ICNZ Insurance Council of New Zealand

Insurance Council of New Zealand
P.O. Box 474 Wellington 6140
Level 2, 139 The Terrace
Tel 64 4 472 5230
email icnz@icnz.org.nz
Fax 64 4 473 3011
www.icnz.org.nz

22 July 2015

Corporate Law
Labour and Commercial Environment Group
MBIE
PO Box 3705
Wellington

Emailed to: Iain.Southall@mbie.govt.nz
faareview@mbie.govt.nz

Dear Iain,

Submission on the Review of the *Financial Advisers Act 2008* ('FAA') and the *Financial Service Providers (Registration and Dispute Resolution) Act 2008* ('FSPA')

Introduction

1. Thank you for the opportunity to submit on the review of these Acts. We provide this submission on behalf of our members, though we understand many will also be providing their own submissions directly to you.

2. We have structured our letter into the following main submissions:
   - First, we describe who ICNZ represents and what their interests are in the Issues Paper.
   - We then summarise previous submissions that ICNZ has made to Government about the regulation of insurance brokers (and their remuneration in particular).
   - Third, we make submissions about who should be regulated by the FAA and how they should be regulated. We agree that advice and sales should be distinguished and the FAA should focus on regulating for a strong and independent advice market. Parallel protections already exist to regulate sales. We support companies being able to take responsibility for their staff and agents, and we submit that brokers – regardless of whether they are salespeople or advisers – should have to disclose how they are remunerated to their clients.

- We submit that the current professional, ethical and education standards for AFAs should be the benchmark for all financial advisers regulated under the FAA, and that industry bodies should be authorised to administer education to the industry.
- We accept the Financial Service Providers Register has limited use for consumers and support changes to increase its utility. However, any changes should only be made if the benefits clearly outweigh the costs, given the financial services industry will likely be paying for those changes.
- Finally, we submit in support of competition between dispute resolution schemes, noting that while the theoretical concerns raised by MBIE are legitimate concerns, they are not concerns in practice. Further, sufficient protections exist as a check to prevent those concerns from becoming a problem in practice.

3. If you have any questions please contact us directly. Our contact details are at the bottom of this letter.

About us and our submission

4. ICNZ represents the interests of the fire and general insurance industry in New Zealand. Our 28 members insure over $600 billion worth of New Zealand assets and liabilities.

5. Many of our members are Registered Entities or QFEs because their staff give 'financial advice' as that term is currently defined in the FAA. Many of our members also do business through intermediaries, such as insurance brokers, who are also regulated under the FAA.

6. Naturally our interests limit our submission to our perspectives on fire and general insurance (a 'financial service' and 'category 2 product' under the current legislation), and the intermediation of fire and general insurance through Registered Entities and 'QFE Advisers' (our members' own staff and agents) and 'financial advisers' (insurance brokers). We appreciate our comments will have some relevance to life and health insurance products and to other financial products and services to a lesser degree, but we do not submit on their behalf and have not weighed considerations particular to those products and services into our submission.

Our previous submissions to Government

7. We have advocated for insurance brokers to disclose their remuneration[1] for some years. We would like to briefly summarise and reiterate the submissions we made to previous Minister for Commerce particularly through letters to the Ministers in May and September 2011 and July 2012. The following paragraphs summarise those submissions.

8. Save some exceptional circumstances, insurance brokers are the agent of the insured. However, when remunerated by an insurer, the broker is automatically under a conflict of interest. In our

[1] Our references to 'remuneration' in this submission and previous submissions include all payments and benefits intermediaries are entitled to receive for distributing insurance products, including raw/base commission, over rides, fees for service, and soft commissions such as travel incentives.

view, it is trite to argue that a professional under a conflict of interest should have to disclose that conflict to their client (the insured). Without disclosure:

- Consumers of insurance products are vulnerable to influences on their broker's recommendations.
- Consumers are uninformed about the real cost of insurance.
- New Zealand will continue to lag behind international best practice. Comparable jurisdictions, notably Australia and the United Kingdom, regulate broker remuneration disclosure.

These factors will already be impacting the trust and confidence New Zealanders can have when engaging in markets for insurance products.

9. The collapse of Western Pacific Insurance following the Canterbury Earthquakes impacted a large number of consumers in New Zealand. Media have reported that broker commissions for placing business with Western Pacific were significant. Had broker remuneration disclosure regulation been in place, fewer consumers may have been affected by the collapse.

10. We have previously noted anecdotal concerns of brokers requesting a premium discount from insurers at the annual renewal of their insured's insurance contract, and then only passing on some of the discount to the customer. In other words, the broker keeps a portion of the discount for themselves. This remains a concern and underscores our argument for transparency of remuneration. For this reason, we argue that brokers must go further than simply acknowledging they are under a conflict for their client; brokers must disclose the nature and extent of that conflict through transparency of any remuneration and transparency about where sums paid by their client will be directed.

Overview of our submissions on the Financial Advisers Act ('FAA') review

11. We make three core submissions:
    - The FAA should make a clearer distinction between advice and sales.
    - Companies should take responsibility for their staff and agents.
    - Financial advisers must be transparent about their remuneration.

12. We also make four general submissions. First, we broadly support retention of the current regulatory regime for financial advisers, with the adjustments noted in our core submissions below.

13. Second, we support and reinforce the need for quality advice in the insurance market. Good insurance brokers provide a valuable service to the insured by accurately assessing their risks and recommending a suitable insurance product to manage those risks. They create efficiencies for insurers' benefit for the same reason. Brokers are particularly valuable to the insurance market for their ability to handle riskier, more unusual, higher value, higher volume or complex insurance arrangements between insurer and insured. Given these factors, in our view any regulation of insurance brokers through the FAA should promote, not distort, the quality of advice about insurance products in the market.

14. Third, we support regulation that does not hinder innovation. We expect technology will significantly impact the way insurance products are bought and sold, and the way information and advice about insurance products is disseminated, throughout the lifespan of the FAA. In our view the current FAA is lengthy, complex and restrictive rather than permissive. If the FAA hinders insurers and insurance brokers from adapting to changes in technology and to otherwise innovating their service offerings, that would be a bad outcome for the insurance market and ultimately consumers of insurance products.

15. Fourth, in our view consumers do not understand the complexities of financial advisers' regulatory framework. The distinction between Registered Entities, QFE Advisers, AFAs and RFAs, and the difference in levels of responsibility between categories of financial product are artificial boundaries. The regulatory framework is complex and can be difficult for the industry to understand as well. In our view the potential adjustments to the framework outlined in the review document and supported by us below will remove the complexity of the regime.

The FAA should distinguish advice and sales

16. Our first core submission focuses on **who** should be regulated by the FAA, and the following two core submissions then focus on **how** those caught should be regulated.

17. We support MBIE's analysis of the distinction between sales and advice.[2] A clear distinction can be drawn between an adviser and a salesperson.[3] It is currently possible to make this distinction in New Zealand's market for insurance products, and, in our view, in a much clearer way of dividing the market for financial advice than distinguishing Registered Entities, QFE Advisers, AFAs and RFAs.

18. The FAA's current definition of financial advice is broad and does not distinguish sales and advice, to the extent that many 'sales' situations will be caught by the current definition of 'financial advice'. Some of our members have registered as QFEs because their staff and agents will from time to time have conversations with customers which could fall within the definition of 'financial advice' (generally) or a 'personalised service' (in particular), even though the conversations are about the characteristics of an insurance product and whether that product is suitable for the customer's needs. This, as MBIE rightly identifies, is not 'pure advice', and should therefore not be regulated by the FAA. Insurers' staff and agents should be able to have free and frank conversations with customers about the products being sold by the insurer.

2 At paragraphs 119 to 127 of the Issues Paper.
3 We support MBIE's 'pure sales' and 'pure advice' characterisations in paragraph 119 of the Issues Paper.

19. Consumer protection for sales can by and large be regulated by other existing legislation, such as the Consumer Guarantees Act generally,[4] and the Financial Markets Conduct Act specifically.[5] In our view the Fair Dealing provisions of the Financial Markets Conduct Act provide substantial protection for the purchasers of financial services.[6] Those provisions ensure that accurate information and representations about insurance products will be made at point of sale with the customer, irrespective of whether the customer is dealing with the insurance company directly or through an intermediary. Further, provided the *Financial Service Providers (Registration and Dispute Resolution) Act 2008* continues to apply to individuals and companies selling insurance products, consumers will have access to basic information about those salespeople through their own or their company's registration and free dispute resolution if any problems should arise.

20. We do not agree that salespeople should be subject to greater regulation simply because of information asymmetries between the seller and the insured.[7] First, we expect these asymmetries will be reduced over time through other avenues such as financial literacy projects[8] and the introduction of new service requirements in the Fair Insurance Code.[9] But we also submit that salespeople and financial advisers would operate in a market for their services that overlaps to a certain extent. Consumers who require a higher level of care to understand insurance and make optimal purchasing decisions should be able to disengage with a salesperson and engage a financial adviser instead.

21. Given existing protections for the regulation of sales, the FAA could be left to focus on regulating 'pure advice' about insurance products and focus on supporting a strong, efficient market for independent financial advice. In our view 'independence' helps to distinguish a salesperson from an adviser. Someone who holds themselves out as being able to provide holistic analysis of different products supplied by different providers in the insurance market should, by nature, be professionals. As professionals, they should either be totally independent (that is, free of conflicts of interest) or fully and transparently canvass their conflicts to their client, have strong fiduciary obligations to their clients, and should be able to meet regulated conduct obligations and education and training requirements.

---

4 Under sections 28 and 29 of the *Consumer Guarantees Act 1993*, 'services' (which specifically includes contracts of insurance under the definition of services in section 2 of that Act) must be supplied to consumers with reasonable care and skill and must be fit for **any** particular purpose. We expect the Consumer Guarantees Act would apply to the sale of most (if not all) personal risk insurance products as those products are 'ordinarily acquired for personal, domestic or household use...'

5 We have not reiterated the *Fair Trading Act 1986* prohibition on misleading and deceptive conduct because of the more specific provisions in Part 2 of the *Financial Markets Conduct Act 2013*.

6 Under sections 19 and 21-23 of the *Financial Markets Conduct Act 2013*.

7 See paragraph 124 of the Issues Paper.

8 For example, ICNZ has a financial literacy strategy which includes a public education website: www.covered.org.nz. ICNZ has also developed partnerships with the Young Enterprise Trust (see http://www.icnz.org.nz/educating-small-businesses-a-focus-of-insurance-council-young-enterprise-trust-partnership/) and Banqer, who are developing an insurance module for their classroom virtual economy (see http://www.icnz.org.nz/virtual-classroom-economy-to-get-real-lessons-on-insurance/). ICNZ is not the only organisation involved in promoting consumer insurance and financial literacy. The Commission for Financial Capability and ASB Bank's GetWise financial literacy programme in schools are examples of organisations that are joining current efforts to boost demand side financial literacy.

9 The new Code, which comes into force on 1 January 2016, will require insurers to provide a clear summary of key policy features to the insured and to otherwise engage in more effective communication with the insured, and in particular to assist people who may have difficulty communicating with the insured like speakers of English as a second language or people with disabilities.

22. In contrast, a salesperson could be subject to lighter, broader, more fundamental regulation as outlined above.[10]

23. Independence can therefore determine whether financial adviser regulation should apply or not:
    - If the individual concerned is an employee or agent of the insurer that is underwriting the insurance product, then the individual concerned should generally be regarded as a salesperson.
    - If the individual concerned is independent of the insurer, and is assisting the customer to distinguish between two (or more) underwriters' insurance products, then the individual concerned should be regarded as an adviser and regulated by the FAA.[11]

24. We support this analysis because in our view the greatest potential for consumer harm arises where a salesperson or adviser holds themselves out as being independent when they are not. There will need to be discussion about how an individual's independence (or lack thereof) is communicated to the consumer. We would appreciate consultation with MBIE officials on this topic if MBIE chooses to pursue a sales/advice distinction. However, we do not support the strictures of template disclosures, which, in our view, are inflexible and can be ineffective.

25. For independent advisers (as more strictly defined in our submission than as in the current Act), we support a regime that fosters strong occupational regulation to ensure sound independent advice that consumers can have confidence in. In our view this would align more closely with the AFA 'brand' that was originally intended to be fostered under the FAA.

Companies should take responsibility for their staff and agents

26. In a regulatory regime that allows for company responsibility, licensed insurers can take responsibility for their staff and agents. Provided they distinguish themselves as staff or agents of the insurer, then they should be free to provide product information and make recommendations to consumers about buying or not buying that product, including by reference to the consumer's individual circumstances. This would allow greater access to high quality information about insurance products for many consumers than is possible under the current regime.

---

10 See paragraph 19 above.

11 One of our members supports an additional requirement for the individual to be remunerated by the underwriter when considering whether the individual should be regarded as an 'adviser'. So, where an individual is assisting the consumer to distinguish between two or more underwriters' insurance products but is not remunerated for the sale of those products, then the individual should be a 'salesperson' rather than an 'adviser'. We think this approach is arguable: the individual is not under a conflict if they are not remunerated, and can be impartial in their assistance to the customer. However, they are still providing financial advice to distinguish between two products. That advice needs to be quality, which means it needs to be regulated in the manner we outline. On balance our view is that the individual distinguishing two or more products for a consumer must provide quality advice regardless of whether they are remunerated for that advice or not. This approach accords with the current Act, which regulates individuals in the business of advice whether given for profit or not (under the section 5 definition of 'business' in the FAA).

27. Our members strongly support being able to take responsibility for their staff and agents. Centralising compliance allows them to regulate more directly and effectively while significantly reducing compliance costs. Many of our members have become QFEs and continue to support the QFE model for this reason. Other members are not QFEs, but their staff give class financial advice to their customers (as Registered Entities under the FAA) and want to retain the ability to do so.

28. The review document notes a perception that company responsibility allows QFEs to get away with lower standards than AFAs must adhere to.[12] We are not aware of this perception having any substance or supporting evidence. Further, we do not think the concerns about financial advice raised in Australia translate automatically to how advice is being given about insurance products in New Zealand. In our view the current regime of company-based responsibility is working well. Absent any concerns from the Financial Markets Authority (which, as MBIE notes, has oversight of a QFE's business and would be best-placed to identify and remedy any issues arising) we support the status quo and submit that the QFE regime is helping insurers to keep their compliance costs in check.

29. We make one qualification to our comments about the QFE regime's compliance costs. Submitting a QFE adviser business statement to the Financial Markets Authority is a costly exercise for our members. One of our members estimates that it takes a team of one or two full time staff up to a month to prepare the statement. Different insurers may have different compliance burdens in preparing the statement, depending on their size. In our view, filing a statement afresh annually is unnecessary. The costs outweigh the benefits. Instead, our members support a continuous disclosure requirement to update their statement over time when their circumstances change or where the information in the statement is no longer accurate.

Brokers must disclose how they are remunerated

30. As noted above, we have made this argument and expressed related concerns to MBIE officials for a number of years.[13] We support a thorough discussion of this issue as part of the review of the FAA.

31. We do not support a ban on any types of commissions in the fire and general industry. We note that the ban on commissions in the UK is only in respect of investment products, not fire and general insurance products.[14] At a principled level, insurers and brokers should be free to determine how brokers are remunerated for providing business to insurers. Restricting this commercial freedom would be unjustified and unnecessary in our view. Consumers may also not want to pay fees for advice if commissions are banned, which would impact the availability of quality independent advice about insurance products.

---

12 At paragraph 203 of the Issues Paper.
13 At paragraphs 7-10 above.
14 In response to the Issues Paper at page 37.

32. Whatever arrangement is agreed to between broker and insurer, there should be transparency about the broker's conflict of interest. Brokers should have to disclose that conflict to the insured, irrespective of what 'type' of adviser they are under the FAA. Further, for brokers that are independent as outlined above, and are therefore giving pure insurance advice, we submit that basic details of any remuneration agreement should also be disclosed to the insured, alongside the fact of their conflict of interest.

33. We appreciate that mandatory disclosure could have unintended consequences. A consumer may turn down a product that best meets their needs, simply because a higher commission attaches to that product across a range of products advised on by the insured's independent financial adviser. But in our view an informed consumer that makes poor decisions is better off than an uninformed consumer making uninformed decisions. We also suspect it is unlikely this unintended consequence will eventuate, given consumer trust in advisers seems to be driven more by personal relationships than the quality of regulation.[15] Finally, behaviour-oriented market failures like poor consumer decision-making can be remedied through other measures like improved financial literacy.

Professional, ethical and education standards for financial advisers

34. Relying on our tightened view of what types of financial adviser the FAA should regulate as outlined above[16], we make the following submissions on occupational standards for those advisers who are actually providing advice:
    - The ethical standards currently set out for AFAs should be a benchmark for all financial advisers regulated by the FAA. Requirements like putting your clients first and acting with integrity are fundamental to any profession (financial advice included), regardless of artificial distinctions between categories within that profession.
    - The current level 5 qualification for AFAs is an appropriate benchmark for all financial advisers regulated by the FAA. The current National Certificate of Financial Services (Financial Advice) Level 5 qualification for AFAs is an appropriate minimum qualification level. However, the qualification needs to recognise the type of advice being given to the client and therefore needs to be flexible in its design and application across the spectrum of financial advisers. Financial advisers with a similar level of overseas qualification should also be recognised in the New Zealand regulatory regime. We understand that Australia is moving toward requiring higher educational standards for financial advisers selling more complex products and suggest that in the fullness of time, New Zealand may look to follow.
    - Industry bodies like ANZIIF, IBANZ and ICNZ should be permitted to administer the training and assessment of industry standards in particular and play a broader role in the regulation of the industry, more generally. ICNZ strongly supports the need for

[15] Under MBIE's consumer focus group report prepared by Colmar Brunton, available at: http://www.mbie.govt.nz/pdf-library/what-we-do/financial-advisers-act/colmar-brunton-consumer-focus-group-report.pdf

[16] See paragraphs 16-25 above.

effective industry self-regulation because it can be more effective and responsive than Government regulation. We support MBIE's comments in paragraph 196 of the Issues Paper. A recent example of effective self-regulation outside the financial adviser space is ICNZ's Fair Insurance Code, which, in our view, sets a new benchmark for industry self-regulation. We support that if any legislated regulatory functions are 'outsourced' from government regulators to industry bodies, that those functions are performed to the regulators' satisfaction to ensure consistent standards are being enforced across the industry.

Financial Service Providers Act review – registration

35. We agree that the register lacks useful information for consumers and could be improved. We accept that for financial advisers a record of the adviser's qualifications and disciplinary history, as has been proposed in Australia, would be a useful addition for consumers.

36. We appreciate that changes to the register may cost more, and we support rigorous cost benefit analysis before those changes are agreed to. We expect that any increased costs will be passed on to registered financial service providers through fees and levies collected by the Companies Office. The benefits of any changes must clearly outweigh the costs.

37. We acknowledge and welcome MBIE's upcoming review of registration fees and Financial Markets Authority ('FMA') levies. We would appreciate the opportunity to comment on these fees and levies. In our view they are set too high for insurers. A fairer levy system would align as closely to a 'user pays' model as possible, while acknowledging that some financial service providers derive benefit from a soundly regulated financial system without directly taking up the FMA's regulatory time. Licensed insurers are regulated thoroughly and effectively by the Reserve Bank of New Zealand and the approved dispute resolution schemes. Insurers that are ICNZ members also self-regulate effectively, with the new Fair Insurance Code coming into force from 1 January 2016. Compared to other parts of the financial services industry, licensed insurers have little to do with the FMA and derive less benefit from FMA's regulatory activities than other types of financial service provider and consumer of financial services.

38. We say this means insurers should pay less in levies. At a principled level, the financial services industry should have this kind of incentive to continue to self-regulate effectively.

Financial Service Providers Act review – dispute resolution

39. We support competition between dispute resolution schemes. Some of our members have had sufficiently compelling reasons to switch schemes, which can be a costly and time-consuming exercise. We support the positive features of competition noted by MBIE, including cost savings and more innovative and improved dispute resolution services.[17]

[17] At paragraph 280 of the Issues Paper.

40. We understand our members will be submitting to MBIE directly with the views on competition between schemes that are unique to their businesses.

41. There are risks associated with not having competition between schemes. Schemes in competition have a greater incentive to operate efficiently. In contrast, Australia's Financial Ombudsman Service has developed quasi-regulatory functions such as a systemic issues team. These kinds of function would impose potentially significant costs for little additional benefit in the New Zealand context. Our existing regulatory regime already provides adequate protection in this regard.

42. We acknowledge the concerns raised about competition between schemes, but in our view these are not practical problems. There is no evidence that these are practical problems. And there are sufficient checks to ensure they do not become practical problems. Those checks are:
    - All schemes must meet the universal benchmarks of accessibility, independence, fairness, accountability, efficiency and effectiveness. The Minister regulates the Schemes' compliance with these benchmarks, and the Minister already has the power to request further information from the Schemes if there are concerns that these benchmarks are not being met.[18]
    - All schemes must receive an independent review every 5 years from approval, a copy of which must be supplied to the Minister.[19]
    - Consumers continue having access rights to the courts if they do not accept the schemes' decision.[20]
    - The Minister continues to have the power to prescribe provisions to be implied into rules about the schemes by Regulation made under the FSPA.[21]

43. We accept that having different schemes means the outcome of particular disputes could hypothetically differ between the schemes. We suspect similar disputes are already being resolved differently by different schemes, which will not only be a result of differences in schemes' rules but also a function of their staff, subject matter expertise, and dispute resolution culture. However, we do not think these differences pose an issue for consumers. Industry dispute resolution as an alternative to the court system is intended to provide free, fast and sound access to justice. Provided the scheme benchmarks noted above continue to be met to the Minister's satisfaction, the schemes will be operating to their purpose in competition with one another.

44. We acknowledge MBIE's concern that some schemes may be less accessible to consumers than others, and we submit that this can be dealt through a review of scheme accessibility by the Minister. In our view this can be dealt with under the existing review powers noted above.

---

18 Under section 69(1)(b) of the *Financial Service Providers (Registration and Dispute Resolution) Act 2008*.
19 Under section 63(1)(q) of the *Financial Service Providers (Registration and Dispute Resolution) Act 2008*.
20 Under section 63(1)(o) of the *Financial Service Providers (Registration and Dispute Resolution) Act 2008* and the corresponding rule in the schemes' rules.
21 Under section 79(1)(cb) of the *Financial Service Providers (Registration and Dispute Resolution) Act 2008*.

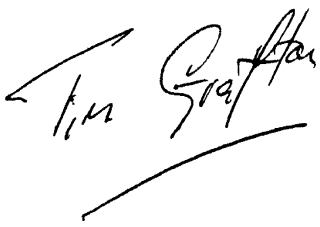
45. We acknowledge that consumer awareness of dispute resolution is low. Again, we do not consider this to be a significant issue per se. There would be an issue if consumers who were in dispute with their insurer were unaware of the schemes. In our view it is vitally important to ensure this basic accessibility need is being met. Consumers who are not in dispute with their insurer do not have as pressing a need to know. However, we do acknowledge a high awareness of the schemes may improve consumers' trust and confidence in financial markets, and to that end we support further inquiry into measures that could improve consumer awareness of the schemes. We note that the Banking Ombudsman and Insurance and Savings Ombudsman have operated for over 20 years, and that some of our members promote their membership of the Insurance and Savings Ombudsman on every incoming phone call made to that member. Consumer awareness is low in spite of these facts.

46. We do not accept that the mere fact of having multiple schemes is a barrier to the schemes' accessibility. We understand that operational agreements are in place between the schemes, so that if a consumer with a dispute calls the wrong scheme, then that scheme will provide the consumer with the contact details for the right scheme. With this kind of agreement in place, when a consumer has access to one scheme, that consumer can have access to all schemes.

Next steps

Thank you again for allowing us the opportunity to submit. If you have any questions you can contact Tim on (04) 495 8001 or tim@icnz.org.nz, or Nick on (04) 495 8008 or nick@icnz.org.nz. We look forward to hearing from you as to the next steps of the review.

Yours sincerely,



Tim Grafton
Chief Executive

Nick Mereu
Legal Counsel