

Is insurance the new banking? Part 4: Facing up to behaviour and risk in the London Market

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In September 2019 Lloyd's of London "... announced ... actions designed to make [its] market a place where everyone can feel safe, valued and respected ..."

This followed findings from "the largest culture survey ever conducted in the insurance sector" which showed that of the Lloyd's market participants surveyed:

- "8% ... had witnessed sexual harassment over the previous [year], however just 45% said they would feel comfortable raising a concern"
- "22% ... have seen people in their organisation turn a blind eye to inappropriate behaviour."

Our previous article addressed the regulatory issues around Lloyd's' evidence of inappropriate personal behaviour (sexual discrimination / harassment, and alcohol / substance abuse). This article addresses the ramifications of the 'raising a concern' (ie whistleblowing) issue.

The whistleblowing issue has been given increased significance following the 'Dear CEO' letter of 5 November from Gareth Truran, Acting Director, Insurance Supervision of the Prudential Regulation Authority ("PRA"). The PRA said in that letter that its "priority areas of focus for general insurance firms over the coming year" include:

"Ensuring firms develop and maintain a culture where staff feel able to speak up and raise concerns, with effective mechanisms in place to support them in doing so (including mechanisms to ensure access for control functions to non-executive board members)."

The letter elaborated on the above point:

"Recent public reports relating to sexual harassment and bullying within the London market are of deep concern and it is clear that some firms have more work to do to improve aspects of corporate culture and individual behaviour ... these issues also raise broader questions about whether firms are promoting a culture where staff feel able to speak up about poor practices or unidentified risks within their organisations, including issues relating to a firm's financial soundness ..."

The above indicates that the PRA's position is that firm's handling of whistleblowing on inappropriate personal behaviour has a potential link to problems in whistleblowing on inappropriate prudential risk-taking.

Importantly, the PRA letter refers to a speech from June 2019 by Anna Sweeney, Director Insurance Supervision that made a specific connection between –

- fostering – and preventing the undermining of – a culture of diversity within financial institutions and markets, and
- the safety and soundness of those institutions / markets:

"The global financial crisis demonstrated perfectly how uniformity is a poor starting point from which to challenge existing practices. The lack of intellectual diversity, including from the lack of gender, race and other diversity, we believe contributed to the severity of the crisis through confirmation bias [ie a person's interpretation of new information simply to confirm, and not challenge, pre-existing expectations]."

The various propositions raised in the November letter (including the June speech) give rise to an inference that, for the PRA, problems in whistleblowing where the subject-matter is inappropriate personal behaviour will inevitably signify or result in problems in whistleblowing

where the subject-matter is inappropriate prudential risk-taking: both subject-matters, or problems, are symptomatic of “groupthink”.

The PRA's explicit position on this is: *“The remedy for groupthink [is to] bring diverse groups together.”* Conversely, the advancement of diversity (eg in terms of gender or sexual orientation) is inevitably harmed by sexual harassment. Key components in remedying this harm are of course:

- whistleblowing;
- verifying the issues raised in that whistleblowing; and
- responding appropriately to the legal and regulatory issues identified.

As the FCA stated in its Final Notice as to Staley (May 2018), CEO of Barclays Bank, who was found to have breached conduct rules in attempting to identify a whistleblower in contravention of Barclays' policies: *“whistleblowers play a vital role in exposing poor practice and misconduct in the financial services sector. It is critical that individuals who wish to raise concerns feel able to speak up anonymously and without fear of retaliation ...”*

The PRA's letter places particular emphasis on whistleblowing as part of boards' *“collective responsibility for articulating and maintaining a culture of risk awareness and prudent management of risk for their organisation.”* The PRA is especially concerned that the general insurance market is experiencing, or at least at risk of experiencing, *“challenging market conditions, when commercial pressures may be high.”*

The PRA summarises the factors that could heighten *“commercial pressures”* as being:

“Reserve adequacy and associated reserving governance and controls, particularly in the light of emerging risk developments including in the US;

The extent to which firms are demonstrating discipline in underwriting strategies remediation activity and controls, notwithstanding recent rate rises in some specialty lines;

Emerging risk trends and experience in firms' exposure management practices, including both natural catastrophe and man-made accumulations;

... UK retail general insurers' responses to the FCA's pricing practices review, once [it] is finalized ...”

Particular points that the PRA makes in relation to reserving, underwriting and exposure management are that the PRA has:

- *“heard some anecdotal concern that commercial pressure from management to deliver improved results may sometimes translate into actuarial judgements being challenged disproportionately ...”*; and
- *“seen examples where:*
 - *reserve deterioration over recent years raises concerns about ongoing optimism within firms' reserving and business planning assumptions ...*
 - *... underdeveloped links between ... business and control functions with the result that key underwriting, claims and reserving trends may not be being picked up and acted upon quickly;*
 - *there is insufficient MI and transparency [for] boards [to] understand and ... [firms] to ... act on trends relating to underwriting performance, reserving and exposure management.*

The PRA is -

- especially alive to the potential that *“... pressure [on management] to deliver results translate[s] into inappropriate pressure on individuals within control [including actuarial] functions to weaken assumptions ...”* and
- especially keen that *“boards should be alert to this risk and ensure that the effectiveness of the risk control framework is supported by the organisation's culture ...”*

The appropriate handling of whistleblowing, as a *“formal channel”* of communication, is a key feature of both a firm's *“risk control framework”* and its *“culture”*. It is not however the only channel. The PRA's letter:

- asks *“boards to consider what other internal mechanisms may be useful in supporting [control] function holders and allowing board members to understand directly their views and perspectives ...”*;
- gives an *“example”* of such an *“internal mechanism”* as being that *“some heads of control functions such as Chief Actuaries have told us that they do not have routine opportunities to meet non-executive [directors – “NEDs”] outside formal board meetings.”*

It is of course essential that NEDs “*provide effective oversight and challenge*” to the executive, in particular by “*satisfying themselves that financial controls and systems of risk management are robust and defensible*” (as per the FCA’s Code of Conduct, Annex 1, on the roles and responsibilities of NEDs).

However, it is possible to infer from the above that the PRA’s concerns about general insurers’ executive management are such that the PRA is looking for communications that are outside the formal reporting lines established by firms pursuant to the Senior Managers and Certification Regime (“SMCR”).

If so, these concerns raise some challenging questions as to the point at which NEDs’ ability and willingness to take a particular view on specific operational activities will in effect give NEDs an executive role. Furthermore, this must inevitably raise questions about the very effectiveness of SMCR.

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