated to the firm's leaders in such a way as to ensure it enjoys appropriate priority with the firm's other strategic goals.

In larger groups where different parts of the business form part of the overall value chain, there was sometimes a lack of clarity regarding how TCF accountability had been allocated across different functional areas. For example, where product supplier entities within a group made use of the distribution capacity of another entity within the group, the distribution division took a view that the product division was solely responsible for certain TCF outcomes, and vice versa. In multi-faceted groups, the FSB would expect the top level board and management structures to ensure a clear enterprise wide understanding of the responsibilities of all areas in delivering TCF outcomes for their shared customers.

Firms should also take care to ensure that, in using committees or other collectives to drive TCF initiatives, specific individual management accountability and leadership, where needed, is not overlooked.

Risk: Poor assessment or evidence of how the firm meets its TCF obligations

This risk was apparent in two main ways: there were some firms who saw their role as limited to their own activities, and took no cognisance of their potential TCF in other areas of the value chain. And then there were firms that had apparently limited ability to demonstrate their TCF outcomes. These will be discussed in turn:

In the first instance, a number of firms made clear their view that they were strictly only responsible for generating TCF outcomes from their own in-house activities. Hence more than a handful of firms submitted their returns by simply stating that particular outcomes - such as Outcome 2 (Suitable product) or Outcome 4 (Appropriate advice) - were not applicable. From the perspective of the FSB, while a firm may primarily on-sell products, or only distribute its products through external intermediaries, this is an inadequate approach and indicates an incomplete understanding of the implications of TCF. While no firm can be required to take responsibility entirely for another's activity elsewhere in the value chain, the question that should be asked is "what can we do to ensure fairness throughout the value chain?" This matter is taken up again later in the document.

From the questionnaire and interview responses, some firms had limited ability to evaluate or demonstrate their fair treatment of customers – or otherwise. There were several reasons for this, prime among them being that the process of evaluation was too informal or that reporting to the board was often around satisfaction, rather than fairness.

Regarding informality, there was a sense that for some firms there was a general expectation that all employees and agents could be relied upon to "do the right thing", even when this was not explicitly spelt out or monitored. One large organisation put it like this: *"As they are part of [the group] we can reasonably expect them to apply TCF in their environment".* The problem with this approach is that it does not take into consideration the incentives to take short cuts. In one case, in answer to the question "How does the strategy planning process take delivery of TCF outcomes into account?" the answer was "*There are no formal guidelines, this is informally considered*". A similar answer was obtained regarding the question, "Do you believe the introduction of TCF will required changes to your business operations?" The response was "*We have assessed the gaps informally*". The FSB is of the view that achievement of TCF will require both formally monitored and informal processes.

Responses regarding how TCF or market conduct risks were managed within firms' risk management frameworks were usually somewhat vague. Almost all firms stated that these risks were not explicitly identified or categorised, but were indirectly incorporated into risk categorisation systems. In most cases, firms said that TCF related risks (although not necessarily labelled as "TCF") were dealt with mainly under the operational risk category, with some elements managed as part of compliance and regulatory risk and / or reputational risk, where these were separately categorised. Despite most firms stating that TCF or

customer centricity was a core strategy of the firm, hardly any firms classified TCF or conduct risks as strategic risks.[5]

Regarding reporting to the board and senior management, typical management information appears to revolve around customer satisfaction – often expressed as whether the consumer would recommend the service or product to a friend. This, together with various consumer complaints metrics (often focussed on the time taken to resolve a complaint), appears to be the crux of "fairness MI". While satisfaction and complaints are important measures, they may well need to be supplemented or re-designed to capture "fairness". A few examples were apparent:

- A consumer's view of the satisfaction he or she derives from a product or service may differ substantially shortly after acquisition compared with shortly after having made a claim, or having attempted to realise value from an investment. From this perspective, consumer satisfaction throughout the life cycle of the product needs to be gauged, not just after the sale.
- While the number of product related queries may provide a proxy as to whether products are suitable and easy to understand, it may also be that where customers are confused, they do not take the matter further. Hence the strength of proxies needs to be tested.
- While it is often firm practice to attempt to shorten the period of time taken to resolve a complaint or process a claim, the firm-specified period may not align with customer expectations. Shortening resolution periods, or altering service processes, need to be evaluated against customer expectations.

Examples of good practice for Outcome 1

A number of firms were able to state (and show to some extent), that they were explicitly addressing TCF as a principle embedded within the operations of the firm, rather than a regulatory compliance function. For them, it was important that TCF was part of the daily practice of the firm.

Firms expressed their willingness to embed TCF in a number of ways. The examples below include processes firms said they already had in place and would enhance to address TCF issues more explicitly, as well as new processes they intended to introduce:

- Ensuring that existing customer centricity strategies are, to quote a firm, *"supported by a coherent set of governance mechanisms, measures and work plans in pursuit of the aim"*
- Conducting a gap analysis of existing policies and practices to identify areas where the TCF outcomes are not being achieved

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[5] See further discussion on conduct risk management frameworks in section 4 below.

- Conducting an assessment of the extent to which board members and senior management are in a position to identify and assess TCF objectives, including whether sufficient control measures are in place to alert management to any deviations from TCF
- Formally including TCF insights and goals into high level strategic planning sessions
- Recognition that there is a need to formally identify any conflicts of interest between the firm's commitment to TCF and other business goals and ensure these are analysed and managed
- Embedding TCF into existing group-wide customer service strategies, including training and awareness initiatives cascaded to staff all levels of the organisation
- Involving human resources specialists in TCF implementation plans to address embedding TCF in recruitment, training, performance management and remuneration processes
- Making the achievement of TCF outcomes a key performance indicator (KPI) of customer facing staff as well as the retail executives in the firm and giving TCF outcomes or client retention a substantial weighting (more than 20%) in performance reviews
- Developing differentiated TCF training programmes for staff at different seniority levels
- Incorporating TCF training within general initiation into the business
- Developing a customized self-evaluation process for each affected area of the business to enable it to assess its delivery of TCF outcomes applicable to its particular role in the value chain
- Establishment of forums or websites to encourage and, in some cases, incentivise staff members to make suggestions to improve customer outcomes
- Information sessions across business units to communicate new approaches to doing business
- Regular meetings within business units to evaluate the impact of the six TCF outcomes on daily business activities
- Development of a business case checklist for all material projects (not only product development) which includes TCF
- Re-designing certain processes to ensure better monitoring ability
- Designing TCF related MI to generate "warning signs" of emerging TCF risks and using these to take pre-emptive action
- Explicitly including identification of the segment appropriate distribution or customer interaction model and customer servicing model in the product approval process

2.2 Responses for Outcome 2

Products and services marketed and sold in the retail market are designed to meet the needs of identified customer groups and are targeted accordingly.

General trend: Limited direct customer feedback

The responses indicated that the majority of firms design products to meet the needs of customer target markets, although the approaches vary markedly. What is common, however, is that the customer has not always been a direct source of information in this process.

While some firms make use of in-house research, consumer focus groups, outsourced research, the findings of published surveys and market trend analysis, others appear to rely heavily on the feedback of intermediaries. In particular, products may be improved over time as a consequence of complaints or comments received from intermediaries. Once a product has been designed however, even less use is made of specific post-launch direct product testing with customers, although post-launch testing is sometimes carried out with intermediaries. What appears to drive evaluation of a product after its launch is the extent to which it meets with the firm's expectations – rather than those of the consumer.

While firms indicated that advertising and promotional material is profiled according to customer segment, direct customer testing of such material is rare. Once again, where testing takes place, feedback is typically obtained from intermediaries and material is often developed with a view to ensuring the intermediary understands the product and can explain it to customers. One firm acknowledged that products tend to be designed based on *"what intermediaries will sell"* rather than on identified customer needs. Another stated that the *"true test"* of product suitability for the target market was the extent to which intermediaries recommended the firm's products to their clients. Although the FSB accepts that advisers are best positioned to match a particular product to a particular customer's needs, this "test" on its own runs the risk of firms disregarding potential conflicts of interest between intermediary and customer.

The view of the FSB is that firms should consider increasing their use of direct customer feedback where appropriate, with a view to obtain a better understanding of the target markets and the extent to which product design meets expectations.

General trend: Selection of a distribution channel

While almost all firms segmented the market at the design phase, approaches to segmentation during the distribution phase were mixed. Hence, it was not always clear whether the selection of a distribution channel or distribution strategy formed part of the product design process, or whether the suitability of the distribution channel or strategy for the target market concerned was tested. In many cases, selection of the distribution channel appeared to be implicit in the firm's business model, with firms designing products to suit their existing distribution strategies. Some firms explained that they used selection of a distribution channel and sales process appropriate to their target market as the starting point

of their customer suitability approach, and that this strategy helped them to reduce the risk of a mismatch between product and target market.

In some but not all cases where firms used multiple distribution channels, product differentiation across distribution channels takes place, with certain products being allocated to certain channels – usually based on product complexity. In other cases, it appeared that all products developed were made available as a matter of course to all available channels.

Although most product suppliers' promotional and / or intermediary training material might implicitly describe the intended target market for a product, there was no sense that explicit disclosures were made regarding the target markets or customer types for whom products would be inappropriate. There was also little evidence that intermediaries / distributors take active steps to obtain confirmation from product suppliers as to the intended target markets or customer types the product is suitable or unsuitable for.

While it appears substantial effort is put into identification of target markets and customer needs at product development stage, far less is done to identify and monitor the extent to which the products concerned do indeed reach the identified markets and whether or not they meet the needs of the customers into which they are sold. It appears that little active monitoring of mismatch between targeted and realised customers takes place. As a result, there were few examples of risk mitigation measures or management information in place to detect and respond to emerging mismatches. In some instances, the view was expressed that the nature of the product was such that a mismatch risk simply does not arise.

While selection of distribution channels and the communication with such channels are well established, the FSB would like to see that firms more consciously interrogate the suitability of such channels and their associated training in order to ensure that consumers are provided with appropriate products. Moreover, firms need to consider more explicitly whether they need to monitor the extent to which the target market is being reached by their distribution strategies.

Risks related to Outcome 2

- *Products are sold to unsuited and unintended customers*
- *Distribution channels or strategies are inappropriate for products or targeted customers*
- *Bundling of products and / or services, or excessive incentives to customers leads to inappropriate or unnecessary sales*
- *The risk profile of customer groups does not match that of the product*
- *Firm doesn't understand or monitor the risks of the product*
- *Products are launched without appropriately targeted after sales support and service structures in place*

Risk: Products sold to unsuited and unintended customers

Some product supplier firms with highly intermediated distribution strategies acknowledged that this means the firm itself has little engagement with customers, thus creating the risk of less focus on customer outcomes. One such firm was of the view *that "marketing products via independent intermediaries removes the risk of selling products to a wrong target group given that products are sold on the back of a financial needs analysis"*.[6]

A number of firms – particularly short-term insurers – explained that the value proposition of their products was self-evident, and there was therefore little or no risk of products being sold to unsuited customers. A motor insurance provider for example stated that: *"If you don't own a car you won't buy car insurance, so there won't be a mismatch".* The FSB is concerned that this approach underestimates the extent of the information asymmetry between financial services firms and retail consumers, even in respect of ostensibly straightforward products. Continuing with the example of short-term insurance, as another short-term insurer described this risk, even in respect of commercial clients: *"Most insurance policies are sufficiently complex that customers don't know what they are buying".*

Risk: Bundling, loyalty benefits and "add-on" services leading to inappropriate sales

The literature on regulation has long debated the relative merits of bundling and creating a secondary market for add-ons. The general consensus is, however, that while there may be a place for bundling, with potential benefits to consumers, bundling of products can make it difficult for consumers to take informed decisions.[7]

The responses to the questionnaire indicated very little sensitivity to the possible ambiguity regarding bundling (or indeed to loyalty programmes and "add-on" services) by firms. In the first instance, there was no special evaluation of such products in terms of fairness - so a number of firms expressed confidence that they had complied with TCF expectations because the same approach was applied to approval of the loyalty or "add-on" features or bundled product as applied to the core product. Moreover, in some instances, the view appeared to be that such features were almost without exception to the customer's advantage and that there was therefore very little or no risk of unfair treatment in respect of these features. One response to bundling without a client opt-out clause was: *"This will never be to the disadvantage of the client, but rather to his or her benefit"*. One firm expressed the view that the only way in which mis-selling could occur in relation to their particular offering would be if the adviser failed to adequately explain to the customer how they could benefit from the product concerned.

Some international Consumer Protection Codes raise doubts about this view as, if a consumer's ability to make an informed decision is impaired as a consequence of bundling,

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[6] See further discussion later in this report regarding the need for further guidance on shared responsibility of product suppliers and intermediaries regarding Outcome 4 (appropriate advice).
[7] See for example, FSA, 2011, *Packaged Accounts*, CP11/20

then the benefits of bundling for the consumer are not without ambiguity. The FSB is mindful of approaches elsewhere where regulation of bundling is deemed necessary[8], and firms will need to show better evidence of customer benefit than simply stating there is one. One firm expressed this risk as follows: *"One of the biggest potential abuses is customers paying for add-on or flexible options that they do not use".*

In a number of cases, firm felt that risks associated with bundling or add-ons were eliminated by virtue of the fact that the customer could choose whether or not to take up the bundled or add-on product (or choose to "unbundle" it at a later stage). However, it was less clear what steps were taken to ensure that customers understood that they had this option – not only at initial sales stage but also whether or not they could "unbundle" or remove add-on's later in the life of the core product.

Risk: Mismatch between customer and product risk profile - particularly in relation to assessing financial capability

Responses to the question of what measures are used to evaluate customers' financial capability and understanding of products were mixed. In some cases reliance was placed on market research relating to customer segmentation (usually along "LSM" lines), while in other cases reliance was placed on the intermediary or call centre agent, as applicable, carrying out an affordability test as part of the FAIS advice process. The extent to which actual monitoring of these affordability checks was carried out varied quite substantially. In some instances, typically in direct marketing models, customers were asked to confirm whether they understood the explanations provided, either at the end of a sales call or, in some cases, in a separate post sales call. In a few instances, it seemed that no affordability or capability assessment of any kind was carried out, the assumption being that these checks were unnecessary as the product benefits were straightforward and the price in line with industry norms.

Risk: Inadequate understanding and monitoring of product risks

While the vast majority of firms *are* addressing the implications of TCF, both in terms of enhancing their understanding and monitoring, for a handful of firms lack of understanding and monitoring emerged dramatically as a potential risk. The responses of these firms are highlighted, because they simply indicated that Outcome 2 was not applicable to their operations.

Some of the reasons given were that they sold their products in conjunction with other products or services on an ancillary basis and therefore there was no risk of unsuitability. One response also asserted that *"the products have been in existence for more than ten years and are priced by actuaries".* Another stated, in response to a question regarding measures undertaken to identify and mitigate risks the product may pose to particular customer groups, that the firm requires the customer to *"sign next to certain explanatory clauses where there is a risk of misunderstanding from the client's side"*.

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[8] See for example, the Irish central Bank, 2010, *Review of the Consumer Protection code,* CP 47

While the FSB notes that some firms have a limited range of products which may not have changed for some time, firms are expected to be able to show how they have reviewed their products and their distribution channels, and how it is that their product is a fair product, especially when sold in conjunction with others.

Again, there was a trend among short-term insurers to regard their products as inherently less risky to customers than investment or long-term insurance risk products.

In some short-term insurance models which utilise binder or similar intermediary relationships to outsource aspects of product design, there is a risk of confusion as to which entity (underwriting insurer or binder holder / intermediary) is accountable for ensuring product suitability and mitigating product risks. In most such instances, the binder holders / intermediary entities concerned refer to the insurance products as "their" products and take full ownership of the product design process. One intermediary firm explained this as follows: *"[We] do not have an insurance licence but design [our] own product range to [our] target market".* One insurer (not a pilot participant) has expressed the view that delivering TCF outcomes will be a challenge as *"they only underwrite the products".* Although the pending binder regulations and FSB insurance outsourcing directive will further clarify the legal position in this regard, firms are reminded that, regardless of the extent to which they may outsource elements of their business, they remain accountable for delivery of TCF outcomes.

The FSB supports the view expressed by one firm that: *"The reality is that our clients do not differentiate between our product and anything else that is provided and we therefore must take ownership of these issues for resolution".*

Risk: Products launched without appropriate after sales support and service in place

Firms whose target markets are unsophisticated consumers highlighted the challenges associated with the "contactability" of these customers – for example customers living in rural areas or informal settlements - as a potential TCF risk. Although technology such as cell phone SMS contact proved effective to a degree, this remains a challenge.

Examples of good practice for Outcome 2

- A product design process based on the needs of customer segments, so that the product matrix and customer segmentation are better aligned
- An integrated set of measures, going beyond overall take-up and retention measures, to evaluate the success of a product – such as: extent of take-up within target market, product flexibility, competitive pricing, claims, lapses, early terminations, maintenance expenses, complaints data, compliance records, profitability, customer and other stakeholder feedback
- Explicitly including detailed target customer descriptions, and an explanation of how this target market was identified, as a component of the product approval process
- Piloting of a product prior to launching it, including evaluation of consumer demand, consumer understanding, business partner understanding and so on

- Structured, regular monitoring of sales against targeted demographics (such as geography, payment method, distribution channel, product type, customer occupation, customer income, etc.) as defined in the original approved business case, with full investigation and product review in the event of a mismatch being detected
- Incorporation of customer complaints and service call data into product understanding, marketing and training material – including formally including complaints handling officials in the product approval governance structures
- Evaluation of reasons where sales exceed expected targets, with a view to identifying mis-selling, mispricing or over-simplification- as opposed to only initiating an investigation when sales fall below targets
- Structured post implementation or post launch reviews to assess product performance against targets (with the reviews to be restructured to take TCF outcomes into account more explicitly in future). A few firms already focus specifically on a basket of customer outcome measures in their post implementation reviews.
- Strictly enforcing a rule that no product may be launched without the full back-end administration process finalised and in place
- Including an “exit strategy” into the product development process, to ensure an orderly withdrawal or redesign of a product in need
- Recognition – by only a handful of firms – that embedding TCF will entail not only servicing, MI and process improvements, but will entail a review of product design and costing philosophies.
- A few firms used previous customer payment histories with the firm and / or requested evidence such as pay slips to assist in affordability checking, instead of relying purely on self-certification by customers

2.3 Responses for Outcome 3

Customers are given clear information and are kept appropriately informed before, during and after the time of contracting.

General trend: Technical and legal emphasis

Generally, testing of the appropriateness and clarity of information is entrusted to functional specialists in the compliance and legal departments, with additional approvals required by marketing specialists and, in a number of cases, distribution divisions. As a result, vetting may be focussed more on technical accuracy than on suitability or clarity for the target market concerned.

While firms do take note of matters relating to lack of clarity in documentation and marketing material when customers complain, the notion of testing information prior to release on target markets seems relatively rare.

Most firms stated that they would promptly withdraw and then correct documentation that was found to have been misleading or unclear. However, there was little evidence that, if this situation arose, firms had a proactive process in place to mitigate risks to customers who had already received the potentially misleading or unclear information or consider redress. Instead, this appeared to generally be approached on a reactive, complaints driven basis.

Most firms have quality assurance processes in place regarding standard documentation as supported by functional specialists. However, controls in respect of the accuracy of once-off or non-standard documentation were less evident. In most cases, this risk is mitigated by using standardised documentation wherever feasible, and controlling which staff members are permitted to generate non-standard responses.

Some firms also confirmed that they have no controls in place regarding the quality or accuracy of once-off or non-standard documentation generated by their FAIS representatives (e.g. their tied agents or individual brokers within a brokerage).

In most cases, reviews of standard documentation are carried out on an ad hoc basis – often in response to complaints – with few firms indicating that they had a structured process in place for regular documentation reviews. One firm admitted that, even where reviews were undertaken, implementation of recommended changes often gave way to other business priorities.

The view of the FSB is that clear information is essential for customers to make informed decisions hence approaches that have tested clarity (rather than marketing success) need to be considered more widely. Greater emphasis should also be placed on ensuring that information remains current and appropriate.

Risks related to Outcome 3

- *Promotions are not clear or are misleading*
- *Customers do not understand product information aimed at them*
- *Customers do not receive key information they need to make an informed decision or key information is not appropriately highlighted*
- *Information regarding product performance, product risks, after sales services available, or action required from the customer is inadequate or not provided at appropriate times*

In the discussion below, the potential risks highlighted are the comprehensibility of product information and the re-active (rather than pro-active) nature of provision of such information.

Risk: Promotions are unclear and customers do not understand product information

It is clear from the responses of the firms canvassed that relatively little on-the-ground testing of customer understanding is carried out. Moreover, as discussed above, approval of material is largely entrusted to compliance and legal specialists whose assessment of the ability of certain customer segments to understand relatively rare and complicated arrangements may be heroic. The FSB is not convinced that relying solely on after sale surveys and complaints data as measures of comprehensibility is adequate.

For example, in some call centre based business models, customers are asked at the end of the sales call to confirm that they understand what they have been told. This approach, on its own, is unlikely to mitigate this risk, as customers will generally be reluctant to admit that they have not understood the information provided to them. Indeed, it can be argued that they would not necessarily be able to tell if they have misunderstood it. Similar concerns arise with models where customers are asked to sign a document confirming that they have read and understood information provided to them.

Risk: Failure to provide key information at appropriate times

The responses from firms suggest that there is a risk that information regarding product performance, product risks, the after sales services available or actions required from the customer is inadequate or not provided timeously.

Firms appear to place greater emphasis on providing information at the marketing and sale stages, than on providing information post sale in regard to recent or pending changes to products, contractual events or actions required from the customer.

A concern is that information is typically provided up front only, at the point of sale, without reminders taking place after the event. Many customers may be unfamiliar with the nature of the arrangements that they have undertaken and moreover, there is a lot to absorb at the time of contracting. Consumer education and financial literacy narratives emphasise the notion of a “teachable moment”, which relates to timing a specific educational or informational intervention, as when the timing is right, the ability to learn a particular task will be possible. The almost exclusive emphasis of some firms on disseminating information only

at the point of sale is liable to disadvantage the customer, and firms need to focus on how they can provide information more strategically post-sale for the benefit of consumers. It is notable that for many firms with recurring payment products, post- sale contact with customers is most likely to take place when there has been a missed payment.

Examples of good practice for Outcome 3

- A number of firms have undertaken or are in the process of a “Plain English” review of their product and promotional material. Some firms have, as part of such a review, tested their material with target customer groups or other non-industry people. Others have used external experts to vet the “readability” of documents and train staff on “Plain English” drafting skills.
- Some firms have a process in place for regular (e.g. annual) reviews of the accuracy and appropriateness of product information, rather than carrying this out on an *ad hoc* basis.
- Conducting client research after conclusion of a marketing campaign, to determine if the message has been received and understood as intended
- As part of their quality assurance process, some call centre based businesses review calls to test for customer understanding, and specifically follow up on any cases where it appears from the call that the customer may not have fully understood the information provided.
- The use of various media to make customers aware of pending changes through phone calls, SMS’s letters and emails.
- Some firms use the process of providing annual product information updates to also remind customers of pending contractual events or options available to them.

2.4 Responses for Outcome 4

Where customers receive advice, the advice is suitable and takes account of their circumstances.

General trend: Advice - reliance on FAIS compliance

There is a general sense that advice has become driven by regulatory compliance rather than by the need of the consumer. Many of the responses related to form (FAIS licensed and compliant intermediaries) rather than substance (the quality of advice itself).

When asked whether their product approval processes included a determination as to whether advice was essential in selling or marketing their product, the most common response from firms was that this decision was implicit in the product approval process. Where products were deemed to be simple, it was assumed that no or very limited advice would be necessary.

In the case of direct no-advice models, firms stated that they had controls in place to ensure that no advice was in fact provided and that customers understood this fact. There was no particular emphasis placed on an evaluation of whether the consumer could get by without advice. One such no-advice firm explained that, if a customer does need advice, they are referred to their own adviser, but that very few customers do ask for advice. The FSB is concerned that merely because a customer – particularly an unsophisticated customer- does not explicitly ask for advice, it does not follow that no advice is necessary.

In cases where advice was considered an essential part of the selling or marketing process, there was little or no evidence that product suppliers have controls in place to monitor the quality of advice provided by independent intermediaries. In respect of their own tied distribution models (i.e. where the product supplier is a FAIS licensed FSP using its own representatives), controls are typically in place to ensure FAIS compliance. These controls generally include process-based checks to confirm that a record of advice had been completed, whereas qualitative reviews of the content of the advice provided are less prevalent. Some firms also acknowledged that, although they have controls in place to ensure records of advice are maintained in regard to up front advice provided by their representatives, record-keeping was less controlled in regard to on-going or post sale advice.

On a related point, product suppliers were asked what processes they had in place to ensure that intermediaries who provide advice on their products have adequate product knowledge, expertise, access to information, TCF training and conflict of interest controls to ensure they are in a position to provide suitable advice. They were asked to answer with reference to the different distribution models they use.

The primary response emphasised training. Where product suppliers used their own tied distribution forces the question was typically answered by stating that the requirements of FAIS were complied with. Where independent brokers are used, responses ranged from the product supplier stating that they felt this was not their responsibility and that they merely

ensured that the intermediary held the appropriate FAIS licence category, to product suppliers who insisted on full accreditation / knowledge assessment of each intermediary in respect of the product supplier's products. One firm articulated the former position by explaining that they *"accept the business submitted on good faith that the broker has committed himself / herself to the legislative requirements".* Responses also varied substantially in respect of the level of "due diligence" undertaken by product suppliers before entering into a broking agreement with an independent FSP. Generally complaints are the motivator for examination of the quality of advice.

Where customer complaints to product suppliers regarding the quality of advice received from their own representatives is concerned, processes are generally in place to ensure investigation and action. However, in respect of complaints regarding advice from independent intermediaries marketing the supplier's products, responses again varied from product suppliers merely referring the customer to the FAIS Ombud and then taking further action if and when the FAIS Ombud issued a negative determination, to product suppliers themselves carrying out investigations and taking contractual action where warranted (such as terminating the intermediary's broking contract). In a number of cases, such monitoring of independent intermediaries that does take place is aimed mainly at product retention and fraud detection. Although these are perfectly legitimate aims, the opportunity to use these same monitoring activities for TCF purposes is often missed.

In the short-term insurance industry, a number of product suppliers using independent intermediaries stated that they receive few or no complaints that relate to the advice customers received from the intermediary. Firms pointed out that intermediaries normally handle complaints "on behalf of their clients" in the short-term sector. If this is correct, it would seem to follow that complaints would typically be framed as relating to the product or the insurer's service, as opposed to the quality of advice or intermediary service provided. Related to this, few short-term insurers analyse customer complaints with a view to checking for indications of mis-selling or inappropriate advice. In the long-term insurance and investment sectors, complaints were more likely to be investigated with a view to determining if the advice provided by the intermediary concerned formed part of the root cause.

When asked what processes are in place to assess, monitor and mitigate risks that may be introduced by representatives in terms of conflicts of interest and sales incentives and targets, most firms responded that they had introduced conflict of interest policies as required by FAIS, that they adhered to the FAIS conflicts of interest requirements regarding permissible financial interests, and/or that they complied with long-term or short-term insurance commission regulations (where applicable). There was little evidence of risk mitigation in this regard over and above FAIS compliance processes.

Risks related to Outcome 4

- *Intermediaries do not understand the products*
- *Intermediaries do not have the information or expertise to support the product range adequately*
- *The risks of products or services are not adequately explained to customers*
- *Sales incentives and targets skew quality of advice*
- *Products sold are not suited to the customer's needs (mis-selling)*

Risk: Intermediaries do not understand products or have insufficient expertise

This risk is apparent in situations where product suppliers distribute products through independent intermediaries, without insisting that the intermediary undergo product specific accreditation and / or training.

In some cases it was put to us that the products concerned were extremely simple and the product information provided to both customers and intermediaries was very clear, so that the provision of specific intermediary product training or accreditation was unnecessary and would lead to unwarranted costs.

Where intermediaries themselves are concerned, there was a general sense that it is the product supplier's responsibility to ensure that the intermediary is provided with appropriate information regarding the product. There was less evidence that intermediaries themselves feel responsible for actively demanding adequate training and information.

The FSB accepts that different types of products and customer segments entail different types of risks, and that comprehensive intermediary product training and accreditation is not the only way to mitigate this TCF risk. Nevertheless, we remind firms (both product suppliers and intermediary firms) that they must be in a position to demonstrate appropriate mitigation of this risk.

Risk: Sales incentives

This is an area where firms need to more critically assess their existing approaches and how they can be said to be sure to achieve the TCF outcomes. A substantial majority of firms replied to questions regarding how intermediary incentives and remuneration were structured to address TCF simply by stating that they comply with insurance commission regulations (where applicable) and FAIS conflict of interest requirements. There is a sense that firms may be reluctant to fully engage with evaluating existing remuneration standards. One firm indicated, for example, that they mitigate incentive risks by ensuing that sales are valid. Another stated that no FSP is particularly favoured.

While a number of firms indicated that their incentive policies included some reference to product retention over and above sales volumes – or at least that they would do in the future - retention on its own may not be able to ensure fairness to customers. Additional quality

aspects such as evaluation of the nature and quality of advice, together with retention data, may more adequately reflect fairness.

The FSB appreciates that the existing regulatory framework for remuneration regulation entrenches inherent conflicts of interest in some respects, and thus arguably poses a structural impediment to ensuring that intermediary remuneration practices are fully supportive of TCF principles. Enabling fair customer outcomes and minimising conflicts of interest are therefore key drivers of the review of intermediary remuneration that the FSB's insurance department has recently initiated. However, this is not to say that product suppliers and intermediary firms alike should not actively be seeking ways to ensure fair customer treatment within the current regulatory framework.

Examples of good practice for Outcome 4

- Reviews of individual files of consumers to ensure financial advisors (representatives) have given quality advice
- Development of an intermediary tracking platform or other methods for tracking trends (such as claims, complaints and / or retention trends) at specific intermediary level
- Where investigation of a complaint reveals a TCF failing by a particular intermediary, reviewing other business of that intermediary to identify whether other customers have been affected by his / her actions and take appropriate action
- A service quality assurance department that monitors the quality of advice (by representatives) on an on-going basis
- Using "mystery shopping" to assess the quality of sales agents' product and / or service knowledge (mostly in call centre based models)
- Product suppliers carrying out a level of "due diligence" over and above FAIS licence vetting and financial soundness checking – for e.g. a review of practice management processes – before concluding a broking agreement with an independent intermediary.

2.5 Responses for Outcome 5

Customers are provided with products that perform as firms have led them to expect, and the associated service is both of an acceptable standard and what they have been led to expect.

General trend: Meeting expectations

When asked how they evaluate whether customer expectations on products have been met, the most common responses were that this was done through monitoring product retention rates (e.g. lapses, early terminations, cancellations, etc.), customer satisfaction surveys and in some cases customer complaints.

Although these measures do provide useful insight regarding this TCF outcome, it must be borne in mind that none of them are on their own necessarily a reliable indicator that customer expectations are being met. We have commented earlier in this report on the fact that positive customer satisfaction scores are not necessarily evidence of fair treatment, as customers may not be aware that they have cause for dissatisfaction at the time they are surveyed. Similarly, the fact that the customer has not terminated a product does not necessarily mean that the product has or will perform as the customer has been led to expect – it could simply be that the time for testing delivery against expectations has not yet arrived. Firms should consider an appropriate combination of measures to test delivery of this outcome, rather than rely solely on measures such as retention or customer satisfaction as proxies.

General trend: Third parties

Where third parties such as binder holders or other outsourced service providers form part of the overall value chain, most firms acknowledged that they have limited controls in place to provide them with assurances that adequate standards of fair treatment of customers exist throughout the value chain, or to mitigate risks to customers where it becomes apparent that a third party's products or services are not meeting customer expectations.

In almost all cases, firms stated that they rely on service level agreements with the third parties in this regard, but agreed that these service level agreements were typically designed to mitigate the firm's own legal and operational risks and did not necessarily provide them with insight into customer outcomes. One firm expressed this learning from the self-assessment process as follows: *"The penny dropped that you can't outsource TCF".* Another expressed concern that: *"We rely on the fair practices of third parties and are vulnerable to unfair practices over which we have no sight and / or control."*

An interesting perspective was offered by one firm that is itself a third party service provider to insurers. The firm pointed out that, in terms of its service contract with an insurer, it was obliged to adopt the claims and servicing philosophy required by the insurer, and thus although it aimed to adhere to the TCF outcomes, it could not fully use its own discretion in this regard.

The FSB recognises that the delivery of TCF outcomes in value chains that entail the use of third parties is an area that will require further guidance, but reiterates that all participants in the value chain are expected to review their processes to consider where they contribute to the outcomes for end customers and thus whether they are adhering to TCF principles in that context.

General trend: Failure of products to perform as expected seen as applying only to investments

A significant number of short-term insurers expressed the view that the risk of products not performing as customers have been led to expect did not arise in the case of short-term insurance products, and that this risk applied only to long-term insurance and investment products (*"We do not offer investment products so the question of what clients have been led to expect is not applicable to our products"* and *"[We] specialise in short-term insurance personal lines only and therefore do not forecast or create performance expectations"*). One long-term insurer had a similar view, stating that this issue did not arise in the case of long-term risk business, but only in relation to investment business.

The FSB takes this opportunity to clarify that the concept of non-performance does not only relate to investment performance, but applies equally to any instance where a product does not deliver on expectations created – including, for example, rejection of a claim, payment of a lower claim amount than reasonably expected, unexpected premium increases or benefit reductions, or application of a higher excess than expected.

Some investment management firms and investment product suppliers, on the other hand, argued that their sole responsibility in ensuring that market related investment products performed as expected was to ensure adherence to investment mandates. Some also argued that it was not possible for them to engage further with investors as this would constitute giving investment advice, with attendant compliance risks. While acknowledging that further guidance and discussion is needed (see below) regarding the respective roles of "wholesalers" in the product value chain, the FSB urges investment firms to consider what further action they can take to ensure delivery of this TCF outcome.

Risks related to Outcome 5

- *Staff do not understand their obligations towards customers*
- *No monitoring of the impact of changes in the wider environment on products and customers or no action taken to mitigate risks when such changes occur*
- *Customers are not informed of the costs or risks of certain action or non-action on their part, which could impact on their benefit expectations being met*
- *Customers are not informed of options available to meet changes in their requirements during the product's life cycle*
- *Customer confidentiality is compromised*

Risk: Customers not informed of impact of changes in the wider environment

While most firms monitor the impact of changes in the wider environment on their business activities, there was little evidence that this results in mitigating risks for customers when such changes occur: Firms, in general, do not appear to have processes in place to proactively inform or mitigate the risks to customers where it becomes apparent that products are not performing or are unlikely to perform as customers have been led to expect. For most firms, these situations are typically dealt with reactively, on a complaints-driven basis.

The processes firms do have in place to monitor on-going developments (such as external environmental, regulatory or economic developments) that could impact on the extent to which products will meet customers' reasonable expectations are monitored primarily for the firm's internal risk management purposes. Identified concerns are not typically passed on to customers when this would have been appropriate to assist customers in ensuring on-going suitability of financial products. While one firm indicated they place educational articles in the media, this is unlikely to be direct enough – or particularly compelling - for many customers.

Risk: Customers not informed of risks of action or non-action on their part

Customers are generally not or seldom informed of the costs or risks of certain action or non-action on their part, which could impact on their benefit expectations being met. With the exception of alerting customers to non-payment in the case of recurring payment products, where there are generally processes in place, customers may not be consistently and adequately alerted to the risks of particular actions (such as early termination of a product, benefit reductions, investment portfolio switches) or non-action (such as failure to regularly review insurance cover needs, investment goals or risk profiles, beneficiary nominations). Where customer engagement does take place, it is typically in the context of "product retention" strategies. For the most part, the responsibility of firms seems to start and end with the provision of a Terms and Conditions statement shortly after contracting.

In the case of intermediated product suppliers, a number stated that they believed it was the intermediary's responsibility to alert customers to such risks. Ironically, a few intermediary firms stated that they believed it was the product supplier's responsibility.

The FSB is of the view that managing customer expectations needs to form part of the post-sale activities of all financial firms – both manufacturers and distributors - and firms should consider pro-active communication of emerging risks.

Examples of good practice for Outcome 5

- Some investment managers communicate economic developments and how to factor these into investment decisions to customers
- Pension fund administrators keep trustees informed of regulatory and other environmental developments to enable them to take informed decisions regarding the interests of their fund members

- Some short-term insurers and intermediaries keep customers informed of how to reduce the risk of falling prey to new forms or increased levels of crime – including through industry and general consumer media publications
- Developing a database of third party service providers that will track and enable customers and intermediaries to monitor quality and cost effectiveness of different providers
- Carrying out a survey to measure customer satisfaction in respect of the service provided by each claim related service provider after completion of every claim or using "mystery shopping" to review third party customer service levels
- Reviewing existing service level and binder agreements to ensure that they incorporate delivery of TCF and enable TCF monitoring
- Frequent – sometimes "real time" - monitoring of customer satisfaction with service across arrange of servicing touch points, and then using feedback from these processes to drive process reviews in a structured manner
- Review and analysis of existing products to ensure they remain suitable to the market
- Investment managers tracking investor behavior to identify risky trends (e.g. frequent portfolio switching) and using this to identify a need for improved investor and / or intermediary communication
- Investment product providers regularly highlighting key responsibilities to customers, such as the need to review investment goals, annuity income levels, risk profiles, etc

2.6 Responses for Outcome 6

Customers do not face unreasonable post-sale barriers to change a product, switch provider, submit a claim or make a complaint.

General trend: One size fits all approach to complaints, claims and servicing

There appears to be a greater focus on meeting the needs of particular customer segments at product development stage (Outcome 2) than at other stages of the product life cycle. Although different products are designed to meet the needs of different customer segments, with different channels selected to market and sell products, the after-sales servicing processes are in a number of cases designed in a "one size fits all" manner, with the same back office procedures being used for all customers.

In general, the innovation apparent in the marketing of products is less evident in terms of capturing complaints, paying out claims or other post-sale servicing transactions.

Where intermediaries were concerned, they typically regarded all aspects of after-sale servicing as the product supplier's responsibility. There was little evidence of intermediary firms having thought through the role the intermediary should play in supporting the customer throughout the product life cycle – with the exception of short-term insurance claims handling, where intermediaries take an active role.

General trend: Claims handling

While there is understandably a greater focus on the efficiency of the claims handling process in the short term insurance industry than in other sectors, most firms referred to the time taken to finalise claims as a key measure of their ability to meet the reasonable expectations of customers. One firm described the speed with which they finalise claims as their competitive advantage.

Firms are reminded that such time-based measures cannot capture all the aspects of meeting customers' expectations. In many instances, customers' expectations relate more to the quality of communication regarding progress of their claim and the reasons for decisions, than to the time taken to complete the claim process. There was somewhat less evidence of controls being in place around these qualitative aspects of the claims process.

General trend: Redress

In relation to processes relating specifically to complaints that include requests for redress, most firms deal with these on a case-by-case basis, with few having developed a policy approach regarding how to deal with the question of customer redress.

A majority of firms advised that, where a customer's complaint is justified, they will seek to place the complainant in the position they would have been in had the particular failing on the part of the firm not occurred. This redress is typically only reserved for those customers who had complained.

Only a small handful of firms indicated that they would take proactive steps to identify other customers who may have been prejudiced by the failing concerned and seek to mitigate risks to those customers.

General trend: Integration of complaints data

The majority of firms appear to have well-structured complaints handling processes in place, which typically include some form of complaint trend and root cause analysis.

However, the maturity of these analyses, and the extent to which complaints data is used as a source of information in relation to possible product and process improvements, varies substantially from firm to firm. In some cases, complaints data appears to be used on an anecdotal or *ad hoc* basis to inform other processes.

Even in instances where complaints data is fed into other operations in a structured manner, it is often not combined with other customer experience related data (such as claims data, lapse or early termination data, investment performance data and customer satisfaction survey data) to produce a more holistic TCF assessment.

From the perspective of the FSB, the failure to integrate complaints data more fully into product and intermediary MI is a missed opportunity for firms.

Risks related to Outcome 6

- *Not meeting customers' reasonable service expectations*
- *Unreasonably inflexible products*
- *Seeking to avoid valid claims or full settlement*
- *Claims handling process is inefficient and / or not transparent*
- *Unreasonable barriers put in place to prevent transfer or switching of funds or providers*
- *Complaints handling process unwieldy or isolated from other parts of the value chain*

Risks: Failure to meet service expectation and lack of flexibility

In line with the observation above that most product information is provided solely at sales stage, the same trend applies to information regarding the availability of flexible product options. Although a number of product supplier firms emphasised the flexibility of their products to meet changing customer needs, there was relatively little evidence of pro-active communication or reminders to customers of these options.

Risks: Unwieldy and isolated complaints handling

The survey responses revealed that in some cases, firms insist on customer complaints being submitted in writing. Although firms said this was in the customer's interests as it would ensure certainty regarding the nature and extent of the complaint, the FSB has a concern that this could pose a barrier for unsophisticated customers. It is quite possible that some customer segments are effectively excluded from the complaints process, for example, because of this monolithic approach.

Examples of good practice for Outcome 6

- Central complaints handling ensuring that feedback is obtained from the responsible department and once settled or resolved fed into the marketing, design, staff management and training processes
- Daily monitoring of progress on complaints and claims and feedback to customer via SMS
- Formally including equity and fairness as principles in a documented and monitored claims philosophy in relation to the assessment, processing and payment of claims
- Ensuring internal dispute resolution / complaint handling officials have clear mandates with regard to redress
- An incident monitoring system built into the complaints process to determine where a particular error or TCF failing impacts multiple customers, to ensure resolution is considered for affected customers over and above the particular complainant/s
- Where customer satisfaction measures are used in respect of particular processes or products, investigating and addressing low ratings as though they were an actual complaint
- Establishing forums for relevant staff members to discuss actual claims, complaints or staff errors as case studies and use these for TCF training purposes and to identify process improvements.

3. FEEDBACK FROM PARTICIPANTS REGARDING THE PILOT PROCESS

The questions in Part C of the pilot questionnaire sought to elicit views on the usefulness of the self-assessment questionnaire and process. It also asked for suggestions regarding future TCF benchmarking, reporting and management information approaches.

In this section, we will summarise general trends in the feedback on Part C and highlight a few specific comments on the pilot exercise as a whole, together with the FSB's response - where required:

Adequacy and completeness of the questionnaire

The majority of pilot participants stated that the questionnaire was very comprehensive. Very few firms identified additional TCF risks that they felt had not been addressed. A couple of firms said the questionnaire was too long.

Usefulness of the pilot process

All participants said that they found the pilot process of self-assessment useful, with some stating that they had found it of exceptional value in helping them identify opportunities for improvements in their customer interactions. Firms acknowledged that during the process they had started to think differently about their response to TCF.

Most large organisations found it useful in helping them to identify inconsistencies in TCF maturity and interpretation across different parts of their business, which they had not previously been aware of.

For those who indicated that they had done little so far, the process had enabled them to consider what they should do and where there were identified gaps. Those firms who saw themselves as relatively prepared for the process admitted that the pilot had exposed them to additional ways of thinking about TCF. Even those who indicated that there was little to be done often revealed new ways in which they could enhance their existing processes. For example, one firm that indicated there was no need for a gap analysis, still indicated that the process had helped them identify additional possible sources of customer related MI.

Almost all firms stated that the pilot had provided useful guidance as to the FSB's expectations of firms regarding TCF at this stage of the TCF roll-out. Firms also generally felt that the in-depth follow up interviews had helped executive and senior management gain better insight into the strategic and cultural implications of TCF and the role the board should play.

Unnecessary, inappropriate or difficult questions

A number of firms felt that some of the questions were repetitive. In particular, they highlighted repetition between Part A (open-ended qualitative questions) and Part B (questions related to specific implementation actions). The FSB pointed out that some of the repetition between Parts A and B was intentional, enabling firms to use their Part B responses as a "reality check" to evaluate their broader, narrative responses in Part A in respect of each outcome. (See further discussion below regarding the usefulness of Part B). Nevertheless, in developing the final self-assessment tool, the FSB will try to limit repetition.

A number of firms pointed out that some of the questions – in particular some of the specific implementation actions in Part B – were not relevant to their business model. This observation is valid. The FSB reminds firms of the limitations of a "one size fits all" self-assessment tool, as highlighted in the TCF Roadmap. In particular, such a tool cannot and will not take into account a firm's specific strategies, business model, operational structure and unique conduct risks. To ensure accurate and comprehensive TCF self-assessment, firms should therefore develop their own self-assessment methods, using the FSB's questionnaire as guidance where appropriate.

Some particular concerns raised by categories of firms regarding appropriateness of the questions were:

- The questions were relevant mainly to firms who interacted directly with retail end customers. As such, it was difficult for "wholesale" entities such as investment managers, collective investment schemes (for some aspects of their business), pension fund administrators and underwriting managers to apply some of the questions to their business. The FSB acknowledges that further guidance will in future be required regarding the allocation of TCF responsibility across complex value chains, and the responses of these pilot participants has been useful input in this regard. Nevertheless, firms are reminded – as discussed earlier in this report – that all entities in the value chain who contribute to outcomes experienced by consumers of financial products, should consider their own role in ensuring fair treatment of those consumers. Those "wholesale" entities who had responded that entire TCF outcomes or substantial components of outcomes were "not applicable" to their business models were challenged to reconsider their responses.

- The structure of some questions made it difficult to distinguish between the responsibilities of product suppliers vs. those of financial advisers or other intermediaries. A number of firms suggested that these questions should be more clearly separated out. Again, the allocation of TCF responsibility between product suppliers (manufacturers) and intermediaries (distributors) is an area that will require future FSB guidance. Both manufacturers and intermediaries are however urged to apply their minds to the role they can play in respect of delivering TCF outcomes they did not traditionally see as their domain. For example, product suppliers should consider what they can do to contribute to Outcome 4 (appropriate advice) over and above simply checking that the intermediaries they contract with are FAIS licenced. Conversely, intermediaries should consider what role they can play in ensuring that

the product suppliers whose products they promote do indeed provide products and services that meet TCF requirements.

- The questions were mainly focussed on intermediated distribution models, and were in some cases inappropriate for direct marketers.

The FSB will take these comments into account in developing the final version of the self-assessment tool.

Usefulness of Part B as a checklist of possible TCF implementation actions

The relationship between firms' responses to Parts A and B of the questionnaire respectively, proved to be particularly interesting. Although in most cases there was a reasonable degree of alignment, in some instances the discrepancies were so marked that it appeared to the FSB that the respective sections must have been completed by completely different people within the organisation.

Some firms expressed a high degree of confidence, in Part A, that they were already well advanced in meeting their TCF obligations and would have little to do to achieve full delivery, whereas their responses to Part B indicated that there were a substantial number of TCF implementation actions that they did not or only partially carried out. Other firms were quite self-critical in Part A, stating that they had made little progress regarding TCF and would need to take extensive further action, whereas their responses to Part B indicated that they had in fact implemented a significant number of the possible TCF implementation action. Accordingly, a number of firms found that Part B was valuable as a "reality check" against which to evaluate their responses in Part A.

The FSB was at pains to point out, as also explained in the TCF Roadmap, that must not regard the questions asked in the self-assessment as an exhaustive or definitive list of the areas the FSB will in future focus on in monitoring and assessing TCF delivery – Part B is therefore not a "compliance checklist" for TCF. Nevertheless, in the follow-up meetings, pilot participants were encouraged to consider those Part B action items to which they had given a "No" or "Partial" response, and ask themselves whether implementation of these actions, or comparable actions, would not in fact be useful in helping them to deliver TCF outcomes. Clearly some actions would not be appropriate to some business models and in some cases firms could have other effective ways of achieving the outcome concerned.

Should the FSB develop a "scoring" or "rating" method for benchmarking TCF readiness?

In reviewing the responses, it became clear to the FSB that we had not expressed our intentions clearly in framing this question. A number of firms interpreted this as the FSB intending to establish a "hurdle rate" or "minimum TCF score" for firms to meet. They therefore quite rightly expressed the concern that this would turn TCF implementation into a "numbers game", rather than embedding fair customer treatment into firm cultures.

The FSB takes this opportunity to clarify its intention: We intend to develop a methodology to carry out an exercise, with a broader and more diverse sample of participants than the initial pilot group, to determine general TCF readiness within the financial services sector. The results of this exercise will then be used as a "baseline" (which we now realise is probably a more accurate term than a "benchmark") against which to measure improvement in customer outcomes at a future stage. No firm-specific "results" or "scores" of such an exercise will be published. The purpose of this question was therefore to elicit recommendations regarding such a methodology.

Most pilot participants were supportive of such a "baseline" exercise. A number of firms cautioned however that in order for it to be meaningful, the exercise should distinguish appropriately between different sectors, distribution models and target markets. Although the intention is for the exercise to be run on a relatively high level and generic basis, we do agree that appropriate segmentation in both the design of the process and the analysis of the results will be necessary. Firms also pointed out that care would need to be taken to mitigate the subjectivity of participants' responses, which the FSB agrees with.

Some firms also made useful suggestions regarding possible approaches, including considering obtaining input from different levels of staff within participating firms, in order to gauge enterprise wide corporate culture.

TCF indicators or measures to be publicly reported

The FSB has advised both in the TCF Roadmap and in Part C of the pilot questionnaire that it intends to develop certain TCF success indicators or measures that firms will be required to report on publicly. Pilot participants were asked for suggestions for appropriate measures – whether applicable to all regulated firms or only to particular types of firms.

The majority of firms supported the introduction of public reporting measures, provided they were structured to avoid unfair or inappropriate comparisons between firms or types of firms. The FSB recognises that great care needs to be taken in designing and reporting any such measures – not only to avoid unfair reputational harm to firms or sectors, but also most importantly to avoid misleading consumers regarding the treatment they can expect from firms.

Some firms felt strongly that these public reporting measures should be introduced, and should be applied as broadly as possible across all financial services sectors. Some firms supported the introduction of public reporting measures, but cautioned that they should not be imposed too early and that firms should be given sufficient time to make progress on their TCF implementation plans before being required to report publicly on their TCF progress. The FSB accepts that public reporting should not be imposed prematurely, but points out that this should be weighed against the fact that the expectation of public disclosure in due course will help to ensure TCF implementation enjoys sufficient priority within firms.

The handful of firms that opposed the introduction of public reporting based their opposition mainly on concerns around what they see as unintended consequences: That firms will focus on reportable measures at the expense of driving real organisational culture change

and that the increased reputational risk will result in a “tick-box” compliance based approach to TCF. The FSB is mindful of the risk of such unintended consequences, but remains of the view that public disclosure can act as both an effective deterrent to poor treatment of customers and a useful incentive for fair treatment. It will however be essential to ensure that the public reporting measures do indeed achieve these results and that they provide meaningful and accurate information to customers. The overall supervisory and enforcement frameworks for TCF will also need to be structured to avoid disproportionate focus by firms on the public measures.

As regards the types of measures or indicators that would be suitable for public reporting, the most commonly suggested measure included appropriately structured complaints data, a view the FSB shares. A number of firms, particularly smaller firms, stressed the need to keep the measures simple.

4. NEXT STEPS IN 2012

Planned further implementation of the TCF Roadmap during 2012 includes the following:

Final version of the TCF self-assessment tool

The FSB had intended to publish the final version of the self-assessment tool together with this feedback report on the self-assessment pilot. In view of the extensive and very constructive feedback received from the pilot participants, this has not been achievable. The revised target is to publish the final version during the first quarter of 2012.

A baseline exercise on TCF readiness

This exercise, to be carried out with a broader and more diverse sample of financial services firms than the initial pilot group, will be used to determine general TCF readiness within the financial services sector. The results of this exercise will be used as a "baseline" against which to measure improvement in customer outcomes at a future stage. Please see the discussion in section 3 above under the heading *"Should the FSB develop a "scoring" or "rating" method for benchmarking TCF readiness?"* for further detail. This baseline exercise will commence in the first quarter of 2012. Generic findings will be published later in 2012.

TCF regulatory framework

The work of the TCF Regulatory Framework SC work streams will continue, culminating in the publication of their analysis and recommendations regarding a TCF regulatory framework. This work will in turn continue to feed into the broader financial regulatory reform process underway between the FSB, the National Treasury and the South African Reserve Bank in shaping the proposed "Twin Peaks" model for financial services regulation.

TCF supervisory framework

Internal work within the FSB will continue in formulating the appropriate supervisory approach and structures and building capacity to supervise the TCF outcomes based regulatory model. Again, this work is being undertaken within the context of shaping the broader supervisory framework required for the FSB's enhanced market conduct mandate in a "Twin Peaks" structure.

FSB regulatory guidance

As indicated in the TCF Roadmap, the FSB will on an ongoing basis and as needs are identified, provide regulatory guidance to affected industry sectors, as the TCF implementation progresses. The self-assessment pilot process has given the FSB very useful indications of areas where such guidance is required. The pilot has confirmed most of the FSB's previously identified areas of potential industry confusion, and has also highlighted additional matters requiring direction. Although by no means a complete list, some matters to be addressed in future guidance will be:

- Allocating TCF responsibility to across the value chain. In particular, the TCF responsibilities of “wholesale” activities such as investment management, wholesale aspects of CIS management, pension fund administrators and reinsurers require further discussion. TCF in third party outsourcing relationships (including but not limited to binder relationships) also requires focus.

- Ensuring delivery of TCF in relation to bundled products, loyalty arrangements and “add-on” services, including arrangements financial products are marketed in conjunction with other products or services.

- The respective roles of product suppliers (manufacturers) and financial advisers and other intermediaries (distributors) in delivering TCF outcomes for their shared customers.

- Regulatory expectations regarding TCF related management information (MI). It was apparent from the pilot responses that there is a risk that firms will concentrate almost exclusively on quantitative data and underestimate the value of qualitative TCF measures and reports. Generally, much of the MI currently used for customer related measures is designed to measure efficiency and cost, without providing evidence as to the delivery of outcomes. On the other hand, it is clear that much existing MI can indeed be adapted for TCF purposes if analysed from a customer outcomes perspective, and if meaningfully analysed together with other existing MI.

- Ensuring that TCF risks are effectively incorporated into enterprise wide risk management frameworks –which typically focus mainly on financial and prudential risks, as opposed to market conduct risks.