REGULATORY CHANGES: IMPACT ON DISTRIBUTION

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# TABLE OF CONTENTS

INTRODUCTION ................................................................................................. 2  
REGULATORY CHANGES ON THE HORIZON ........................................... 4  
IMPACT ON DISTRIBUTION PROCESSES & IT LANDSCAPE ............. 6  
ROADMAP FOR INSURERS .......................................................................... 8  
APPENDIX ...................................................................................................... 10  
ABOUT WIPRO TECHNOLOGIES AND WCIR ........................................ 11
INTRODUCTION

Insurance regulation, worldwide, is undergoing a lot of changes, be it in the developed markets like the US, UK or in evolving markets like India. If you take a closer look at these changes, you will find that there is a pattern behind the thought processes of the regulators of various geographies. The common end objectives, which drive these regulations, are:

- Consumers who cannot make educated decisions due to the complex nature of the products are still protected
- Information for consumers is clear, simple and understandable
- Advice costs to the consumers be decided by the consumers themselves
- Firms are soundly managed, adequately capitalized and treat their customers fairly
- Regulations be risk and principle based

Majority of these objectives are focused towards how insurance products are and should be distributed to end customers. This is because, insurance, being intangible and a complex product, relies much more on effective distribution than any other financial instrument or commodity. The perception of a higher probability of misspelling & miscommunication in insurance sales transactions has led to stringent regulatory mechanisms and continuous monitoring by regulators. Ensuring adequate disclosures to customers is also a very strong driver for regulations. Over the last couple of years, the world has seen complex financial instruments pull down entire institutions and seriously harming national economies. This, among other causes, highlights the role of distribution of financial products as a whole.

Insurers need to ensure that the structure and delivery of distribution channels conform to the changing regulatory challenges while ensuring continuous improvement in delivery. Technology is the primary enabler for achieving compliance to regulations and for distributing insurance products effectively. While evaluating the latest technology concepts for regulatory compliance, care should be taken that they also deliver business value. A lot depends on how the technology concept is used; Social networking is one good example. The changes, be it strategic, involving new channels or tactical ones modifying the existing channels, have a huge dependency on the underlying technology.

The first section discusses the regulatory changes on the horizon affecting insurers’ distribution processes. The next section analyzes the impact these changes have on distribution and IT landscape. Subsequently, we propose a roadmap that insurers can follow to ensure they have a head start in complying with the regulations and in staying ahead of the competition.
REGULATORY CHANGES ON THE HORIZON

In the United States, multiple regulators, which are conventional anachronisms, face a challenge from the state present. The state control over insurance regulation has required insurance business entities to obtain multiple licenses to operate across the country and has complicated the process of selling & distribution of insurance products. To have or not to have a single regulatory body is a burning debate with several proposals for and against this change.

While the insurers look forward to a single federal charter, the White House has proposed an Office of National Insurance which will look holistically at the insurer's entire business organization and recommend federal control of the insurer on a case to case basis. However, the impact on distribution is not clear as of now. There are several bills (proposed legislation), HR 2609, HR 1880 for instance, which propose for some kind of central authority.

The proposed legislation H.R.2554, the National Association of Registered Agents and Brokers (NARAB) Reform Act of 2009 will create a single authority NARAB through which agents can become licensed in multiple jurisdictions apart from their home state license. This, while simplifying the licensing processes, may see insurers develop B2B exchange with NARAB. Also, the proposed legislation mandates criminal check clearance for license issue.

The SEC’s Rule 151A proposes that Equity Indexed Annuities (EIA) be regulated like other security products, which will result in additional requirements such as registration with SEC (for firm) and FINRA (for staff).

In evolving markets like India, distribution mechanism should be made capable of handling complex products. The sales of ULIP products saw the regulator introduce a slew of reactive notifications with regard to the way these products were sold.

The Indian Regulator, Insurance Regulatory and Development Authority (IRDA) had on 5th November 2009 set up a committee chaired by Mr. Peter Akers of Munich Re, to examine all requirements for introduction of variable products.

Earlier, IRDA had appointed the N.M. Govardhan committee to look into the distribution channels. It covered all the existing distribution channels and came out with several recommendations last year including differential pricing by channels. IRDA appointed yet another committee headed by Pension Fund Regulatory and Development Authority (PFRDA) chairman D. Swarup which has come out with the recommendation to eliminate Insurance Agents' upfront commission totally by 2011 and go in for fee based Customer Agreed Remuneration (CAR) as has been suggested in the Retail Distribution Review (RDR) done by FSA in the UK market.

How many of the recommendations get accepted and implemented remains to be seen. But the recommendations of various such committees show that the regulatory mindset is to align with the practices in the developed markets.

In the UK, the financial services regulator FSA’s review of Retail Distribution has been a well analyzed one. The RDR published by FSA in June 2009, has come up with advice segregation with simplified model of commission based basic advice (base lined service for a basic set of products) and Independent/Restricted
with CAR built on it. The Independent/Restricted advice requires status disclosures to customers. The RDR also recommends risk assessment based monitoring.

The full impact of RDR which will be implemented from 2012 will be dependent on the extent of acceptance of its proposals. But the fact is that insurers and adviser firms need to plan and enact now for business process changes and attendant changes in IT enablers.

The changes in Japan’s Insurance Law enacted in May 2008 will come into force on 5th June of 2010. The changed law requires the insurer to inform the customer at the time of buying a policy, the list of material facts that the insurer expects the customer to disclose. Also, if the agent or the broker prevents or discourages the applicant from making a statement on material fact, the insurer cannot rescind the contract. This may entail additional supervision of sales activities. The new law also entitles the policyholder to demand pro rata reduction in premium if there is a substantial reduction of risk. This may need to be incorporated in illustration software.

Countries like Australia are already favouring a fee based model as opposed to the commission based model.
IMPACT ON DISTRIBUTION PROCESSES AND LANDSCAPE

The regulations necessitate changes in the insurance processes & IT landscape and would primarily be in the highlighted areas of the insurance distribution value chain as depicted in figure 1.

Table 1 summarizes and gives a mapping of the technology areas impacted due to the discussed regulatory changes.

Figure 1: Changes in Insurance Distribution Value Chain

In the US, implementation of NARAB reform act of 2009 would mean both the insurers and the distributors would have to enhance the licensing process in their Agency Management Systems.

In India, it will be advantageous to the insurer to proactively introduce monitoring processes towards ensuring suitability of a sale of a product to a customer as a result of recommendations from various committee reports.
Technology changes will not only involve changing the software to enable the change in business processes but also bringing in new technology enablers to deliver the business processes more powerfully to all stakeholders, viz., distribution channels, customers, third party data providers and insurers themselves.

<table>
<thead>
<tr>
<th>Regulation</th>
<th>Regulatory Recommendation</th>
<th>Sample Impacted Processes</th>
<th>Technology Enablers</th>
</tr>
</thead>
<tbody>
<tr>
<td>RDR D.Swarup Committee</td>
<td>Unbundled pricing</td>
<td>Advice</td>
<td>Suitability Software</td>
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<tr>
<td></td>
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<td>Sales</td>
<td>Illustration software; Quote software</td>
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<td></td>
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<td>Remuneration processing</td>
<td>Commission Management Systems</td>
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<td>Tax reporting</td>
<td>B2B integration</td>
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<tr>
<td>N.M.Govardhan committee</td>
<td>Differential pricing</td>
<td>Pricing Design</td>
<td>Modelling Software; B2B filing requirements</td>
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<td></td>
<td>Remuneration processing</td>
<td>Commission Management Systems</td>
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<td>NARAB Reform Act of 2009</td>
<td>Centralized control</td>
<td>Licensing</td>
<td>Agency Management Systems</td>
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<td></td>
<td>Reporting</td>
<td>B2B filing requirements</td>
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<tr>
<td>Japan’s New Insurance Law</td>
<td>Risk change based pricing</td>
<td>Illustration</td>
<td>Illustration software</td>
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</tbody>
</table>

Table 1: Technology Areas Impacted
ROADMAP FOR INSURERS

Insurers whose business processes need to be revamped due to regulatory changes should consider utilizing the opportunity for optimizing them as well as bringing in newer technologies. Such changes should be planned and grouped into short term and long term plans.

Short term plans should have a plan-to-implementation window of about 6 to 12 months depending on the deadline dates and the process complexity. They should be focused on addressing compliance requirements of regulators. They should identify the impacted areas and proceed with implementing the solutions to fix gaps. An indicative roadmap for such an approach is shown in table 2.

<table>
<thead>
<tr>
<th>Action Map</th>
<th>Internal to the Organization</th>
<th>Additional Consulting Support</th>
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</thead>
<tbody>
<tr>
<td>Consider the regulatory changes</td>
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<tr>
<td>Map it to the business processes</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Identify the technology changes</td>
<td>✓</td>
<td>✓</td>
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<tr>
<td>Approve the changes</td>
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<tr>
<td>Consider new technologies</td>
<td>✓</td>
<td>✓</td>
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<tr>
<td>Define implementation areas</td>
<td>✓</td>
<td></td>
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<tr>
<td>Implement the tactical changes</td>
<td>✓</td>
<td>✓</td>
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Table 2: Roadmap for Short Term Plans
A longer term plan should move beyond regulatory compliance even while attempting to leverage on the changes made to comply with the regulations. It should align with the strategies planned by the organization and embrace newer & better technologies for continuous delivery excellence. An indicative roadmap for a longer term strategic approach is shown in figure 2.

Figure 2: Roadmap for Long Term Strategic Approach

Also, as part of bringing in tactical changes, insurers can adopt technology enablers like eSignatures, eForms, transmission of business data through mobile computing and 100% electronic data exchange. These are just a few ways in which tactical changes can be made to business processes. Insurers need to keep looking for trends in the industry and make sure the changes they bring in also align with the technology enablers they have got in place.

Proactive and predictive change of ways in which business processes get enabled is very crucial for insurers to stay ahead in the game!
APPENDIX

References


About the Authors

Srinivasan Varadharajan is a Life and Pensions Domain Consultant with a combined experience of over 15 years in Life Insurance industry and Information Technology services. He has experience in Estimation, Requirement Development, Requirement Management, Gap Analysis and Quality Control activities apart from Insurance Industry business areas.

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