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31 March 2017

Financial Markets Policy
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RE: ICNZ submission on the Consultation Paper – New Financial Advice Regime

1. Thank you for the opportunity to submit on this Consultation Paper. We provide this submission on behalf of the Insurance Council of New Zealand Incorporated ("ICNZ"). ICNZ represents its 26 members, who are general insurers – that is, not life or health insurers – and who conduct insurance business in New Zealand. Our members insure half a trillion dollars' worth of New Zealand property and liabilities, or approximately 95 percent of the general insurance market in New Zealand.

2. Overall, the Bill is a good translation of Cabinet's policy decisions into draft legislation. Our submission focuses on outstanding policy matters in the Consultation Paper, compliance-oriented questions where we seek clarification from MBIE about what is expected of regulated entities and individuals, and minor drafting changes to the exposure draft Bill to avoid unintended consequences.

Offers during unsolicited meetings

3. We support the position as it currently stands in the exposure draft of the Bill. Financial advice providers should be allowed to make offers during unsolicited meetings. We do not have evidence of any problems justifying a change in policy rationale. A financial advice provider will be appropriately licensed and regulated with relevant standards (the duties in sections 431F-M) and oversight (by Financial Markets Authority and the independent external dispute resolution schemes) to ensure that if any problems arise, they are addressed.

4. However, we note there appears to be a drafting error with the Bill. The proposed amendment to section 34(2)(b) and (c) of the Financial Markets Conduct Act ("FMCA") in Part One, Clause 10 of the Bill only applies to "financial products", not to "financial advice products".

“Financial products” has a limited definition in the FMCA – it only includes debt and equity securities, managed investment products and derivatives. “Financial advice products” includes other products that a financial advice provider may sell, as set out in Part One, Clause 5(2) of the Bill. We submit that enhanced duties and obligations for all types of financial adviser means that it should not matter what type of product the financial adviser or representative offers – there is plenty of consumer protection in place.

5. We submit this problem could be addressed by a simple amendment to add the words “or financial advice product” after references to “financial product” in section 34 of the FMCA.

6. We note that if financial advice products like contracts of insurance are not caught under the FMCA provisions on offers during unsolicited meetings, then those same offers may well be caught by the uninvited direct sales provisions of the Fair Trading Act. As we have submitted previously and separately to MBIE on those uninvited direct sales provisions, we would much prefer to comply with a regulatory regime that is designed specifically for the product insurers are selling, so in our view compliance with the FMCA provisions is far preferable to compliance with the generic Fair Trading Act provisions.

Licensing requirements

7. We seek to clarify MBIE’s expectations around licensing requirements where a financial service provider is providing multiple financial services. We submit that financial service providers should be allowed to compartmentalise different services to different parts of their business, with those separate services complying with their separate license conditions, as is currently permitted for entities that are QFEs. We understand this is contemplated – page 14 of the Consultation Paper refers to clearly demarcating a retail service within a business – but we seek more specificity and clarity on this point.

8. To illustrate, an insurer could establish a robo-advice platform that services retail clients. If the insurer does not otherwise provide a financial advice service (or does provide a financial advice service that is not a retail service) then we submit the insurer’s financial advice service obligations in respect of the retail robo-advice platform should only apply to that robo-advice platform, and not to the business at large. If this demarcation were not permitted, insurers would need to create separate legal entities for their various services, and have those entities licensed separately. In our view this would be an onerous, unnecessary and costly compliance exercise, and may dissuade development of robo-advice platforms and other positive customer-oriented initiatives in the financial services industry.

9. An insurer may provide both wholesale and retail financial advice services, or both exempt and non-exempt financial advice services, or both financial advice services and other financial services, through the same or different parts of its business. There are many different combinations and permutations of these business arrangements. And those services could be provided through, for example:
   a. the same individuals within the same team of staff
   b. different individuals within the same team of staff, or
   c. different individuals within separate teams of staff, with the wholesale and retail services compartmentalised to those teams separately.

10. MBIE’s proposal that a financial advice service is a retail service if just one retail client is serviced needs to be clarified in this context. As above, we say a business should be able to demarcate service obligations to apply to different parts of its business, provided it can demonstrate the effectiveness of that demarcation (for example, through clear business processes, protocols or systems) to FMA’s satisfaction. Applying that to the examples in paragraphs 9.a-9.c above, retail service obligations should only need to be adhered to by the

whole team of staff if there is no clear demarcation between the different types of service on offer. Where there is clear demarcation, an insurer should not have to make its whole team or business comply with the retail service standards. Doing so would require a financial advice provider to establish deadweight systems and processes, train and monitor compliance with financial advice obligations for its entire workforce. This would be an unnecessary compliance cost.

The labels "financial adviser" and "financial advice representative"

11. We are unsure why two different types of individual financial adviser have been provided for. The main differences between an adviser and a representative appears to be who bears compliance obligations (individual or entity) and who bears liability when things go wrong (from both a civil liability and disciplinary perspective). In our view, there is potential for consumer confusion and for regulatory arbitrage between the two pathways (adviser or representative), and that instead there should just be one pathway – one type of adviser.

12. However, if having two types of adviser in the legislation is a given, we say:
    a. the proposed labels of "financial adviser" and "financial advice representative" should be retained, but that
    b. disclosure regulations should make it clear that those labels are not mandatory when disclosing the nature of the service to the consumer.

13. Substitution of "financial adviser representative" with another label like "salesperson" would not be appropriate. The regime requires more of representatives in terms of conduct and competency standards than the average salesperson would be.

14. Consumer understanding should be a priority for activities regulated by the disclosure regulations. Those regulations must operate in a way that works for consumers, rather than provide a platform for simple parroting of the legislative provisions back to consumers. And many different types of adviser and salesperson are contemplated by this reform. One would not, for example, expect telemarketer salesperson acting on a licensed insurer's behalf to have to explain to the consumer that they are a "financial advice representative acting on behalf of a financial advice provider". One of our members suggests – and we agree – that a better example would be to permit the telemarketer to say they are a representative of the insurer, and then go on to describe the scope of service they provide to the consumer.

Definition of "financial advice"

15. We are disappointed that the existing definition of "financial advice" is being retained in the Bill. As we previously submitted in the Options Paper on 26 February 2016, the definition is unworkably broad and uncertain. Different financial service providers take different interpretations of when someone gives "financial advice" in respect of the same or similar services. For our member insurers, this difference in interpretation is based on legal advice each insurer has individually received. That legal advice appears to differ significantly, depending on who one's legal adviser is. In our view, there should not be such broad room for interpretive differences. The definition of financial advice is the gateway to the regime, and arguably the most fundamental aspect of the regime to get right.

16. For insurance products, variations and renewals have posed a problem in the past. Clause 5 of the Bill addresses this by amending the definition of when one "acquires" a financial product. In our view this proposed amendment to the definition of acquire is clumsy. It involves an awkward and unnatural stretching of the word "acquire". In our view the better and

more natural drafting solution would be to amend clauses like 431B, to specifically target the problem MBIE has identified. For example, clause 431B could be amended to state a person gives financial advice if they make a recommendation or give an opinion about acquiring, disposing, varying or renewing a financial advice product.

17. Because of uncertainties about when, precisely, a person gives "financial advice" under the current definition, and the fact that the confusion remains six years after the definition came into force, we ask MBIE and FMA to provide guidance on what it considers to be "financial advice" for different financial products as soon as possible. We would be happy to work with MBIE on developing guidance in respect of general insurance products.

18. We also seek clarity about the following aspects of the exclusions from financial advice in Part 2 Clauses 6 and 7 of the Bill. The issue is understanding how MBIE intends the exclusions to apply in practice to general insurance products, rather than understanding MBIE's high-level policy intent as it has been described in the consultation. We seek clarity on:
    a. What information MBIE considers to be "factual" and what would be "non-factual". We have difficulty understanding when information would not be factual except when it is delivered in the form of an opinion or is misleading or deceptive, both of which are covered elsewhere in the regime.
    b. The substitution of the "incidental" service exemption for the "ancillary" service exemption. We understand the swap is meant to clarify, in the context of insurance products, that, for example, distributors who are not otherwise a financial service providers do not fall into the regime, so that the likes of boat and car yards, travel agents, supermarkets, and educational institutions are excluded.
    c. What a "general" recommendation or opinion is.

19. Finally, in response to question 7 of the consultation paper, in our view wholesale clients do not need the client-first protection. If individual wholesale clients feel they do need retail protections, they can opt out of being wholesale. The adviser disclosure requirements can ensure that clients know what service they receive and what regulatory standard their adviser is adhering to. We also do not yet know what putting the client first means in practice, and so would prefer a precautionary approach to be taken to regulating this area rather than applying a blanket standard to all clients from the outset. Finally, we are not aware of any existing problems with wholesale client services that would justify an intervention.

FMA's designation power

20. We support including a power for FMA to designate a service a financial advice service as drafted under part 5, clauses 46 and 47 of the Bill.

Underwriting agents

21. We would like to clarify what status and obligations underwriting agents are intended to have under the financial services legislation regime.

22. An underwriting agent acts on behalf of an insurer and can agree to enter into insurance contracts on the insurer's behalf, on negotiable terms and conditions, within certain limits (monetary and other) imposed by the insurer. They will receive funds from the insured or the insured's broker (a "financial adviser") and pass those funds on to the insurer. Underwriting agents may represent either domestic or offshore insurers, though we note a rise in the

number of underwriting agents representing offshore insurers in the general insurance market in recent years, and we expect this trend may continue in future.

23. In their purest form, underwriting agents do not inherently give “financial advice” in the same way that insurers do not inherently give “financial advice”. However, the line can be blurred. For example, some insurance brokers (who will primarily give “financial advice” under both the old and new regimes) may also hold an agency with a particular insurer. This case is straightforward – if an underwriting agent gives financial advice, then the regime contemplates and regulates their service as a financial advice service provider. However, pure underwriting agents on the other hand will not be giving “financial advice”. They could be broking service providers, but this financial service designation is not a comfortable fit for underwriting agencies and underwriting agencies do not appear to have been contemplated the creation of that broking service category.

24. In our view acting as an underwriting agent should be listed as a new financial service in the Financial Service Providers Act. Despite not fitting neatly within any of the existing financial services categories, many underwriting agencies have registered as either RFAs or broking service providers, and joined a dispute resolution scheme accordingly. We submit this should continue to be the level of regulatory obligation for underwriting agencies that are not giving financial advice. We seek clarity from MBIE on the treatment of underwriting agencies under the regime.

Duty to put the client’s interests first (section 431H)

25. We are concerned about two aspects of this draft section, and submit that the wording in quote marks below should be deleted. The two aspects are:
    a. the words “or the interests of any other person” in 431H(1)(b), and
    b. the words “or doing anything in relation to the giving of advice” in 431H(2).

26. The words “or the interests of any other person” in 431H(1)(b) places too broad and uncertain a duty on the person giving regulated financial advice. We are unsure who, precisely, this drafting is intended to capture beyond the interests of the person giving regulated financial advice. We seek clarity from MBIE on this point and submit that if MBIE has specific persons in mind, that the legislation should refer to those persons specifically, rather than capture “any other person”.

27. We understand from discussions with officials that the broad drafting of section 431H(2) was not intended to compel a person who is licensed to give regulated financial advice into giving financial advice. An insurer may, for example, be licensed as a financial advice provider, but may also have set out business systems and processes to separate its information-only or execution-only or general advice services from its financial advice services.

28. We understand that MBIE does not intend for the insurer in this situation to be in breach of its duties if its information, execution, or general advice services make it clear to the customer that the nature and scope of service is limited. Likewise, we understand MBIE’s policy is that section 431H is not intended to prevent persons giving regulated financial advice from limiting their advice to a select number of financial products (e.g. ABC Insurance’s Comprehensive Motor Vehicle Insurance Policy), rather than all financial products available in the market of a particular category (e.g. all motor vehicle policies available in New Zealand).

29. If this is an accurate description of MBIE’s policy view, then we would support that view. Forcing regulated persons to give financial advice rather than information-only services is

dangerous territory, as is forcing advisers to give advice on products they do not have and should not be expected to have expertise in. Otherwise, significant and costly changes to insurer's existing systems and processes would be required. Given a clear agreement on the nature and scope of service provided to the customer, sufficient protections are otherwise in place. We submit a minor amendment to the Bill would be required to give certainty, for example, by adding a 431H(3) to add that, for the avoidance of doubt, "doing anything in relation to the giving of advice" does not include provision of one of the financial advice exclusions by a financial advice provider, where A has disclosed the limited nature and scope of the advice to B.

30. Alternatively, if this is not an accurate description of MBIE's policy view, then we would submit for the removal of the words "or doing anything in relation to the giving of advice" in section 431H(2). The phrase is too vague and uncertain. A better way of regulating the area for industry certainty would be to delete the phrase and elaborate on what elements of an adviser's role constitutes "giving advice" in the Code of Conduct, and allow the Financial Markets Authority to tackle any practical concerns from the ground up.

31. Finally, we seek clarity on what kinds of evidence a financial advice provider would need to retain to prove that it had put the client's interests first.

Civil liability and disciplinary provisions

32. We will address questions about both civil liability provisions and disciplinary processes together. In our view the questions MBIE has posed about whether individuals should face civil liability and whether entities (financial advice providers) should face disciplinary processes are unavoidably interrelated. They share common territory with each other as well as with:
    a. the dispute resolution schemes' jurisdiction to provide compensation for financial loss
    b. any industry self-regulation mechanisms like the Fair Insurance Code and its Code Compliance Committee
    c. any other court or tribunal that can investigate and make recommendations about poor conduct that breaches relevant laws, like, for example, the Human Rights Commission, the Privacy Commission, the OECD, et cetera.

33. Because of these three or more separate stages of addressing poor conduct in respect of financial advice services, we are concerned at the potential for at least triple jeopardy (but up to septuple jeopardy in the worst-case scenario). This can be avoided by identifying a clear purpose for each process/jurisdiction and by being mindful of the internal limits each jurisdiction requires to avoid unfairness and injustice to the party subject to multiple jeopardy. An example of an internal limit is that the dispute resolution schemes and some tribunals have a limit to their jurisdiction to exclude hearings of cases that have already been appropriately handled in another forum. We prefer to take a principled approach to this exercise, and that approach is outlined as follows.

34. First, wherever poor conduct has caused financial loss to a customer, compensating the customer for that loss should take absolute priority over all other regulatory actions. The dispute resolution schemes currently provide this function. Their process should be the priority of and cornerstone to conduct regulation for any industry regulatory regime.

35. Second, if poor conduct does not cause financial loss, or if it is appropriate to otherwise sanction poor conduct after financial loss had been rectified, then a process (or processes) should exist to sanction the conduct irrespective of whether it was caused by an individual or

an entity. Industry self-regulation like the Fair Insurance Code, civil pecuniary penalties and disciplinary processes all exist to sanction conduct that falls short of acceptable industry standards.

36. Third, for a new financial advice regime, we believe entities (financial advice providers) should face civil pecuniary penalties and individuals (both financial advisers and financial advice representatives) should face disciplinary processes. However, providers should only face civil pecuniary penalties where they failed to take reasonable steps to ensure that their representatives (advisers or "representatives") complied with the legislation, and representatives should only face personal disciplinary processes where they acted outside their financial advice provider's systems, processes, policies or protocols. It should be at FMA's discretion to decide on the facts of a particular case whether the entity or the individual (or both) were at fault, and to proceed down the appropriate civil pecuniary penalty or disciplinary process pathway as appropriate to the case.

37. We would go further and suggest that a representative must be indemnified for the cost of disciplinary proceedings and any associated fine by its financial advice provider. This is to ensure that employees are not unduly burdened by the cost of proceedings to investigate and sanction their conduct. What is important is that there is a central regulator which has oversight of all poor individual conduct in the industry, and can track the behaviour of individuals providing financial advice services over time, irrespective of whether those individuals represent providers as advisers or representatives. Without this kind of tracking, an individual could move from provider to provider 'under the radar' and continue to conduct him or herself out of line with the standards set out in the legislation and Code.

38. Our members did not reach a consensus on this line of argument, and we note that some of our members do not support it. Those members will submit their arguments to you directly. However, we have summarised their views in the following bulleted list, as while we did not on balance put their views forward as our primary submission, we think their arguments have merit. Their submissions are:
    a. That financial advice providers should not indemnify financial advice representatives, as this is a matter best dealt with on a case by case basis in the employment agreement or contract between the provider and the representative.
    b. That representatives should not be subject to disciplinary proceedings. The unusually broad definition of financial advice in the legislation means that some insurers will become licensed financial advice providers (as they are currently QFEs) as a defensive move to prevent issues arising if a salesperson accidentally gives financial advice. Salespeople do not need to be subject to professional regulation of the same gravity as financial advisers. Rogue salespeople are better dealt with through the licensed financial advice providers' employee vetting processes, which the Financial Markets Authority would have licensing oversight of.
    c. In an entity licensing regime, there should simply be no process for disciplinary proceedings against an individual – the entity should bear the full brunt of responsibility.

Remuneration disclosure

39. We support the duty to make prescribed information available under section 431L, and welcome consultation on disclosure regulations during 2017. Insurance brokers will be persons giving regulated financial advice under the regime. We reiterate our previous submission that, in principle, insurance brokers must fully disclose the nature and extent of their remuneration to the customer.

40. We recognise full disclosure may not always be possible. Some information about remuneration may be commercially sensitive or too complex to describe to the customer succinctly. What is important, in our view, is that the customer is clearly advised of the existence of the insurance broker's inherent conflict of interest between their duty to put the client first and their remuneration by the insurer, and some indication of the degree to which the insurance broker is conflicted so that the customer can gauge the extent of the conflict and its potential impact on the insurance broker's advice to the customer.

Inappropriate payments and incentives (section 431O)

41. While we fully support remuneration disclosure, we do not support restrictions on the types of remuneration that can be provided by financial advice providers. Under section 431O, a financial advice provider must not give a financial advice representative an inappropriate payment or other incentive. "Inappropriate" is defined as likely encouraging conduct that contravenes the duties to the client. In our view, any remuneration that comes from a party other than the client automatically puts the financial adviser's interests at odds with the client's interests, and creates an opportunity to fail to carry out the duties at sections 431F to 431M. The question then is simply one of nature and degree as to how likely the financial adviser would be to set aside the client's interests for his or her own interests or the interests of his or her employer.

42. But in our view, this misses the point. Conflicted remuneration is unavoidable in New Zealand's financial services industry. It should be managed, not banned. Market innovation should not be constrained in terms of the types of remuneration that can be offered. What is critical in our view to protect consumers is:
    a. First, the disclosure of that remuneration to consumers, so that consumers can make informed choices about the conflict(s) their financial adviser is under, and
    b. Second, for financial advice providers to have clear and effective policies, procedures and controls around conflicted remuneration in place.

43. We submit that section 431O should be amended accordingly.

Transition and compliance timeframes

44. We strongly support work progressing as soon as possible to develop the detail of the new regime. It is very difficult to give our support to the high-level policy in the Bill – particularly in the financial advice service duties set out in the Bill – without an understanding of what those duties require of financial advice service providers in practice. The sooner industry has the detail of the regime, the sooner industry can have confidence in the reform. We therefore strongly support the Code Woking Group process to develop the Code as soon as possible. We also understand MBIE will begin work and public consultation on disclosure regulations in the next few months. We welcome expedited development of these regulations for the same reason.

45. Unfortunately, as we do not currently know what the detail of the regime will be, we cannot comment on whether the proposed transition and compliance timeframes are appropriate, but six months from the release of the Code of Conduct to the final date to acquire a transitional license seems too short a timeframe at this stage. Entities need sufficient time to decide whether they want to be a financial advice provider (and assume liability for financial advisers and financial advice representatives). Likewise, individual financial advisers need time to decide if they wish to be licensed as a sole trader or instead be engaged by a financial advice

provider. Such decisions will be heavily dependent on what the specific Code of Conduct requirements and content of regulations are.

46. Once insurers know the final content of the Code, they will need to: review that Code content; determine how it applies to their business; work through options to structure their business to either provide financial advice; decide to apply for a transitional and/or full license and comply accordingly, or to not provide financial advice and structure their business to ensure that it does not encroach on the territory regulated by the regime; and then finally to give advice to senior management and governance to allow the business to make a decision on the options before it.

47. If industry does not know the content of the Code and any additional regulations (like disclosure regulations) until the Code is approved, then six months will be an extremely short timeframe to go through all of these process steps. In our view twelve months may be more appropriate. While we understand the point of the transitional license is to be a mechanical carryover of licensing under the existing regime the duties and obligations applicable are markedly different.

48. An alternative to allowing more than six months could be to require the Code Committee to provide stakeholders with better information before the Code is approved. At present, the Code Committee must consult with stakeholders and publish its impact analysis and response to submissions. But there are no timeframes outlining when it must do this. As above, the more notice industry can get on decisions made by the Committee and the Minister, the better. In saying so, we note this option would be far inferior to extending the timeframe for requiring a transitional license. Industry requires certainty, and progress updates provide far less certainty than approved and final decisions by, in this case, the Minister.

49. Finally, we would support faster law changes to allow licenses to be granted as soon as possible for the likes of robo-advice. 2019 is quite some time away when robo-advice platforms are already in development and in the market overseas. Regulation should not hinder the development of services that are beneficial for consumers of financial advice.

Dispute schemes providing information to FMA

50. We do not support a power for dispute schemes to provide information to FMA if they believe relevant financial markets legislation has been breached. The existing requirement to report a series of material complaints – that is, systemic issues – is sufficient. We provided for a comparable reporting requirement in our Fair Insurance Code 2016 for the schemes to only report “significant” breaches of the Code to us. “Significant” breaches are breaches of the Code that have the potential to bring the industry into disrepute. Requiring reporting of all breaches interferes with the schemes’ ability to do their core job.

51. The schemes’ core purpose is to resolve individual complaints in confidence by providing redress for a financial loss that a complainant has suffered. The concerns we have are:
    a. First, the reporting trigger in the Consultation Document is unclear. Would a scheme be expected to report every instance where a breach of financial markets legislation was alleged by a complainant, or where a breach could arguably be made out in the scheme’s opinion, or where the scheme had made a written determination that there was in fact a breach?
    b. Second, the schemes have a staged dispute resolution process with different degrees of investigative and adjudicative formality through that process. Many disputes will settle by way of negotiation or mediation after some initial investigation, before

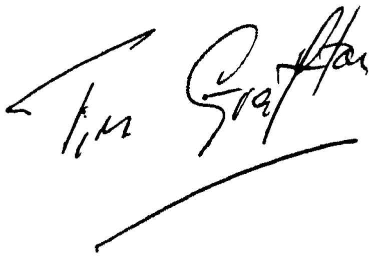
proceeding to the Ombudsman or Chief Executive for a final, formal written decision on the complaint. So it may not be possible for a scheme to make a robust determination about whether financial markets legislation has been breached at this underdeveloped stage of the dispute resolution process.

c. Third, the schemes are separate businesses in competition with each other. This means there is a risk of different approaches being taken by different schemes in determining whether a potential legislation breach has been made out, and, given the competitive element, a theoretical disincentive to full, free and frank reporting to FMA, as less scrupulous financial service providers may choose to join a scheme that has a less liberal approach to reporting to FMA.
d. Fourth, complainants can currently take complaints directly to FMA. The schemes routinely advise complainants of their ability to take complaints to other forums.
e. Fifth, and perhaps most importantly, a requirement to report to FMA could affect settlement outcomes for individual consumers. In negotiating settlements there tends to be not insignificant room for movement between both parties in terms of settlement offers and acceptances that are on the table. Financial service providers may be less liberal with settlement offers to complainants if the provider knows there is one or potentially two additional costly and time-consuming processes to proceed through once the individual complainant's financial loss has been compensated for.

Conclusion

52. Thank you again for the opportunity to submit. If you have any questions, please contact our legal counsel Nick Mereu on (04) 495 8008 or by emailing nick@icnz.org.nz.

Yours sincerely,



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