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Committee Secretariat
Economic Development, Science and Innovation Committee
Parliament Buildings
Wellington

Emailed to: john.thomson@parliament.govt.nz

Dear Committee Members,

ICNZ submission on the Financial Services Legislation Amendment Bill

Thank you for the opportunity to submit on the *Financial Services Legislation Amendment Bill* ("the Bill'). ICNZ represents general insurers who insure about 95 percent of the New Zealand general insurance market, including over half a trillion dollars' worth of New Zealand property and liabilities.

We wish to appear before the Committee to speak to our submission.

Please contact Andrew Saunders (andrew@icnz.org.nz or 04 914 2224) if you have any questions on our submission or require further information.

This submission is in two parts:

- Submission on individual clauses of the Bill
- Technical and drafting comments

Individual members may take differing views to ICNZ on some issues and those members will submit to you separately.

Submission on individual clauses of the Bill

Offers during unsolicited meetings (clause 11)

We support the position that financial advice providers should be allowed to make offers during unsolicited meetings. A financial advice provider will be appropriately regulated and where relevant licensed, with relevant standards (the duties in sections 431H-O) and oversight (by the Financial Markets Authority ('FMA') and the independent external dispute resolution schemes) to ensure that if any problems arise, they are addressed.

We note that if financial advice products like contracts of insurance are not captured under the *Financial Markets Conduct Act* ('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 1986*. It is more appropriate in this context to be required to comply with a regulatory regime that is designed more specifically for the product insurers are selling, so in our view compliance with the FMCA provisions is preferable to compliance with the generic Fair Trading Act provisions.

However, we note that section 34(2)(b) and (c) of the FMCA, which is covered in clause 11 of the Bill, only applies to 'financial products' and 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 (i.e. not insurance contracts). The category of 'financial <u>advice</u> products' includes other products that a financial advice provider may sell, as set out in clause 5(2) of the Bill, and this includes contracts of insurance. We submit that enhanced duties and obligations for all types of financial advisers means that it should not matter what type of product the financial adviser or representative offers – there is adequate consumer protection in place.

This issue could be addressed by amending section 34 of the FMCA to provide that 'for the purposes of section 34 of the FMCA, "financial products" includes "financial advice products"'.

Recommendation: amend Clause 11 to also provide that 'for the purposes of section 34 of the FMCA, "financial products" includes "financial advice products"'.

Definition of 'financial advice' - clause 27 and Schedule 2 of the Bill (new Schedule 5 of the FMCA)

As we have submitted previously we remain concerned the definition of 'financial advice" is unworkably broad and in some respects uncertain, and consequently propose refinements to address issues identified.

We submit two additional exclusions from the definition of 'financial advice' should be provided in clause 7 of Schedule 5 of the FMCA for:

- advertisements for financial products that are not specifically addressed to any person (e.g. websites, television or print advertisements, direct marketing and social media); and
- offers of renewal for insurance products.

In terms of uncertainties, while the legislation has 'providing factual information is not financial advice', it can in practice be difficult to distinguish the line between factual information and a recommendation on a website which sells a product to consumers. Because the legislation is about regulating the provision of financial advice, there should be something in the definition which indicates that the recommendation is made to an individual customer rather than to the world at large. Advertising material is already governed by the *Fair Trading Act 1986* and the relatively recent changes to that relating to having to be able to substantiate representations has already introduced further controls in this area.

Under the existing *Financial Advisers Act 2008*, there is a 'class service' which means that you are permitted to generally promote to the public or groups, a product on a website or other media (e.g. TV and marketing materials such as newsletters and brochures) – this is the opposite of personalised service. The definition of 'advertisement' under that Act includes any form of communication made to the public or a section of the public for the purpose of promoting the supply of financial services.

Under the proposed FMCA regime, the absence of 'category 2' products and 'class service' would suggest that the general marketing of insurance products (i.e. that are not personalised) could only be carried out if all the requirements of advertising regulated offers are met. If so, this level of regulation would seem excessive. Also, under the current *Financial Advisers Act 2008* they would be considered class advice and therefore require the entity making the advertisement to be registered on the FSPR. However, under the new regime the entity would be required to be licenced. If this is the only type of 'financial advice' the entity 'gives', then it does not seem necessary for the entity to be licenced given all advertising would be subject to current consumer protection and trade practices law including the fair dealing provisions under the FMCA.

We don't consider offers of renewal for insurance products are financial advice but they should be exempted for the definition to provide certainty. Renewal is best described as an 'offer' or the provision of 'factual information' about price and terms. Offers of renewal for insurance products being treated as financial advice could be counterproductive by encouraging providers to give as little information as possible, even where that information could be helpful to consumers. Any extra complexity imposed if they were considered 'financial advice' would also involve costs and complexity that would be passed to consumers and there are millions of renewals every year. For the avoidance of any doubt insurance renewals should be specifically excluded.

Recommendation: amend clause 7 of Schedule 5 of the FMCA to provide specific exclusions for:

- **advertisements for financial products that are not specifically addressed to any person (e.g. websites, television or print advertisements, direct marketing and social media); and**
- **offers of renewal for insurance products.**

Duty to give priority to the client's interests and application of that duty to wholesale clients (clause 27 - section 431J of the FMCA)

We support the general intent of this clause, however, we have concerns over how this duty would apply in practice in some situations. For example, in the case of a nominated representative or an online sales tool that only sells products from one provider. Industry participants want to avoid situations where there is a risk of non-compliance, particularly in relation to high volume transactions. Whilst this may be able to be addressed through defining scope this adds time and complexity for consumers and clarification could avoid this.

It is potentially challenging to understand in practice what would constitute 'ought reasonably to know' and 'taking all reasonable steps'. We note for instance that in the absence of further refinement sub-para (2) could be interpreted as requiring insurers to tell customers that another company has a cash back offer on their contents policies or that the cover is better. Expecting sales consultants employed by a vendor of financial products to, in some situations, advise against purchasing those products does not appear like a realistic or workable situation.

We assume this is not the intent, however, to address any uncertainty there should be an additional sub-clause in section 431J that clarifies that product-providers are not required to consider other product-providers products when giving financial advice. If this does not occur, it will at minimum need to be addressed in the Code of Conduct.

We also submit that it is not necessary for this duty to apply to wholesale clients as they will be sophisticated enough to manage any potential conflicts of interest.

Recommendation: Amend section 431J of the FMCA to address the issues outlined above.

Remuneration disclosure (clause 27 - section 431N of the FMCA)

We support the duty to make prescribed information available under section 431N, and welcome consultation on disclosure regulations.

Inappropriate payments and incentives (clause 27 - section 431Q of the FMCA)

While as outlined above 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 431Q, a financial advice provider must not give a nominated representative any kind of payment or other incentive that is intended to encourage, or is likely to have the effect of encouraging, a nominated representative to engage in conduct that contravenes any duty under sections 431H to 431O. 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 in sections 431H to 431O. 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.

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:

- first, the disclosure of that remuneration to consumers, so that consumers can make informed choices about the conflict(s) their financial adviser is under (to be addressed by regulations made under section 431N, and
- second, for financial advice providers to have clear and effective policies, procedures and controls around conflicted remuneration in place.

We submit that section 431Q should be amended accordingly by removing paragraph 431Q(b). If section 431Q is nonetheless to be progressed we submit that at minimum the words 'or is likely to have the effect of' should be removed as this is overly broad and subjective.

Recommendation: amend clause 27 to not include subparagraph 431Q(b) in section 431Q of the FMCA, or at minimum remove the words 'or is likely to have the effect of' from 431Q(b).

Status and obligations of underwriting agents (clause 61)

We consider it important to clarify what status and obligations underwriting agents are intended to have under the financial services legislation regime.

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. We note a rise in the number of underwriting agents representing offshore insurers in the general insurance market in recent years and expect this trend may continue in future.

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 in the creation of that broking service category.

In our view acting as an underwriting agent should be listed as a new financial service in section 5 of the *Financial Service Providers (Registration and Dispute Resolution) Act 2008*. Despite not fitting neatly within any of the existing financial services categories, many underwriting agencies have registered as either registered financial advisers 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.

Recommendation: amend clause 61 to list 'underwriting agent' as a new financial service in section 5 of the Financial Service Providers (Registration and Dispute Resolution) Act 2008.

Changes to information sharing by dispute resolution schemes (clauses 81 and 87)

We do not support the proposed changes in the Bill in relation to information sharing by dispute resolution schemes. The existing requirements in section 67 of the *Financial Service Providers (Registration and Dispute Resolution) Act 2008* to report a series of material complaints – that is, systemic issues – are appropriate.

We are concerned that requiring reporting of all breaches ('has contravened, may have contravened, or is likely to contravene…') may interfere with the schemes' ability to do their core job, which is to resolve individual complaints in confidence by providing redress for a financial loss that a complainant has suffered. The specific concerns we have are:

a. A requirement to report to FMA and other regulators 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.

b. Adding this duty could slow and complicate processes to the detriment of complainants. The communication of speculative breaches to regulators could result in additional and unnecessary costs. Extra costs incurred would ultimately be passed on to customers.

c. Complainants can take complaints directly to FMA. The schemes routinely advise complainants of their ability to take complaints to other forums.

d. 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. 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.

e. A series of 'material breaches' may give an insight into the culture of a business whereas this may not be able to be understood from a single breach or action.

f. 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. There are risks of both a theoretical disincentive to full, free and frank reporting to FMA for competitive reasons or conversely excessive disclosure to avoid any non-compliance.

If notwithstanding these concerns, the proposed changes to section 87 of the Act are to be progressed, the following two matters need to be addressed:

- The reporting trigger 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? Further clarity is required on what is meant by 'may have contravened, or is likely to contravene relevant legislation' and what is considered 'in a material respect'.
- There should be a requirement that before, or at the same time as the scheme communicates a potential breach to the regulator, they should also communicate the same information to the relevant entity.

Recommendation: amend clause 87 to retain the current duty in section 67 of the *Financial Service Providers (Registration and Dispute Resolution) Act 2008* to communicate a 'series of material complaints'.

Section 536 of the FMCA

Sections 535 and 536 of the FMCA mean that an insurer could be responsible for the conduct of agents where they are acting within the scope of their actual or apparent authority. An agent who acts beyond their actual authority could therefore still incur liability on the part of its principal. We are mindful that in the insurance industry brokers often hold the relationship with the customer and so the insurer in some situations has no direct contact with the insured except perhaps during the claim process. We also note that under our *Fair Insurance Code*, a guideline that sets out industry best-practice standards for insurers in all their dealings with customers, brokers are considered to be the agent of the insured (i.e. customer).

In considering the Bill some of our members have expressed concern that although brokers are not considered to be agents of insurers there could be situations where deficient actions of brokers that are independent entities in their own right could be instead visited on the insurer based on the possible argument that the broker was the insurer's agent under this regime. Given the purpose of this Bill is improving the quality of financial advice it would seem illogical to have a situation where

deficient conduct by financial advisers is not addressed due to the agency provisions in the FMCA. We submit further consideration should be given to this.

Transition and compliance timeframes

It is important that the transition and compliance timeframes are sufficient to be workable and not impose excessive costs on industry. We support the date for the new regime coming into effect being set by Order in Council so as to enable a sensible transition to be imposed independent of when the Bill is passed into law.

It is important that the transition approach works for all types of organisation, including for entities that may be treated differently under the new regime (e.g. non-QFEs at present that may need to be licensed under the new regime) or new entities looking to establish across this period. Existing Qualifying Financial Entities (QFEs) can engage nominated representatives under transitional licences. Non-QFEs will however have to receive a full licence before they can engage nominated representatives (refer to Schedule 1 of the Bill, clause 75). This means that non-QFEs that currently only give class advice through individual employees or agents (as is permitted by the *Financial Advisers Act 2008*) will need to be a licenced financial advice provider under the new regime. From a practical perspective, this appears to mean that such entities will need to have a full licence as soon as the regime comes into force, however, it is not clear on the proposed timeframes indicated whether it is practical to obtain a full licence by that date.

We also note that other major regulatory changes impacting the insurance industry are scheduled to come into effect in 2019 (e.g. changes to the collection of the Fire Service Levy) and so it is important the timeframe determined is realistic given the wider regulatory compliance burden being imposed on the industry.

We note the current indication from the Ministry of Business, Innovation and Employment is that the new regime will take effect approximately nine months after the Code is expected to be approved. We consider this is the shortest timeframe that should be considered.

We are ultimately mindful that further understanding is required of what insurers will be expected to do to comply with the proposed changes, and when those requirements will be confirmed, before being able to be specific on appropriate transition and compliance timeframes.

Technical and drafting comments

In the below table we raise some technical and drafting comments on the Bill.

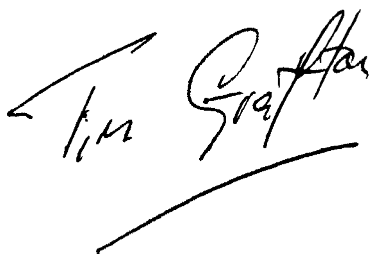
Clause 5 - Definition of “financial adviser” (clause 5)	We note that the definition of ‘financial adviser’ does not include a ‘financial advice provider’. However, on page 21 the Ministry of Business, Innovation & Employment’s consultation paper ‘New Financial Advice Regime’ released in February 2017, it seems a sole trader would potentially be both a ‘financial advice provider’ and a ‘financial adviser’. It would be helpful if the legislation clarified whether a sole trader that is a ‘financial advice provider’ could also be a ‘financial adviser’.
Clause 16 - Section 388 of the FMCA	New section 388(ba) of the FMCA would require a provider of financial advice services to have a licence. However, section 389(2) says the provider doesn’t need a licence if ‘the service is not provided to any retail clients’. This suggests a provider would only need a licence if it is providing that service to a retail client – for instance, if the provider had 10 retail

	clients but provides no financial advice services to any of them, then the provider does not need a licence. However, the example (which is new) provided under section 389(2)(a) says "A service provider may provide a financial advice to a number of clients. As long as the service provider has no retail clients, the provider need not be licensed as a financial advice service provider." The underlined words appear to take it a good notch higher, i.e. the provider must not have any retail clients at all, in order to come under the licence exemption. Having no retail clients at all is quite different from not providing financial advice services to any retail clients.
Clause 27 - Section 431A of the FMCA	It is not clear whether a financial adviser can be engaged by more than one financial advice provider and we consider this should be clarified in the legislation. If a financial adviser can be engaged by more than one financial advice provider, the legislation should also address how the civil liability provisions would be applied in this instance.
Clause 27 - Section 431S of the FMCA	If an entity gives advice to wholesale clients only, then under new section 389(2) of the FMCA it doesn't need to be licensed under the new regime. The financial advice provider would still need to use financial advisers or nominated reps to provide advice to its wholesale clients under section 431E. However under new section 431S the financial advice provider can't nominate any nominated representatives if it doesn't have a licence. So it could only use financial advisers to provide advice to wholesale clients – which seems to go against the policy intention of this new regime (and the way the FMCA generally operates). This could be resolved if new section 431S excluded the requirement on the financial advice provider to be licensed if an exemption under section 389 applies.

Conclusion

Thank you again for the opportunity to submit on the Bill. If you have any questions, please contact our Regulatory Affairs Manager on (04) 914 2224 or by emailing andrew@icnz.org.nz.

Yours sincerely,



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