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Committee Secretariat
Finance and Expenditure Committee
Parliament Buildings
Wellington
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Submission on Financial Markets (Conduct of Institutions) Amendment Bill (Bill)

To the Finance and Expenditure Committee,

This submission is from Rebecca Sellers, Chief Conduct Officer of Partners Life, 33-45 Hurstmere Road, Takapuna, Auckland 0622.

I wish to appear before the committee to speak to our submission.

I can be contacted at 021 771 537 or rebeccasellers@partnerslife.co.nz.

Submission

Partners Life supports the intent of this Bill "to ensure that conduct and culture in the financial sector is promoting good outcomes for customers."[1]

Partners Life is a leading life and health insurer. Our aim is to protect families and businesses and care for individuals when their lives are negatively affected by ill-health or death. Our products are mainly distributed by independent financial advisers because we believe that independent financial advice provides customers with the best outcomes.

Partners Life strongly supports the development of a sound regime to regulate financial services. Improving standards across the industry will increase consumer confidence and play a part in ameliorating New Zealand's underinsurance problem.

We are in partnership with our customers for the future. We believe that customers deserve best practice regulation, tailored to the New Zealand market. We are proud of the support we provide to New Zealanders.

Opening comments from Partners Life

- Customers should be treated fairly by everyone involved in the provision of financial products and services – the scope of entities caught by the regime should be widened.
- Where customers are not protected by financial advice, they need additional protection.
- Disclosing the fair conduct programme to customers is not appropriate.
- The definition of "incentives" is too wide and may prevent adequate training and support of intermediaries. Decisions about regulation of incentives should be made by Parliament and not delegated to regulation.

[1] Regulatory Impact Statement: Regulatory regime to govern the conduct of financial institutions – December 2019, page 24

- More haste less speed - the Ministry of Business, Innovation and Employment (MBIE) stated that their analysis has been prepared "under significant time constraints".[2] This legislation should be fit for the future and avoid unintended consequences that negatively impact customers or the sustainability of the insurance market.

Customers deserve good outcomes now – Clause 2 of the Bill and Schedule 4 clause 92[3]

MBIE identified that some life insurers are making positive changes. An example of this is that Partners Life has changed the way commission is paid. Partners Life does not use volume or value incentives and has restructured bonus commission to incentivise good customer outcomes.

MBIE noted that "*we have seen an example of a life insurer reassuring its advisers that they do not need to be concerned about changes to either commissions or adviser agreements in the next 12 months unless required by law or regulation.*"[4]

We are concerned that the commencement period for this legislation is long and uncertain. If no action is to be taken in the intervening period, insurers who have responded positively to concerns raised by the Financial Markets Authority (FMA) and the Reserve Bank (RBNZ),[5] risk being left at a disadvantage.

The Courts have a role to play in establishing whether the behaviour identified by MBIE amounts to a contravention of the fair dealing provisions of Part 2 of the Financial Markets Conduct Act 2013 (FMCA). The scope of current legislation should be properly considered by the Courts. An example of recent developments by the Courts include the decision in Young v TOWER in which Gendall J held that a contractual duty of good faith is implied into every insurance contract and is a duty that flows both ways. This duty requires an insurer to process a claim in a reasonable time, taking into account the time required to investigate and assess all aspects of the claim.[6] This case illustrates that the Courts will step in to protect customers. Considering uncertainty as to the timing of implementation of this Bill, the Courts should be given an opportunity to consider the scope of Part 2, FMCA.

Properly resourced regulator - Clause 3 of the Bill

Partners Life supports the FMA as the appropriate regulator to enforce a conduct regime and agrees that conduct licensing best sits within the FMCA. Partners Life has submitted that the FMA should be provided with enhanced funding to enable the FMA to provide much needed guidance to the market on conduct and the new financial advice regime. This would in turn reduce regulatory burden on industry, which would benefit customers.[7] However, we are concerned that the funding recently sought by the FMA does not include implementation of this Bill.

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[2] Regulatory Impact Statement: Regulatory regime to govern the conduct of financial institutions – December 2019, page 5

[3] Unless otherwise stated, references in this submission are to the proposed sections of the Financial Markets Conduct Act 2013 as it would be amended by the Bill in its current form.

[4] Regulatory Impact Statement: Regulatory regime to govern the conduct of financial institutions – December 2019 , page 8

[5] Conduct and Culture Review, see for example – Life Insurer Conduct and Culture Report 2019 at https://www.fma.govt.nz/news-and-resources/reports-and-papers/life-insurer-conduct-and-culture/

[6] Young v Tower Insurance Limited [2016] NZHC 2956

[7] Partners Life Submission on Review of Financial Markets Authority Funding and Levy, 21 February 2020.

Overlapping regulatory regimes – sections 403(e), 446E, 446F, 446L and 446M

We acknowledge that the FMA is currently faced with resourcing pressure. We are concerned that implementing a new conduct regime in addition to the new regime for financial advice exposes industry, the regulator and customers to unnecessary levels of risk.

Further, there is a risk of significant overlap between the Bill and the new financial advice regime[8] and the drafting in the Bill that attempts to distinguish the two regimes is not sufficiently clear. Partners Life submits that the mechanics of the exclusion for financial advice be reconsidered to ensure that this Bill does not impose multiple layers of regulation and cost on financial advisers. The impact of that could be to limit access to advice, which would be a poor outcome for New Zealanders.

At the date of writing, significant aspects of the new financial advice regime are yet to be released (particularly the disclosure regulations and full licensing requirements). We note the guidance of the International Association of Insurance Supervisors Insurance Core Principles (IAIS ICPs) which provide that

> *"Supervisors should be aware of the conduct of business requirements set by the regulators of other financial services sectors with a view to minimising unnecessary inconsistencies, possible duplication and the potential for regulatory arbitrage."*

Scope of the proposed regime – Section 388, 446D and 446F

Partners Life is concerned that the current scope of the Bill:

- Does not adequately ameliorate the risk to customers who are sold financial products without financial advice. Independent financial advisers provide additional protections to customers. This is because only licensed banks and insurers are caught by the proposed scope of the Bill.
- Does not produce a level playing field. For example, a customer would have the protection provided by the Bill if they acquire a KiwiSaver product from a Bank, but not if they acquire a KiwiSaver product from a fund manager.
- Exposes the New Zealand financial markets to the risk of regulatory arbitrage. This risk is exacerbated by increasing globalization, use of artificial intelligence and disruption in the financial services industry which leaves incumbent participants at a disadvantage.
- Imposes significant cost and inefficiencies on market participants who may already hold one or more of the licenses listed in section 388 of the FMCA.

Partners Life submits that that any provider of a financial service[9] to a retail customer should be required to meet best practice conduct standards and be licensed. We propose alternatives to the current scope on page 5, following the section which details our concerns about the Bill's approach to intermediaries.

[8] Financial Services Legislation Amendment Act 2019
[9] As defined in the Financial Service Providers (Registration and Dispute Resolution) Act 2008

Intermediaries

Financial advisers

Partners Life strongly supports the new financial advice regime.[10] Financial advisers should not be caught or impacted by the proposals in the Bill. We are concerned that the drafting of the Bill could capture financial advisers or licensed financial advice providers. For that reason, further reference to "intermediaries" in this submission does not include financial advisers.

Intermediaries

Partners Life strongly supports additional scrutiny being applied to financial products or services that are sold without financial advice. Independent financial advisers provide additional protections to customers. When customers are sold products without financial advice, the customers should benefit from additional protection.

Under the Bill, intermediaries are not licensed but are required to comply with a licensee's fair conduct programme. Partners Life submits that customers should be treated fairly by any party involved in the design, offer, distribution or communication about a financial product or service. However, we have practical and conceptual concerns about the regime set out in the Bill.

Practical concerns

- The definition of "intermediaries" is very wide. As consideration can be paid indirectly (s446E(1)(c)) there will be circumstances in which financial institutions will not be aware who is acting as an "intermediary" for a product or service, yet that institution will be responsible for the actions of the intermediary (s446K).
- Intermediaries will represent multiple financial institutions. There would be significant challenges and costs in ensuring that an intermediary complies with multiple fair conduct programmes.
- It will not be clear which activities are being carried out by an intermediary for which institution. This will impose a high regulatory burden on intermediaries and financial institutions.
- Action by customers or the supervisor will be compromised by the complexity of the evidence, disclaimers and other contractual arrangements between intermediaries and financial institutions.

Conceptual concerns

Our consideration turned to international best practice to identify how intermediaries should be regulated. The IAIS ICPs proposes that all intermediaries should be licensed:

> *"19.4.1 The supervisor should require insurers to conduct business only with intermediaries that are licensed."*

The IAIS ICPs further provide that intermediaries play a key role and should share responsibility for good customer outcomes:

> *"19.0.8 The insurer has a responsibility for good conduct throughout the insurance life-cycle, as it is the insurer that is the ultimate risk carrier. However, where more than one party is involved in the design, marketing, distribution and policy servicing of insurance products, the*

[10] Financial Services Legislation Amendment Act 2019

> *good conduct in respect of the relevant service(s) is **a shared responsibility of those involved**.*
>
> *19.0.9 Intermediaries typically play a significant role in insurance distribution but may also be involved in other areas. Their interface between customers and insurers gives them **a key role, and their good conduct in performing the services in which they are involved is critical in building and justifying public trust and confidence in the insurance sector**."*

Accordingly, Partners Life submits that all intermediaries should be directly regulated by the new fair conduct regime and required to obtain a licence.

Outsourcing arrangements

The exception for this is if a financial institution directly outsources an activity to a third party. We note that the IAIS ICPs provide

> *19.0.10 Insurers sometimes outsource specific processes, such as claims handling, to third parties (including intermediaries). Where an insurer outsources processes, the insurer should only deal with third parties whose policies, procedures and processes are expected to result in fair treatment of customers; the insurer retains ultimately responsibility for those functions.*

We note that in the UK, firms do not need to be authorised by the UK regulators if they are appointed as an appointed representative of an Financial Conduct Authority authorised insurance intermediary which takes responsibility for its conduct of regulatory activities.[11] Similarly, in Australia, intermediaries who provide a financial service must either be an Australian financial service licensee (AFSL) or be an Authorised Representative of an AFSL.[12]

These overseas regimes impose clarity on who is responsible for the actions of the intermediaries. Clarity of responsibility would lead to clarity of enforcement and a reduction in the costs associated with an opaque regulatory regime.

Scope of the regime - Alternatives

Partners Life's preferred position is that that any provider of a financial service to a retail customer should be required to meet best practice conduct standards and be licensed. However, we acknowledge that this is not consistent with Cabinet decisions and for that reason suggest the following two alternatives which could deliver the outcome sought, while avoiding some of the concerns expressed on page 3.

Alternative 1 - Customers should be protected regardless of who they engage with

We are concerned that limiting the scope of the regime to only licensing banks and insurers is not fit for purpose. Any entity that provides or is an intermediary in providing financial products or services should be licensed.

Partners Life acknowledges the Cabinet decision to start licensing with banking and insurance. We recommend that to prevent regulatory arbitrage, the requirement to license is qualified by reference to the product or service rather than the institution. Accordingly, section 33 which sets out when a provider of a market service needs to be licensed should be amended to include a new s388(ca)

[11] See section 39 UK Financial Services and Markets Act 2000
[12] Or be otherwise exempt for having to hold a licence.

section 388(ca) "acting as a provider or an intermediary of a banking or insurance product".

Alternative 2 – Immediately impose a requirement to treat customers fairly

To respond to the Government's desire to put legislation in to place quickly, we propose an alternative that Part 2 FMCA be amended to include a modified fair conduct principle. This alternative avoids the risk of regulatory arbitrage and unintended consequences. Consideration should be given to a new section 19A:

"*Fair conduct principle*

19A Fair conduct principle

(1) A person in trade must treat customers fairly, including by paying due regard to their interests, in relation to:
   a. any dealing in financial products; or
   b. the supply or possible supply of a financial service or the promotion by any means of the supply or use of financial services."

The requirement could be supported by guidance issued by the FMA and enforceable industry codes, such as the Financial Services Council Code of Conduct.

Section 446H Duty to make fair conduct programme available

Partners Life supports the proposal that licensed entities be required to have a fair conduct programme.

We do not endorse the proposal that the fair conduct programme be available to the public. Our view is that this proposal would have no advantage to customers but would impose significant costs on licensed entities (which would be passed on to customers).

Professor Pamela Hanrahan highlighted concerns about the effectiveness of disclosure to customers in her Background paper to the Australian Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industries [13] including:

- "Recent work in the field of behavioural economics supports the long-held intuition of many that mandatory disclosure is not particularly effective, at least outside its original securities law context where the purpose is to inform the market to ensure that all relevant information is captured in the price of securities in the secondary markets, rather than to support consumer choice."[14]
- "the sufficiency of disclosure can depend on the sophistication and intelligence of the persons to whom disclosure must be made."[15]
- "Mandatory disclosure may suggest to clients that the government is looking after their interests, making them less vigilant. These factors may have contributed to the observation in the Murray FSI Interim Report that 'although disclosure can be an effective regulatory

[13] "Legal Framework for the Provision of Financial Advice and Sale of Financial Products to Australian Households", Background paper 7, prepared for the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industries, Professor Pamela Hanrahan, Sydney, April 2018

[14] Ibid, page 83

[15] Ibid, page 106 from Farah Constructions Pty Ltd v Say-Dee Pty Ltd (2007) 230 CLR 89 at 138–139 [107]

tool, it is currently applied in many instances where it may not be the best tool to overcome a particular market problem." [16]

The IAIS proposes as more limited approach to disclosure in the context of conduct of business:

> *"19.2.5 Insurers' and intermediaries' strategies, policies and procedures dealing with the fair treatment of customers should be made available to the supervisor. The supervisor should encourage insurers and intermediaries to make relevant policies and procedures publicly available as good practice, in particular their claims handling, complaints handling and dispute resolution policies and procedures."*

Partners Life submits that the IAIS ICPs provide a workable solution. We propose that the Bill be amended to provide that claims handling, complaints handing, and dispute resolution policies and procedure are disclosed to the public. The FMA may choose to encourage licensed entities to disclosure additional information about fair treatment of customers, but this should not be included in the Bill.

Regulation of incentives – sections 446P,446N, 446P 546(1)(d)(v) and Schedule 4 (clause 94)

Incentives are too important to delegate to regulation

The Cabinet Manual[17] states that:

> *"Regulations usually deal with matters of detail or implementation, matters of a technical nature, or matters likely to require frequent alteration or updating…. Regulations should not, in general, deal with matters of substantive policy.."*

Partners Life submits that the law concerning incentives should be considered by the full House of Representatives, not delegated to regulation, because of the significant impact restricting incentives could have on the lives of so many New Zealanders. Partners Life has previously provided officials with research papers.[18]

The research papers concluded that headline commission rates do not reflect the profits earned by financial advisers. Recent experiences from other markets such as Australia, the United Kingdom, South Africa and the Netherlands have shown that the alternative to commission (a fee-for-service model) is associated with:

- reduced affordability of advice;
- reduced access to advice;
- financial advisers leaving the industry; and
- lower levels of insurance and higher insurance premiums.

Incentives play an important part in the livelihood of many small New Zealand businesses and regulation of incentives is a matter of substantive policy that should not be delegated to regulation.

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[16] Ibid, page 108-109
[17] https://dpmc.govt.nz/our-business-units/cabinet-office/supporting-work-cabinet/cabinet-manual
[18] These research papers were prepared in June and May 2019 respectively and were disclosed to officials with Partners Life submission on the Conduct of Financial Institutions Options Paper. They contain confidential information and should not be disclosed.

Clarify the wording of s546(1)(d)(v)

Partners Life notes that Cabinet decided not to ban commission, but to regulate sales incentives based on volume or value targets.[19] The wording of the Bill needs to be amended to clarify that the intention is not to ban incentives. As currently worded, s546(1)(d)(v) could be interpreted as providing a power to make regulations "that prohibit..the offer or giving of incentives".

Further consultation is required on the definition of "incentive"

Partners Life submits that insufficient consideration and consultation has been undertaken on the definition of "incentive" (s446P). The definition of "incentive" is too wide and will catch activities that should not be regulated. This will result in additional costs to customers and the risk that activities that are beneficial to customers will be restricted (for example training of financial advisers and intermediaries).

Partners Life is particularly concerned with the drafting of clause 94 of Schedule 1 which provides that incentive regulation may apply to existing agreements. This provision is not sufficiently clear (for example what it means to be "entitled" to an incentive). This may be because of the rushed nature of the preparation of this Bill. Further consultation with industry and the public is required to ensure that any regulation of incentives is fair, effective and does not amount to retrospective legislation.

Effective efficiency and more haste less speed

Finally, we would like to comment on ensuring effective efficiency in our regulatory regime. Regulation is often described as "red tape". Our view is that regulators provide an invaluable role in ensuring stability and confidence in the financial markets. It is for this reason that Partners Life submitted for enhanced funding for the FMA. However, there are opportunities for increasing efficiencies.

We note that the Final Report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry called for the law to be simplified so that its intent is met. We are concerned that multiple overlapping licence requirements impose costs on the regulated population and the regulator and, by the nature of their structure, increase risk to customers.

MBIE has advised that this Bill will result in "a high increase in administration, monitoring and enforcement costs" for the FMA and "moderate-to-high increase in compliance costs for regulated entities".[20] MBIE also stated that their analysis has been prepared "under significant time constraints".[21] Partners Life believes that there is an opportunity to introduce efficiencies in the licensing of financial institutions.

Developing conduct regulation in a timely and measured way would provide the opportunity to increase efficiency and cut through the "red tape" for the licensed population and increase efficiencies for regulators. This may be achieved by combining all financial institutions licences within one licence with different components, to avoid duplication. For example, once an entity obtains a licence, it is not necessary to conduct the due diligence process again. Instead, a new

[19] Minute of a decision 25 September 2019
[20] Regulatory Impact Statement: Regulatory regime to govern the conduct of financial institutions – December 2019, page 1-2
[21] Regulatory Impact Statement: Regulatory regime to govern the conduct of financial institutions – December 2019, page 5

aspect/category of licence can be added to the overall licence of that entity by demonstrating capability in the relevant field. We envisage this overall license would be a Financial Services License, containing authorised functions.