ICNZ Insurance Council of New Zealand
Te Kāhui Inihua o Aotearoa

Insurance Council of New Zealand
Level 2 Asteron House, 139 The Terrace,
Wellington 6011
Tel 64 4 472 5230
Email icnz@icnz.org.nz
Fax 64 4 473 3011
www.icnz.org.nz

7 September 2022

Financial Markets Authority
Wellington

By email: consultation@fma.govt.nz

Dear Sir/Madam,

ICNZ submission on Proposed standard conditions for financial institutions (COFI)

Thank you for the opportunity to submit on the proposed standard conditions for financial institutions (**Proposed Conditions**) with respect to the implementation of fair conduct programmes.

By way of background, the Insurance Council of New Zealand - Te Kāhui Inihua o Aotearoa (**ICNZ**'s) members are general insurers and reinsurers that insure about 95 percent of the New Zealand general insurance market, including about a trillion dollars' worth of New Zealand assets and liabilities. ICNZ members provide insurance products ranging from those usually purchased by individuals (such as home and contents, travel and motor vehicle insurance) to those purchased by small businesses and larger organisations (such as product and public liability, business interruption, professional indemnity, commercial property and directors and officers insurance).

Please contact Greig Epps (greig@icnz.org.nz) if you have any questions on our submission or require further information.

This submission has two parts:

- overarching comments, and
- answers to questions in the consultation paper (Appendix One).

1. Overarching comments

It is useful to briefly remind ourselves of the regulatory context within which ICNZ Members operate – the "twin peaks" model, whereby the Reserve Bank of New Zealand (**RBNZ**) oversees the prudential requirements of insurers, and the Financial Markets Authority (**FMA**) has oversight of the market conduct of participants[1].

The RBNZ's legislative tool is the Insurance (Prudential Supervision) Act 2010 (**IPSA**), while the FMA uses the Financial Markets Conduct Act 2013 (**FMCA**), as subsequently amended from time to time. Parliament has passed the Financial Markets (Conduct of Financial Institutions) Amendment Act

[1] We note also that the FMA and the Commerce Commission have overlapping jurisdiction for misleading and deceptive conduct and have a Memorandum of Understanding with respect to how that jurisdiction is allocated.

(**COFI**) requiring financial institutions[2] to develop "fair conduct programmes" aimed at ensuring that consumers receive fair treatment from organisations distributing certain financial advice products and providing financial services.

Once in force, COFI will require licensed insurers to obtain a licence relating to the market service of acting as a "financial institution".

That will mean that many licensed insurers may be required to hold three concurrent licences:

- A licence to act as an insurer in New Zealand, issued by the RBNZ under IPSA;
- A market service licence to provide financial advice (commonly referred to as being a licensed "FAP")[3] with regulatory oversight by the FMA; and
- A separate market service licence to act as a financial institution, with regulatory oversight by the FMA[4].

However, the marketplace is complex and not all involved in the provision of general insurance products will be insurers (they might be intermediaries involved in the sale and distribution of insurance products). Not all insurers deliver product to consumers (being more focused on the commercial market), and not all insurers or intermediaries are FAPs.

While this context is known to the regulator and the industry, it is worth painting the picture of the already complex compliance landscape within which the insurance industry must operate. It is important that the development of new requirements align with and complement existing regulations.

As currently drafted, some of the proposed standard conditions are extremely broad and overlap and/or duplicate with existing obligations on financial institutions. These obligations include existing prudential requirements that are subject to regulatory oversight from the RNBZ. Overlap and duplication in obligations and regulatory requirements result in uncertainty and unnecessarily increases compliance costs. In line with New Zealand's twin peaks model, we strongly recommend overlap and duplication are avoided and there is clarity as to which entity is the responsible regulator.

The main concerns of general insurers

The wording of the Proposed Conditions is very broad and goes beyond matters intrinsically related to the new conduct regime.

- ➢ The Proposed Conditions should relate specifically to the fair conduct requirements introduced by COFI. They should not impose broader requirements on a financial institution's core business that do not relate to those requirements and are not related to the interface between the financial institution and consumers[5].

---

[2] The definition of "financial institution" under the Financial Markets (Conduct of Financial Institutions) Amendment Act 2022 includes licensed insurers providing relevant services to consumers. This submission is from the perspective of the General Insurance provider.

[3] Contrasted with an organisation that simply provides information about financial products, being a "non-FAP".

[4] These licences are or will be issued by the Minister of Commerce and Consumer Affairs, on the advice of the FMA, and the actions of licensees are overseen by the FMA.

[5] If the intent was for such matters to be overseen by the FMA, this should have been explicitly considered in consultation with industry and then provided for in the legislation.

- The industry is concerned that the Proposed Conditions introduce obligations on licensed insurers that do not directly relate to the obligation to comply with the fair conduct principle.

There is a risk that the industry becomes unnecessarily subject to duplicate regulatory requirements.

- With the many similarities to the FAP licence conditions, the FMA must draw out and distinguish the differences and focus on what is appropriate for the conduct regimes.
- FMA should consider whether institutions licenced by the RBNZ should be exempt from some of the proposed licence conditions because these areas of activity are already being monitored by, or are more appropriately monitored by, the RBNZ (for example, outsourcing, business continuity plans, and technology systems).

In short, the Proposed Conditions should be designed to relate only to the COFI "fair conduct" obligation (with exemptions where existing obligations overlap with the Proposed Conditions), to avoid unnecessary and inefficient duplication of regulatory requirements.

2. Conclusion

Thank you again for the opportunity to submit on this matter. If you have any questions, please contact our Regulatory Affairs Manager by emailing greig@icnz.org.nz.

Yours sincerely,

Tim Grafton
Chief Executive

Greig Epps
Regulatory Affairs Manager

APPENDIX ONE: Answers to questions in the consultation paper

Question	Feedback
Consultation Paper: Proposed standard conditions for financial institution licences	
Conduct of Financial Institutions / Fair Conduct Programmes	
Condition 1 – Ongoing requirements	
(a) Do you agree or disagree with the proposed standard condition? Please provide your reasons.	We agree in principle with a condition confirming that the licensing requirements must continue to be satisfied at all times while a financial institution holds a licence. However, as stated above, the licensing requirements should relate to a financial institution's ability to comply with the fair conduct principle. To reflect this, we suggest the explanatory note should read "*You will need to ensure you keep your policies, processes, systems and controls ~~(including those~~ that form your fair conduct programme~~)~~ up to date, and that they take into account any changes you may make to your business or service arrangements*". We also suggest the following wording change to the Explanatory Note: *"where you make changes to your business or service arrangements, you will need to ensure that they ~~support and do not hinder, the fair treatment of consumers and compliance~~ are consistent with the fair conduct principle and your fair conduct programme".* This change avoids potential difficulties in interpreting "support" and "not hinder" and aligns with language in FMCA.
(b) Would the proposed standard condition create any additional compliance costs for your business? If so, please detail those costs.	Adherence to the proposed licensing conditions on an ongoing basis may create significant additional compliance costs for some insurers, particularly as some of the proposed conditions overlap with, but do not align with the FAP licensing conditions. Insurers have undertaken significant conduct uplift activity since the FMA and RBNZ's conduct and culture reviews in 2019 and have already implemented policies, processes, systems, and controls to ensure fair consumer outcomes. However, until the FMA publishes the Financial Institution Licence Application Guide and its guidance on expectations for fair conduct programmes, any additional compliance costs cannot be quantified. ICNZ recommends that the FMA releases the licensing application guide as soon as possible to enable the industry to assess the costs of compliance with this Proposed Condition.

Question	Feedback
(c) Would the proposed standard condition have any other adverse impact on your business? If so, please describe what this would be.	It is difficult to assess this without the relevant FMA guidance mentioned in response to question 1 (b) above.
(d) Does this proposed standard condition create a barrier to enter the market? If so, please explain why this is the case.	We do not consider that this proposed standard condition on its own would create a barrier to enter the market. However, the increasing and extensive regulatory obligations (for example, requiring some financial institutions to obtain three licenses; a prudential licence, a licence to be a FAP, and a 'financial services' licence under CoFI) and the associated compliance costs are likely to create a barrier to enter the market.
(e) Do you have any other comments on the proposed standard condition or how it is drafted?	We refer you to our response to question 1(a) above. The requirements of section 396 of the FMCA include ensuring that directors and senior managers are fit and proper persons to hold their respective positions and otherwise satisfy the requirements that are prescribed by the regulations for licences for that service (if any). Insurers are already subject to fit and proper requirements under prudential and FAP licensing. As stated above, we strongly encourage the FMA to ensure that the proposed standard conditions do not result in unnecessary duplication and an increase in the associated compliance costs required to satisfy the different regimes. We support and encourage collaboration with the RBNZ to minimize duplication where possible and ensure consistency where there is any necessary overlap. Consideration should be given to whether licensed insurers should be deemed to comply with the fit and proper requirements, given the fit and proper obligations already owed by insurers under IPSA.
Condition 2 – Notification of material changes	
(a) Do you agree or disagree with the proposed standard condition? Please provide your reasons.	We agree with this proposed condition in principle.
(b) Would the proposed standard condition create any additional compliance costs for your business? If so, please detail those costs.	Our members to not anticipate any significant additional costs to comply with this proposed condition.

Question	Feedback
(c) Would the proposed standard condition have any other adverse impact on your business? If so, please describe what this would be.	Our members to not anticipate any other adverse impacts.
(d) Does this proposed standard condition create a barrier to enter the market? If so, please explain why this is the case.	Our members to not consider this proposed condition would create a barrier to enter the market.
(e) Are there any material matters other than those detailed in the explanatory note that should be notified to the FMA?	We refer you to our response to question 2(f) below.
(f) Do you have any other comments on the proposed standard condition or how it is drafted?	As drafted, proposed standard condition 2 is narrower than the equivalent FAP licensing condition: *You must notify us in writing within 10 working days of implementing any material change to the nature of, or manner in which you provide, your financial advice service.* Whilst in general we support consistency across the licensing conditions, we agree that the proposed wording better reflects the FMA's intent as described in the explanatory note and comments section for this condition. FMA should provide guidance on a definition of "materiality". The Explanatory Note suggests that the FMA's view is that a change to a financial institution's business is "material", and therefore within the scope of the "notification" obligation, **only** when it amounts to the financial institution (a) ceasing to be a financial institution (or, in the case of an insurer, moving into run-off), (b) becoming a different "type" of financial institution, or (b) ceasing to provide its products or services to consumers. If that is the FMA's view, that should be more clearly drawn out on the Explanatory Note. If the FMA's view is that other changes to a financial institution's business would meet the "materiality" threshold, it would be helpful for the Explanatory Note to set that out more clearly.

Question	Feedback
Condition 3 – Regulatory returns	
(a) Do you agree or disagree with the proposed standard condition? Please provide your reasons.	We broadly agree with this proposed condition. Financial institutions should provide the FMA the information it requires to monitor financial institutions under the CoFI regime. We are pleased to see the FMA is intending on consulting with industry prior to publishing the proposed Regulatory Return Framework and Methodology as it is important to ensure that any Framework is proportionate and not unduly costly or onerous.
(b) Would the proposed standard condition create any additional compliance costs for your business? If so, please detail those costs.	We anticipate the requirement for annual regulatory returns will create additional compliance costs, including additional resourcing and changes to systems to enable the required reporting. Until the FMA issues its Regulatory Return Framework and Methodology it is difficult to assess the full extent of the additional compliance costs. However, based on the examples of the information the FMA is likely to require, costs to provide regulatory returns on an annual basis could be significant.
(c) Would the proposed standard condition have any other adverse impact on your business? If so, please describe what this would be.	Other impacts are difficult to assess without more detail.
(d) Does this proposed standard condition create a barrier to enter the market? If so, please explain why this is the case.	This is difficult to assess without more detail about the requirements of the regulatory returns.

Question	Feedback
(e) Do you have any other comments on the proposed standard condition or how it is drafted?	The guidance document states that regulatory returns are likely to require reporting of factual business information, such as “numbers and types of breaches” and complaints information. Given the focus of COFI on conduct towards consumers, regulatory return information should only relate to consumer insurance products as defined in COFI. Whilst most insurers have robust reporting at a benefit/risk level, calculating the number of “consumers” can be complex and in some cases, it is simply unknown and can only be estimated. A consumer may have multiple different policies across different brands which may be held in different names. For example, a consumer may have home insurance with one brand held in the name of a trust, motor insurance with another brand (which may operate on a separate system) held in their own name, and contents insurance held jointly with their partner. Therefore, unless a consumer confirms they already hold insurance with that provider and provides the required consent, an insurer may not be able to link two policies held by the same person. It will be important for the FMA to clearly articulate the definitions used in its Regulatory Return Framework and Methodology as the complexity of completing the returns and the associated costs will be impacted by the scope of these definitions. For example, for general insurance a “product” could be determined at a portfolio level (Motor, Home, Contents etc.) or it could be further drilled down into different channels or policy wordings within a particular portfolio that have variations in the benefits offered. In addition, an insurer’s business may not have a clear delineation between consumer products and non-consumer products and separately reporting on consumer products may be problematic. As well as factual business information, the FMA has indicated it will be asking for information about the implementation and maintenance of, and compliance with, a financial institution’s fair conduct programme. When determining the scope of regulatory returns, we urge the FMA to consider in detail the cost to financial institutions in providing this information on an annual basis against the benefit it is hoping to achieve and ensures a proportional approach is taken. We would also encourage the FMA to consider the timing of their request for regulatory returns. The end of calendar/financial years are generally extremely busy with resources at full capacity. Ensuring requests for regulatory returns outside of these timeframes or allowing financial institutions to nominate the month in which they will provide their return, would help to manage resourcing and minimize the associated compliance costs.

Question	Feedback
Condition 4 – Outsourcing	
(a) Do you agree or disagree with the proposed standard condition? Please provide your reasons.	The proposed standard condition 4 relating to outsourcing and condition 5 relating to business continuity and technology systems relate to the core functions of being an insurer and do not relate specifically to how financial institutions ensure they treat their consumers fairly. Unlike the new financial advice regime where many entities/individuals who now hold a FAP licence were not previously subject to a licensing regime with oversight from a regulator, all financial institutions are currently registered/licensed with oversight from the RBNZ. Therefore, we question whether conditions 4 and 5 are necessary or appropriate as standard licencing conditions under the CoFI conduct licensing regime. The condition should be clear about what arrangements the FMA considers to be an "outsourcing" arrangement. In a complex insurance business, there are likely to be a vast array of outsourced arrangements relating to core functions with a range of different outsource providers. If this condition is retained, it is important that the condition is clearly articulated so it relates to a financial institution's obligations under CoFI and its ability to treat consumers fairly as opposed to broader requirements of an insurer. One of the examples of arrangements captured by condition 4 is hosting of technology that supports the provision of relevant services and associated products to consumers. Whilst technology is a key enabler of an insurer's core operations, we consider it more appropriate for a conduct licensing regime to focus on how outsourcing a core function impacts a financial institution's ability to treat consumers fairly (if it does at all). As currently drafted the scope of the condition is far wider than this. We encourage the FMA to consider what other outsourcing requirements regulated entities are subject to (or will be subject to), to ensure that there is no duplication or inconsistencies between the regimes which would add unnecessary complexity and further increase compliance costs. Insurers are required under IPSA to be subject to, and take all practicable steps to comply with, a risk management programme. This programme must set out the procedures that the insurer will use for the effective identification and management of risks including insurance risks and operational risks such as outsourcing of core functions. The RBNZ is currently reviewing the IPSA and has consulted specifically on proposed requirements for outsourcing. An interesting point here though is the situation for **insurers acting as agents of EQC** where EQC is not subject to license conditions. In practical terms, insurers would apply the same systems though would have to comply with EQC obligations. This area does not seem to have been contemplated.

Question	Feedback
(b) What core services that will be related to your financial institution service do you currently outsource?	There are a range of services an insurer may outsource, including IT services, hosting and software services, underwriting, call centres, managed repairs, and claims investigations and management.
(c) We are proposing that any parts of your financial institution service that are performed by an authorised body on your financial institution licence will not constitute an outsourcing arrangement for the purposes of this condition. Do you agree or disagree with this proposal? Please provide your reasons.	We agree. It is not necessary for this condition to extend to Authorised Bodies, given the oversight obligations in section 400 of the FMC Act.
(d) Would the proposed standard condition create any additional compliance costs for your business? If so, please detail those costs.	There may be additional compliance costs involved depending on the scope of this condition and the FMA's expectations for how a financial institution effectively monitors performance of its outsourced providers including any reporting requirements.
(e) Would the proposed standard condition have any other adverse impact on your business? If so, please describe what this would be.	
(f) Does this proposed standard condition create a barrier to enter the market? If so, please explain why this is the case.	
(g) Do you have any other comments on the proposed standard condition or how it is drafted?	We submit that this condition should be clarified to ensure it relates to the outsourcing of functions related to the fair treatment of consumers and does not apply to *all* outsourcing arrangements entered into by licensed insurers. We suggest that the wording is amended so that it refers to systems and processes necessary for a financial institution to perform its "*financial institution service <u>in circumstances in which the fair conduct principle applies…</u>*" to reflect the language of section 446C of the FMC Act as amended by COFI. The guidance states that the condition applies if you outsource a **<u>system or process</u>** necessary to the provision of your financial institution service to meet your market services licensee obligations as they relate to your financial institution service (licensee obligations). Further clarity is required on when an arrangement constitutes outsourcing. In particular:

Question	Feedback
(Question 4(g) continued)	i. Further clarity is required on what a “system or process” is that is necessary for the provision of a financial institution service as an insurer, given that COFI is a licence which regulates conduct relevant to acting as an insurer for consumers rather than a specific service whereby systems and processes can be easily identified. We consider that only systems and processes that are consumer facing should fall within the scope of the outsourcing condition. ii. The outsourcing condition should be subject to a materiality threshold. That is, the condition should only apply to material outsourcing arrangements which have an impact on consumers. The minimum requirements for fair conduct programmes in section 446M already requires financial institutions to implement risk-based processes, systems and controls to ensure fair outcomes for consumers across all of these areas (and regardless of the distribution method.) This requires financial institutions to review the entire product life cycle to adopt a risk-based approach to ensure fair outcomes. The requirement to implement broader outsourcing considerations to other day-to-day functions would be unduly onerous and would in effect reduce the business partners insurers work with, which would ultimately reduce competition and choice for consumers. iii. The FMA refers to outsourcing the “processing of insurance claims to a specialist claims management company”. Insurers may outsource all or parts of their claims handling services for particular products, brands or portfolios. Loss adjusters are often involved in assessing claims; however, the insurer retains overall management of the claim. In some situations, the arrangement may not be subject to full due diligence and may not have a written contract between the parties as the overall management of the claim remains with the insurer and provides the required oversight to ensure consumers are treated fairly. A materiality threshold would allow the appropriate balance between what arrangements should be subject to full due diligence processes and what can be subject to usual business oversight practices. iv. The FMA states that “We would not expect typical distribution arrangements where a third party is involved in distributing the financial institution’s relevant services and associated products to consumers to be an outsourcing arrangement.” It is unclear what is meant by a “typical” distribution arrangement. It appears that the intention is for all distribution arrangements to be excluded from the outsourcing condition (which we would agree with), but this should be clarified.

Question	Feedback
(Question 4(g) continued)	The **due diligence** requirements set out in the Explanatory Note require financial institutions to consider “reported complaints and their complaints handling procedures”. Due diligence obligations of this nature do not make sense in the context of many outsourcing arrangements entered into by licensed insurers. For instance, technology providers and records management providers are not consumer facing, so complaints handling is not relevant. This highlights the overly wide scope of the Proposed Condition. We suggest that the FMA provide clarity as to whether the matters in the explanatory note (eg “important matters that you should consider when conducting due diligence” and “other important information you should consider in respect of your outsourcing arrangements”) are mandatory or whether they only apply where relevant to the context. **Multinational - Intragroup Shared Services Arrangements**: In the context of the financial advice provider licence, multinational organisations that rely on intragroup shared services are not considered to be an outsourcing arrangement. This is in accordance with the “Key themes from the FAP Consultation on the proposed licence conditions document” (snip below) where the FMA stated that intragroup arrangements were not outsourcing and therefore not captured by the standards condition. A similar approach should be adopted in this instance as the reliance on group company services does not impose an additional risk to fair outcomes for consumers. Intragroup arrangements Some submitters asked whether intragroup arrangements were outsourcing. FMA response: We do not consider intragroup arrangements outsourcing and therefore they are not captured by this standard condition.

Question	Feedback
Condition 5 – Business continuity and technology systems	
(a) Do you agree or disagree with the proposed standard condition? Please provide your reasons.	It is not clear how this Proposed Condition relates to the core obligation of complying with the fair conduct principle, or the FMA's ability to monitor compliance with that obligation. As currently drafted, the Proposed Condition is very broad and does not relate specifically to a financial institution's obligations under CoFI. We reiterate that we encourage the FMA to ensure licensing conditions do not duplicate with existing requirements creating uncertainty and unnecessary compliance costs. In addition to requirements under IPSA described above, the RBNZ has issued Guidance on Cyber Resilience which applies to all entities regulated by the RBNZ, including financial institutions under CoFI. We suggest licensing conditions and regulatory requirements in relation to BCP and technology more appropriately fit with the RNBZ's regulatory mandate and query whether this condition is necessary or appropriate under the CoFI regime.
(b) Do you currently have a documented business continuity plan?	We understand our members have documented business continuity plans in place.
(c) Will you rely on critical technology systems to deliver the market service of acting as a financial institution? If not, why do you not consider any of your technology systems to be critical?	Our members rely on critical technology systems to deliver core insurance services. However, it is not currently anticipated that there will be changes in the critical technology systems relied upon to comply with obligations under CoFI.
(d) Would the proposed standard condition create any additional compliance costs for your business? If so, please detail those costs.	
(e) Would the proposed standard condition have any other adverse impact on your business? If so, please describe what this would be.	
(f) Does this proposed standard condition create a barrier to enter the market? If so, please explain why this is the case.	

Question	Feedback
(g) Do you have any other comments on the proposed standard condition or how it is drafted?	Given the existing regulatory requirements already applying to insurers detailed above (and similar requirements for other financial institutions). We question whether there is a need for this condition for Financial Institutions. If it is to be retained, in line with our feedback above, the focus should be on the consumer treatment, and so better wording in the Explanatory note would be: ○ *When establishing, implementing and maintaining your business continuity plan and technology systems, you will need to ensure that they ~~support, and do not hinder, the fair treatment of consumers and compliance~~ with are consistent with your fair conduct programme.* It is also important to clarify when a timeframe for notification commences. An insurer may experience intermittent outages of a critical technology system and it may take a number of days before it is determined to be an event that materially impacts the operational resilience of that system. The notification timeframe should not commence until this has clearly been established. If this standard condition is retained, we consider alignment with the 10 working days for FAP licences is appropriate. In the first 72 hours after an event that materially impacts the operational resilience of a critical technology system, the financial institution will be focuses on actioning its BCP and remedying the issue as soon as possible in order to continue to service its consumers. A requirement for a financial institution to notify a regulator (or potentially multiple regulators in the event of overlap in oversight by the FMA and RBNZ) within the first 72 hours will only serve to distract the financial institution from this focus. Financial intuitions already have significant motivation to resolve an event that materially impacts the operational resilience of a critical technology system to manage the significant associated financial and reputational risks.
Condition 6 – Record keeping	
(a) Do you agree or disagree with the proposed standard condition? Please provide your reasons.	The explanatory note to this proposed condition 6 specifies requirements to retain records to demonstrate how the financial institution has established, implemented and maintained their fair conduct programme and taken all reasonable steps to comply with it. FMA guidance on what records would satisfy this requirement would be helpful as the scope of a fair conduct programme under CoFI is wide and therefore the associated record keeping requirements may be significant and overly burdensome.

Question	Feedback
(b) Would the proposed standard condition create any additional compliance costs for your business? If so, please detail those costs.	The assessments of cost and potential additional compliance burden for our members cannot be answered without more detail.
(c) Would the proposed standard condition have any other adverse impact on your business? If so, please describe what this would be.	
(d) Does this proposed standard condition create a barrier to enter the market? If so, please explain why this is the case.	The assessments of cost and potential barriers to new entrants to the market cannot be answered without more detail.
(e) Do you have any other comments on the proposed standard condition or how it is drafted?	