PANDEMIC BRIEFING

Addressing COVID-19 Impacts on Non-Financial Risks in FCRs

DATE: 27 July 2020

PREPARED BY: GI NFR Focus Group

DRAFT

Introduction

This note is intended to support Appointed Actuaries in their preparation of FCRs, as they consider the impacts that the COVID-19 pandemic and shutdowns have had on NFRs.

Background

The requirements of an FCR in relation to review of risk management are:

- **APRA's CPS 320** requires us (paragraph 25(g)) to include

"…general observations on the overall risk management framework, with a focus on financial risks, and how these risks are managed by the insurer."

  - While this clearly limits the focus to financial risks, APRA has (subsequent to the release of CPS 320, and in the context of the Hayne Royal Commission etc.) explicitly asked actuaries to consider NFRs as well:

    "Actuaries need [to operate] beyond the realm of traditional financial risks. We want them to broaden their thinking… into areas such as culture, governance, remuneration and consumer outcomes."[1]

[1] John Lonsdale (APRA Deputy Chair) at 2019 Actuaries Summit

- **PS 102**
    - Explicitly requires consideration of NFRs (paragraph 6.10.1):

    "The AA must provide general observations on the overall risk management framework, with a focus on financial and non-financial risks that could have a Material adverse effect on the financial condition of the Entity, including how these risks are managed by the insurer."

    - Specifically mentions operational changes (6.4.4):

    "The AA must also comment on recent developments in the entity's operational environment which could have an impact on its future financial position."

What is the AA's role?

It's important to emphasise that AAs are not primarily responsible for risk management – our 'angle' is a view on whether the insurer is identifying and managing NFRs appropriately. We need to make sure that we're not stepping on the CRO's toes, but aim to provide observations, input and ideas which are useful for the Risk Management function and CRO. It makes sense to focus on the NFRs that are important for the particular insurer.

What risks has COVID-19 impacted?

The table below sets out our thoughts on NFRs that may have been impacted by COVID 19, and what the main impacts might be. The importance of each risk will depend on the individual insurer's circumstances.

Area	Impact of COVID-19	Potential unfavourable outcomes
Strategy	Change in market, customer dynamics	Disruption of plans to target market segments, expand business, re-price…
	'Shake-up' of priorities – urgent response to COVID-19	Distraction from BAU initiatives (focus change from longer term to short term) – regulatory reforms, climate risk etc
	Increased frequency of revision to strategy as pandemic and its impacts unfold	Management and staff lose track of changes, become confused about direction. Implementation is complicated by lack of clarity.

DRAFT

Area	Impact of COVID-19	Potential unfavourable outcomes
Operations	Move to work from home	Increase/change in WHS risks
		Lack of connection leads to lower staff engagement/morale
		Lower productivity
		Drift of focus – failure to execute, deadlines not met
		Privacy – information 'leaks' outside company (via family/others connected to WFH environment)
		Operational failures at office (e.g. machinery breakdown)
	Reduction in day to day contact among teams	Issues, and departures from normal protocols/standards, not observed and called out by colleagues (e.g. claims management)
		Newer staff members' learning suffers from lack of contact (e.g. reduced opportunity to 'learn by observing')
		Dilution or deterioration of corporate culture, including risk culture
	Expansion of range of priorities/issues for senior team to manage	Burnout in senior team
	Interruptions to outsourcing (esp. OS)	Failure to deliver normal service to customers
	Interruptions to supply chains (goods, services)	Failure to deliver normal service to customers
	Return to office	Staff not adequately protected by COVID-19 safety measures, become ill
		Loss of efficiency due to insufficient coordination between staff in office and those at home
		Transition difficult due to need to coordinate staff preferences/needs
Governance	Remote meetings of boards, committees, management – reduced clarity of communication (including greater difficulty of 'reading the room')	More difficult to agree on important decisions at a time when they may be needed
		Lack of challenge/discussion leads to sub-optimal decisions
Product/ customer	Uncertainty about coverage/exclusions	Requests for refunds which are not able to be satisfied

DRAFT

These risks, and any consequential negative outcomes, can be teased out in the pre-FCR meetings with the insurer's management. It will be useful to discuss the insurer's response to any unfavourable outcomes – including actions taken to remediate or mitigate the risk, as well as how each risk is being monitored over time.

Has COVID-19 resulted in new risks being recognised in the risk register? What is the approach to rating of new risks?

Has the company given any thought to whether it needs to increase its capital in response to heightened NFRs?

It's worth noting that there are some areas where the COVID-19 situation may have positive impacts – for example, the deferral of requirements to implement regulatory changes (DDO, CPS 234). Apart from having extra time via the deferral, regulators may allow more 'wriggle room' in timelines.

Potential Analysis

The AA may be able to identify areas where analysis could provide insights into emerging NFRs. Even what we would consider as very 'low tech' analysis may be seen as valuable by boards.

Staff engagement/morale/effectiveness:

- Trends in staff turnover/absences by team/department.
- Useage of staff welfare (employee assistance) programs such as company-funded psychological support.
- Trends in staff engagement during shutdown (compared to pre-shutdown) – employee surveys, internal feedback.
- Trends in measures of productivity e.g. policies processed, claims opened etc.

Product/pricing (would analyse by product/segment where possible):

- Refund requests.
- Response times to customer queries/complaints .
- Customer dissatisfaction.
    - Cancellations.
    - Complaints/disputes – including tracking of responses/outcomes.
- Results of customer satisfaction surveys – trends by month.

DRAFT

Technical/IT:

- Tracking of outages by extent/duration, phishing/scams, cyber-attacks.

Compliance:

- Compliance breaches by type/severity, by month.

The AA may also be able to assist in the development of key risk indicators in a range of areas.

Further Material

The Institute has produced two Pandemic Briefing notes relating to risk management, and these may prompt further ideas.

Considerations for management

Considerations for non-executive directors

DRAFT

DISCLAIMER
This *Pandemic Briefing* has been created to assist actuaries consider the potential impacts of COVID-19 in their area of work. The *Briefings* are discussion notes which may be updated as future developments occur. The Actuaries Institute and the employers of the authors accept no responsibility, nor liability, for any action taken in respect of the advice and information contained in this discussion note.