

Systemic Event Risks: the need for a customer-centric approach to policy drafting

31 January 2023

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As noted by the European Insurance and Occupational Pensions Authority (EIOPA) in its [recent supervisory statement](#), a systemic event is “*any severe event that causes broad-based disruption and significant adverse effects on public health, public safety, national security, or the economy*”. In recent times, this includes events such as the COVID-19 pandemic and the war in Ukraine.

Needless to say, systemic events can cause significant issues for prospective policyholders and third parties. Following a public consultation by EIOPA, national competent authorities (NCAs) have identified the following key issues:

1. Uncertainty around policy coverage due to product complexity and unclear policy wording;
2. Insurance manufacturers, following systemic events, frequently review or amend products to clarify or add exclusions without consideration for oversight of the product and particular governance rules (such as the product oversight and governance rules under Directive 2016/97 of the Insurance Distribution Directive); and
3. Prospective policyholders often rely on marketing materials that suggest systemic events are covered, without considering the full scope of policy coverage.

Considerations for insurers

In light of the above findings of EIOPA, insurers need to assess the extent to which existing products have been impacted by systemic events. If they have, EIOPA recommends that insurers:

1. certify that customers benefit from the same level of protection under policies, irrespective of the distribution channels;
2. communicate with customers clearly to prevent misinformation regarding policy coverage;
3. avoid drafting extensive exclusions;
4. steer clear of unclear or incomprehensible wording; and
5. ensure customers can sufficiently assess exclusions. This includes clarifying if the scope and type of coverage are related to direct or indirect losses.

Product development

EIOPA advises that when developing new products, insurers should consider exclusionary elements from the product design phase, and not just from point of sale or point of claim. Specifically, this means:

1. considering exclusions when identifying and defining the target market of the product;

2. assessing whether the exclusion meets the target market's demands and needs;
3. testing product disclosures to ensure customers have a clear understanding of the exclusions; and
4. employing monitoring activities to recognise customer experience issues.

Uninsurable risks

Some systemic risks will simply be uninsurable. Where that is the case, EIOPA says insurers should:

1. ensure a balance between loss limitation and alignment with the target market's demands and needs;
2. assess whether the distribution strategy is consistent with the changes to the insurance product; and
3. reflect on whether amended product disclosures are clear and are communicated efficiently, to ensure third parties understand product changes.

Conclusion

The recommendations made by the EIOPA reinforce the need for a customer-centric approach to drafting policies. Although the EIOPA guidance relates specifically to systemic risks, the recommendations could apply equally to any product development or product change process.

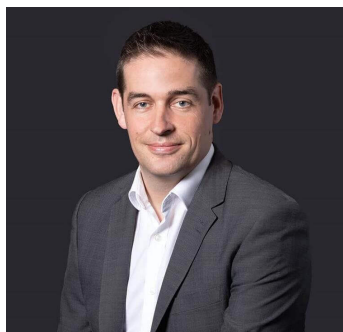
It is also notable that the focus on customer communication and understanding is entirely consistent with the incoming FCA's Consumer Duty.

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