

30 April 2020

Dr Deborah Russell
Chairperson
Finance and Expenditure Committee
Parliament Buildings
Wellington 6160

Dear Committee Members,

FIDELITY LIFE SUBMISSION ON THE FINANCIAL MARKETS (CONDUCT OF INSTITUTIONS) AMENDMENT BILL

Introduction

Thank you for the opportunity to submit on the Financial Markets (Conduct of Institutions) Amendment Bill (**Bill**). Fidelity Life (**we/our**) supports measures that will build consumer trust in the life insurance industry. We're the largest New Zealand-owned and operated life insurer and the 2017, 2018 and 2019 ANZIIF New Zealand Life Insurance Company of the Year. We're all about protecting your way of life.

We're in the business of paying claims and we're there for our 300,000 customers and their families when they need us. In the 2019 financial year we paid out \$125.7 million in claims and since 1973 we've paid out more than \$1 billion.

Our overall opinion on the Bill

- 1 Fidelity Life supports the regulation of conduct of financial institutions. It's our view, however, that the current draft of the Bill is not well considered regulation. It lacks sufficient detail to provide long term sustainability and ensure fair, efficient and transparent outcomes for both consumers and the financial services industry. Instead it relies heavily on regulation-making power, creating uncertainty for the industry and its consumers.
- 2 The life insurance industry is facing significant regulatory, technology and consumer change. As acknowledged by the Ministry for Business, Innovation and Employment (**MBIE**) in its regulatory impact statement, their analysis was prepared under significant time constraints which did not allow time for more extensive consultation with stakeholders on the development and refinement of options.
- 3 There is an existing network of regulation that controls every aspect of an insurer's business. There appears to be duplication with existing licensing regimes and obligations which creates confusion both for the industry and consumers.
- 4 Clarity and consistency across related legislation is required to ensure the Bill will achieve what it sets out to do. For example, consideration should be given to how the proposed requirements interact with the duties of financial advisers under the Financial Services Legislation Amendment Act 2019 (**FSLAA**), and the fair dealing

provisions (including the fair dealing provisions in Part 2 of the Financial Markets Conduct Act 2013 (**FMCA**)).

- 5 We reiterate that further consideration should also be given to whether regulatory powers that already exist under the FMCA can be expanded upon, and to extending the regulation to all financial services providers so that consumers will get the same protection across the financial sector. It's our view that an additional licence is not necessary and that the objectives of conduct licensing can be achieved by adding to existing licensing regimes.
- 6 An additional licensing regime increases compliance costs, which will ultimately be borne by consumers. We want to ensure that any increased compliance costs arising from the Bill are kept to a minimum if it is to achieve its purpose of protecting consumers and to promote confident and informed participation in financial markets. This is especially important given the current economic downturn and the impact COVID-19 is having on both businesses and consumers.
- 7 Instead, there should be a focus on the forthcoming changes to the regulation of financial advice and recognition of the work completed by the financial services industry in relation to conduct and culture.
- 8 It's important New Zealanders have access to independent financial advice and insurance protection. We're concerned the Bill may have unintended consequences which negatively impact the same consumers the Bill is aiming to protect. Our concerns (which are addressed in more detail later in our submission) are:
 - 8.1 **Increased compliance costs** arising from the imposition of an additional licensing regime that will ultimately be borne by consumers;
 - 8.2 **Consumer protection confusion** as a result of different fair conduct rules applying to different types of market services licenses under the FMCA;
 - 8.3 **Lack of clarity regarding the regulation of sales incentives and commission** will impact the long-term sustainability of the life insurance industry. The Bill does not directly address the concerns called out by the International Monetary Fund (**IMF**), the regulators and the current government on "high and very high" upfront commissions. This is in contrast to Australian regulation which is prescriptive with respect to upfront commissions;
 - 8.4 **Reduced availability of independent advice for consumers** because of the compliance burden placed on financial advisers having to comply with multiple fair conduct programmes; and
 - 8.5 **The breadth of the regulation making power** creates uncertainty for the industry and consumers.
- 9 Our submission also addresses other concerns we have with the Bill, namely:
 - 9.1 **an additional licensing regime;**
 - 9.2 **the publication of fair conduct programmes;**

9.3 the carve out for Financial Advice Providers; and

9.4 the impact on innovative product design.

- 10** To that end, we endorse the codification of the fair conduct principle proposed in the Bill but recommend it is set out as a duty to ensure efficacy with other FMCA provisions. We also endorse giving the appropriate regulator the necessary enforcement powers.
- 11** In summary, and in light of the current economic downturn, we ask that this Bill is postponed to enable further stakeholder consultation and time to amend the Bill to address these issues. We commend MBIE for the work undertaken so far and under significant time constraints but recommend a more balanced and measured approach needs to be taken to the development of conduct regulation, especially given the new financial advice providers licensing regime, and the need to ensure the long-term viability and sustainability of the industry.
- 12** Further consultation is needed to ensure that the desired outcomes are achieved - to provide improve sustainability and ensure fair, efficient and transparent outcomes for both the industry and consumers.

Unintended consequences of the Bill

- 13** At Fidelity Life we want to ensure New Zealanders have access to independent financial advice and insurance protection. However, we know there is a long-standing underinsurance gap in New Zealand. Below we address concerns regarding unintended consequences that may negatively impact the same consumers the Bill is aiming to protect.

Increased compliance costs arising from the imposition of an additional licensing regime

- 14** In their regulatory impact statement MBIE said that the most significant costs of the Bill are likely to fall on insurers and their intermediaries. MBIE says that the increase in compliance costs for regulated entities will be moderate-to-high and it's likely that these costs will be passed on to consumers.
- 15** New Zealand has one of the lowest rates of life insurance in the developed world and Fidelity Life is committed to improving it. We know one of the critical drivers of consumers' decisions to take out life insurance is the price of the product. In our view the increased compliance costs arising from the introduction of the new licensing regime under the Bill will likely worsen rather than improve this issue.
- 16** Fidelity Life considers it critical that any increased compliance costs arising from the Bill are kept to a minimum if it's to achieve its purpose of protecting consumers when the consequential effect could be to 'price' many New Zealanders out of the insurance market.
- 17** This is especially important given the economic downturn as a result of the COVID-19 pandemic.

Consumer protection confusion

18 Hon Kris Faafoi (Minister of Commerce and Consumer Affairs) noted at the Bill's first reading that "by introducing this Bill to improve conduct in the financial sector, we're putting the consumer at the center and helping banks and insurers to ensure trust and confidence in their industry." While we support this good intent, we're concerned that, without extending these regulations to all financial services providers, consumers will not get the same protection across the financial sector.

19 Further, with a number of different fair conduct rules applying to different types of market services licenses under the FMCA, it's very likely this will create consumer confusion and layer upon layer of compliance functions and costs within regulated entities.

20 The regulators play an important role in ensuring consistency and clarity for consumers across the whole financial services industry, especially given the current economic climate and the vulnerabilities that people are currently facing into.

Lack of clarity regarding the regulation of sales incentives and commission

21 The Bill in its current form includes a broad-regulation making power in relation to sales incentives without any high-level principles to guide regulation-making power. We're concerned this will create uncertainty in the industry and our ability to undertake future strategic planning. It's important to future proof the regulation of sales incentives and commission to ensure a sustainable model for both consumers and the industry.

22 To provide some certainty we think the Bill should specify at a high level:

22.1 what types of incentives can be curtailed or banned;

22.2 what positions/roles/job titles the regulations can apply to;

22.3 what is considered an unacceptable rate of commission; and

22.4 what financial institutions will be required to do to ensure their intermediaries/third party distributors comply with the regulations.

23 It's unclear if the Bill has taken into account the long-term sustainability of the life insurance industry and does not directly address the concerns called out by the IMF¹, the regulators and the current government² on "high and very high" upfront commissions and, in particular, the exposure of New Zealand's insurance sector to undue risk due to high upfront commissions.

24 In January this year the RBNZ again raised concerns about "high upfront commissions" undermining public confidence in the sector. (RBNZ Bulletin, An overview of the life insurance sector in New Zealand Vol. 83, No. 1, January 2020). Given competition law restrictions, the industry is unable to self-regulate this and

¹ International Monetary Fund - Detailed assessment of observance—insurance core principles report, May 2017

² Update on the FMA's ongoing review of insurance and replacement business and conflicted conduct - March 2018; FMA and RBNZ report on Life Insurer Conduct and Culture - January 2019;

<https://www.mbie.govt.nz/dmsdocument/5154-conduct-of-financial-institutions-review-options-paper>

without clarity, consumer confidence and trust as well as the long-term sustainability of the industry is at risk.

- 25** The new financial advice regime includes disclosure obligations with the provision of transparency around the percentage or dollar value of commission. We expect this will not only increase lack of trust in the industry, but, given the lack of clarity in the Bill on this, also lead to disappointment that the government hasn't taken sufficient action. Especially in contrast to Australian regulation which as noted at paragraph 8.3 is prescriptive with respect to upfront commissions.
- 26** The Bill should also focus on addressing incentives for sales of products that are not 'fit for purpose'. For example, a better way of addressing this issue could be to introduce standardised sales incentives across all product offerings (regardless of who the product supplier is) which provide sufficient motivation without being directly connected to the product being sold. This would ensure consumers are helped to select a product that best suits their needs while still rewarding the effort expended in achieving the sale.
- 27** Its important financial advisers are fairly remunerated for their work and are encouraged to remain in the industry to ensure independent financial advice remains accessible to New Zealanders. Therefore, we don't support banning commissions or reducing them to a level which does not support a viable financial advice sector. But action is required to ensure the life insurance industry is efficient, sustainable and every New Zealander has access to affordable life insurance.
- 28** To this end, we recommend that proper consultation is undertaken on incentives and commissions to ensure the Bill clearly addresses the issues raised by government, the regulators and the IMF. The outcome of this must be to increase both consumer trust and the sustainability of the industry.

Reduced availability of independent advice for consumers

- 29** Access to independent financial advice is vital for consumers to make informed decisions about suitable insurance protection for their individual circumstances. We want to ensure that regulation does not discourage the role of independent financial advisers or reduce the independence of their advice, both of which would not be in consumers' best interests.
- 30** We want to ensure there's no compliance burden on financial advisers having to comply with multiple fair conduct programmes. This would increase compliance costs which will ultimately be borne by consumers. This could also result in financial advisers limiting the products they provide advice on, becoming tied agents of one product provider or leaving the industry all together.

The broad nature of the regulation making power creates uncertainty for the industry and consumers

- 31** The Bill in its current form includes a broad regulation-making power across numerous provisions without any high-level principles or constraints. We're concerned this will create uncertainty for the industry and consumers and limit our ability to undertake future strategic planning.

- 32 We recommend further clarity is provided as to the nature and scope of the regulation-making powers referred to in the Bill, including ensuring that proper consultation is undertaken with those affected by the proposed regulations.

Other concerns with the Bill

Additional licensing regime

- 33 The Bill introduces additional licensing obligations for financial institutions such as insurers who are already subject to licensing and prudential supervision by the RBNZ, conduct supervision being introduced through the FSLAA, registration on the Financial Service Providers Register and consumer dispute resolution through dispute resolution scheme membership.
- 34 Rather than introducing a new licence, conduct obligations should be aligned or combined with existing licences to streamline the licensing process, provide consistency between new and current obligations and prevent duplication. Fidelity Life does not believe an additional licence is necessary and considers that the objectives of conduct licensing can be achieved by adding to existing licensing regimes.
- 35 Increased compliance costs arising from an additional licensing regime will be ultimately borne by consumers. These costs need to be kept to a minimum if the legislation is to achieve its purpose of protecting consumers and to promote confident and informed participation in financial markets.

Publication of fair conduct programme

- 36 Fidelity Life is concerned the requirement to publish our fair conduct programme and provide a copy of it to customers may lead to further confusion for customers due to the lengthy and complex nature of the document. It would also require the disclosure of confidential material and intellectual property to our competitors.
- 37 We're committed to building consumer trust in the life insurance industry through increased transparency and better communications, the need for which is supported by our brand research. However, we're concerned consumers will feel overwhelmed by the complexity and length of the fair conduct programme if we are required to provide it to them in full. In particular, we're concerned some of the content required to be included, such as how the financial institution does its solvency return, is overly technical and of little relevance to consumers.
- 38 If this obligation remains, we suggest this could be resolved by requiring financial institutions to maintain two versions of the fair conduct programme - one being an in-depth comprehensive plan setting out all aspects of the business which is provided confidentially to the regulator on request. The other being a simplified plain English version provided in a regulator-approved template designed specifically for consumers.

Carve out for Financial Advice Providers

- 39 The Bill requires both a financial institution and its intermediaries to comply with the financial institution's fair conduct programme.

- 40 There is a specific 'carve out' in the Bill from this requirement for intermediaries who are licensed financial advice providers (**FAPs**). This makes sense given they'll have their own conduct obligations under FMCA. However, the carve out does not extend to the financial advisers who are engaged by the FAPs to provide advice on financial products on their behalf.
- 41 In our view this potentially creates an anomaly which means that, although a FAP does not have to comply with a financial institution's fair conduct programme, its financial advisers do. It also means financial advisers may need to comply with multiple fair conduct programmes which is problematic for the advisers and confusing for consumers.
- 42 It's not clear to us how financial institutions such as insurers will ensure compliance by financial advisers where they have no direct control over them as they are engaged by the FAP.
- 43 In our view there needs to be a consistent message to consumers on who is responsible for good customer outcomes and fair conduct. With this anomaly there is scope for consumers to get tangled in a 'responsibility loop' between the financial institution and the FAP.
- 44 Fidelity Life is concerned there may also be confusion among financial advisers about which fair conduct programme they are required to follow in circumstances where they're advising on products provided by more than one financial institution. Such confusion will inevitably lead to poor outcomes for consumers.
- 45 In our view the carve out that applies to FAPs should be extended to financial advisers engaged by that FAP. It should also make it clear that financial advisers are governed by the FAP's good conduct obligations and responsible to the FAP for compliance with them.

Impact on product design

- 46 Finally, Fidelity Life is concerned that regulations made under the Bill could remove our ability to design products in innovative ways that improve outcomes for consumers and encourage them to insure themselves properly.
- 47 We support the introduction of general principles that guide product design, however these should not be so prescriptive as to remove the ability of insurers to be innovative in creating new product offerings. Further clarity is needed on which elements of product design will be included.
- 48 We firmly believe it's in the best interests of consumers to keep our products simple, accessible and easy to understand. There's also a need to be as transparent with consumers as possible. In our view any obligations in the Bill that might decrease transparency and simplicity for consumers are to be discouraged.
- 49 Consideration also needs to be given to any proposed changes to insurance contract law currently being reviewed to ensure there is no duplication or inconsistencies.

Conclusion

- 50** We thank you again for the opportunity to submit on the Bill. We would also like the opportunity to present our submission in person to the select committee. If you have any questions, please contact me.

Yours sincerely,

A handwritten signature in cursive script, appearing to read 'N. Tereora', written in grey ink.**Nadine Tereora**

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