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Financial Markets Authority
1 Grey Street
Wellington

Email to: consultation@fma.govt.nz

Dear Sir/Madam,

ICNZ SUBMISSION ON PROPOSED INTERMEDIATED DISTRIBUTION GUIDANCE

Thank you for the opportunity to submit on the proposed guidance for dealing with intermediated distribution under the CoFI regime[1] (**Guidance**).

Insurance Council of New Zealand/Te Kāhui Inihua o Aotearoa (**ICNZ**) members are general insurers and reinsurers that insure about 95 percent of the Aotearoa New Zealand general insurance market, including over a trillion dollars' worth of Aotearoa New Zealand property 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).

Key points raised in this submission are:

- **The Guidance is useful and reflects welcome early engagement with the industry.**
- **Some elements could benefit from expansion and/or clarification, such as guidance relating to training, communications, assessment of distribution risk, and the use of external audit methods.**
- **References to the "shared responsibility" between insurers and intermediaries are welcome, although the industry is wary of the extent to which contractual arrangements will be able to ensure responsibility is borne to an appropriate degree by each party.**
- **Understanding the FMA's approach to assessing compliance with the CoFI regime will be integral to insurers being clear about how to conduct distribution of services and products through their intermediary channels.**

QUESTIONS FROM THE CONSULTATION DOCUMENT

1. Do you think this guidance will help financial institutions develop their fair conduct programmes in relation to intermediated distribution methods? Please provide reasons for your answer.

We believe the Guidance will be helpful for financial institutions developing fair conduct programmes (FCPs) and in their approach to intermediated distribution. It reflects good early engagement with the industry through the workshops held in 2022 with the FMA, insurers, and brokers. We support ongoing early engagement with the industry as the CoFI regime embeds.

The Guidance is useful in several ways, especially in that it:

a) Provides examples of what a financial institution should have in place to assess the risk arising from its distribution methods.
b) Highlights the benefit and usefulness of a written distribution strategy for treating customers fairly.

[1] The regulatory regime introduced by the Financial Markets (Conduct of Financial Institutions) Amendment Act 2022 (**CoFI**).

c) Emphasizes the need for determining the likely consumers of products and services by identifying and documenting: the intended purpose, likely consumers, and likely objectives and requirements of those consumers.
d) Elaborates on the requirement for distribution methods to operate consistently with the fair conduct principle in the Act.
e) Examines the key themes one-by one and, in each case, gives examples of what they mean and what the FMA might expect to see.
f) Notes the importance of developing policies, processes, systems and controls that are fit for purpose for the business in question to provide that distribution methods operate in a manner that is consistent with the fair conduct principle.
g) Provides examples of what the FMA does not expect.

In particular, the practical examples, 'spotlights', 'useful questions', and the table which includes examples of factors that may increase or decrease risk are helpful[2].

We support the risk based, proportionate approach and appreciate the FMA acknowledging that fair customer outcomes are a shared responsibility between financial institutions and intermediaries (although we do have some questions below on the practicalities of implementing that shared responsibility).

2. Are there any aspects of the guidance you think are unclear or need to be improved? If so, please explain what these are and provide your suggested wording or approach to address these.

Training

The Guidance states that financial institutions are responsible for providing appropriate product information and training to intermediaries to ensure they understand the product. However, we note that the provision of training to intermediaries is not a legislative requirement of CoFI and was removed from an earlier version of the CoFI legislation.

Whilst it does make good sense in ensuring that products are not mis-sold, the Guidance should acknowledge that providing training is only one of the tools that may be used to achieve this objective; there are other options that can be introduced to mitigate the risk of mis-selling. For example, in the context of a FAP intermediary, their existing competence requirements under the financial advice regime requires them to undertake general training on insurance products, therefore it would not be a proportionate approach for each insurer to be required to provide training to FAP intermediaries where the insurer assesses the risk associated with that FAP intermediary to be low.

Likewise, if the intermediary is themselves required to be licensed under CoFI, then the manufacturing insurer should not be required to provide training to the employees of the CoFI-licensed intermediary.

High risk channels and audits

It is still unclear what properly needs to be done to differentiate between low risk and high-risk intermediaries. For example, it would be helpful if the FMA confirmed whether they still consider a FAP as lower risk in a distribution arrangement where the FAP is not providing regulated financial advice and is only providing information support, and therefore (in providing those "information only" services) is not required to comply with the regulatory regime for FAPs. Does the fact that the intermediary holds a FAP licence and therefore has processes in place to adhere to the financial advice regime mean it is still considered lower risk even when providing information support only?

It would also be useful to have a clearer understanding of what sort of activity the FMA considers necessitates an external audit (refer also to our answer to Question 3, below).

[2] Although, as noted later in this submission, the identification and assessment of risk factors could be improved.

3. Are there any aspects of the guidance you think may have unintended consequences?

Communication

An example in the Guidance suggests that where an insurer does not have any direct communication with consumers, it should put in place agreements and processes for intermediaries to regularly communicate with their clients to encourage them to review their cover and products. This seems contrary to the FMA statement that it does not expect insurers to "supervise a FAP intermediary's compliance with their obligations under the financial advice regime".

The implementation of such a process in the context of a FAP intermediary could result in insurers interfering with the financial advice obligations of the FAP intermediary. For clarity, a FAP intermediary undertakes a detailed review of their client's background circumstances and position (in accordance with their financial advice obligations) to determine whether it is appropriate to review their cover or product choice, etc. Such a review may result in the client changing products or, in some circumstances, changing insurers.

For that reason, it would be helpful if the examples could be accompanied by a statement that the examples given are not the *only* way to address responsibility for customer communications, and that the insurers' risk assessment is a relevant factor in the approach taken. We acknowledge that that the "*What we do not expect*" section on page 19 is helpful in this respect.

Increased compliance costs

It is helpful that the Guidance states that the "FCP factors" should be "considered in their totality" when financial institutions make their risk assessment of distribution methods. The Guidance gives an example of the presence of one factor which might decrease risk (e.g. using a FAP intermediary) with other factors which may increase the risk. For completeness, this example should be extended in the opposite direction; that is, providing a scenario where an institution assesses factors that increase the risk (e.g. non-FAP) and balances those with factors that reduce the risk (e.g. experience working with the intermediary).

While it might be inferred that both assessment directions are possible, it would be useful to have this clearly laid out. Without knowing clearly what the FMA's approach will be, a reasonable financial institution may seek to err on the side of caution and treat all non-FAP intermediaries as "higher risk" and thus implement more onerous review processes (eg external audit) for that distribution method. This would be counter to the FMA's view that compliance with CoFI distribution requirements can be done without "adding unnecessary cost" (page 18).

By using FAP intermediaries as the *only* example of a low-risk channel, the FMA might inadvertently incentivise certain behaviour which comes with a cost. Placing too much emphasis on the lower risk of FAP intermediaries might lead institutions to rationalise their distribution models to only use these methods. This may then reduce the available channels for consumers and/or increase the cost of access. We would suggest making it explicitly clear that this is just one of several factors that would deem an intermediary to be lower risk.

4. Are there any aspects of the guidance you do not agree with, or you think should not be included? Please give reasons for your view.

There needs to be clarity about the expected use of external audits. The "Spotlight" on this issue (pp19-20) notes that external audits would not be expected as a "routine compliance measure" but they are expected to be considered for "higher-risk distribution methods". We note that the Guidance does try to limit the expectation for external audits by saying this type of tool should "be considered only for higher-risk distribution methods or to respond to a specific risk" (page 20).

But, if an insurer regularly uses an intermediary distribution channel that is seen as "higher risk" (such as a non-FAP intermediary), does that not then suggest that regular external audits would need to be considered? The Guidance seems to lend itself to this interpretation; if this is not the intent, then this should be clarified.

As we have noted, regular use of external audits for intermediaries will not only increase compliance costs but will also hinder relationships that certain insurers have with their intermediaries and, we think, go against the principle-

based approach of the CoFI regime. The relationships between the insurer and the intermediary are critical to maintaining a partnership approach ("shared responsibility") towards achieving fair treatment of consumers.

5. Are there any additional areas you consider the guidance should address? If so, please provide details.

FAPs not providing financial advice

As mentioned above, it would be helpful to have clarity around the approach for FAPs that are involved in distribution arrangements where they do not provide regulated financial advice, and therefore are not required to comply with the Financial Markets Conduct Act in respect of the service the FAP provides to the insurer.

Referral model

While the Guidance refers to "any" distribution methods, there may be some value in identifying guidance specifically for the "referral only" distribution model (that is, where advisers/agencies generate and refer customer leads to the insurer who then owns and manages the advice, sales, and onboarding process directly with the customer as per the direct distribution approach).

The insurer will still have an obligation to ensure that the customers are treated fairly (including those originating from the referral model) and it will need to be comfortable that its products and services are reaching its target customers and ensuring that they are meeting the requirements and objectives of those customers (when viewed as a group). There will still be an obligation to confirm that the insurer is monitoring this distribution method (and remediating any deficiencies) and reviewing whether this distribution method is operating in a manner that is consistent with the fair conduct principle on an on-going basis.

Remediating deficiencies

It would be useful to understand the FMA's view on or approach to a situation where a financial institution observes that an intermediary is not adequately performing the aspects of distribution for which it is responsible, despite attempts by the financial institution to work with that intermediary to improve. What advice or guidance is there for financial institutions as simply severing the contractual relationship may not be a fair outcome for existing customers.

6. Are the examples useful? Are there any examples that you would like to see changed, clarified, or omitted? Are there any additional examples that should be included? If so, please provide your suggested wording.

The useful questions on page 22 for remedying deficiencies do not align to what is said about a collaborative process and 'shared responsibility'. We suggest these questions could be reframed to reflect this approach, for example:

- "How do you work with your intermediaries to track issues that are identified in how your distribution methods are operating?"
- "When and how do you and your intermediaries notify each other of any issues identified with how distribution methods are operating?"

Whilst financial institutions have obligations to provide for distribution methods to operate in a manner that is consistent with the fair conduct principle[3], there may be difficulties in requiring compliance by intermediaries who are not subject to FMA regulation of any sort. We note that the insurer is not party to what an intermediary (be it a motor vehicle dealer or an insurance broker) is saying in conversations with the customer and an example on how an institution approaches this situation would be helpful.

The clarification on what the FMA does not expect and acknowledging the dangers of over-compliance is helpful. There will always be a danger of increased and unintentional non-compliance with principle-based legislation but the examples of factors that may increase or decrease risk are a good point of reference to assist businesses in determining what is appropriate.

[3] Section 446J(1)(b)(i).

7. Do you have any comments on the length, format, or presentation of the guidance? If so, please provide details.

The length seems appropriate, and it has a good balance of overall guidance, examples, and reference to the core legislative requirements.

8. Is the 'Overview' section summarising the guidance on a page useful? Are there any changes you would suggest to this?

It is useful as a map of the high-level concepts related to each focus area. However, as noted in previous answers, the detail in the body of the document does not always fully or clearly extrapolate the overview sections (perhaps lending itself to the need for a disclaimer sentence that the complete guidance document must be read in conjunction with relevant legislation to fully understand the obligations listed in the overview).

9. Do you have any other comments on the guidance?

The guidance notes on page 6 that it does not focus on incentive arrangements. Once the final form of the regulations for sales incentives have been promulgated, it would be useful for the Guidance to be updated to reference and/or summarise any further guidance from the FMA on the form and use of sales incentives under the new regulations in the context of intermediated distribution. In many instances, insurers will be requiring activity and reporting from intermediaries that goes beyond the current status quo – any such mode shift in requirements on intermediaries is likely to be met with demands from those intermediaries to renegotiate incentives for performing these modified distribution functions[4].

There may be challenges in renegotiating contractual agreements with intermediaries in time for the commencement of the regime in early 2025. Some intermediaries have been reluctant to agree to provisions in distribution agreements that have the intended effect of providing confidence to the financial institution that those intermediaries will operate consistently with the fair conduct principle when distributing the financial institution's products. Whilst the FMA's guidance notes that it is considered "good practice" to have contractual agreements in place, it would be helpful if the FMA provided a firmer view of the importance of requiring intermediaries to take appropriate steps to comply with the insurers' Fair Conduct Programme, where appropriate.

Page 4 of the guidance says the FMA 'will be focusing more on the outcomes resulting from treatment of consumers rather than just on the methods financial institutions have chosen to comply with CoFI obligations.' It would be good to understand how the FMA plans to do this? What would the FMA look at, and how would the FMA understand whether fair outcomes for consumers are achieved?

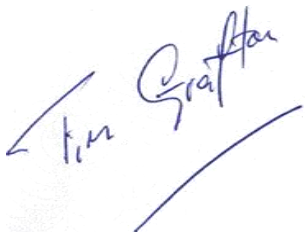
A better understanding of how the FMA intends to assess compliance can assist with understanding what actions are required for compliance.

[4] Noting intermediaries will be required to comply with the incentives regulations (CoFI, section 446L).

CONCLUSION

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

Yours sincerely,



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