

Conduct of Financial Institutions options paper

Fidelity Life's submission

7 June 2019

Introduction

Fidelity Life is the largest Kiwi-owned and operated life insurer and the ANZIIF 2017 and 2018 New Zealand Life Insurance Company of the Year. We support more than 300,000 customers and their families and in 2018 we paid out \$106.9 million in claims.

We distribute our products through a network of 2,700 independent financial advisers, as well as through strategic alliance partners, and employ around 250 staff nationwide.

At Fidelity Life we take conduct and culture seriously. We want consumers to have confidence and trust in our industry so that more Kiwis can get the benefits of independent advice and insurance protection. We encourage all our staff to behave in a way that seeks to achieve good customer outcomes.

The life insurance industry is facing significant regulatory, technology and consumer change. Overall, we support the review of conduct of financial institutions and note that the output of the review should be quality and well considered regulation that provides long term certainty and ensures fair, efficient and transparent outcomes for both the industry and consumers. The review should balance industry and consumer expectations, with the goal of having a profitable, sustainable insurance sector that delivers for New Zealanders in their times of need.

The insurance sector is already subject to prudential regulation, by the Reserve Bank of New Zealand. It is our view, any conduct regulator needs to have a sound understanding of insurance principles, the insurance industry and the unique characteristics of insurance. As noted, the industry is also facing technological change, and as such, any conduct regulator will need to foster innovation, balance the risks of innovation and have adequate understanding of innovations going forward¹. Any regime needs to be future proofed for the impact of technological changes.

It is paramount that any law changes are considered holistically for the whole financial services industry to ensure that there are no unintended consequences for the sector and for consumers. It is our view that before any changes are made, a full assessment of the current toolkit of conduct regulation must be undertaken for the whole of the financial services industry.

We believe access to independent financial advice is important because it enables consumers to make informed decisions about suitable insurance protection. Alongside New Zealand's network of independent financial advisers, we're committed to reducing under-insurance while protecting our customers.

Advisers play a vital role in ensuring good customer outcomes. They look after customers for many years, ensuring they have adequate insurance protection as their circumstances change over time, helping them at claims time, and improving financial literacy.

We welcome MBIE's assessment of each individual option against the high-level outcomes criteria. This will ensure consistency across the objectives and proposed options to address conduct gaps, including consideration of the Treasury's principles for best practice regulation.

¹ International Association of Insurance Supervisors, FinTech Developments in the Insurance Industry, 21 February 2017. Page 8

Fidelity Life is committed to a model where customers' interests come first. We're here for the long term and focussed on a sustainable and successful future, with the customer at the centre of everything we do.

Response to questions asked

Options for overarching duties

Question 1

Which overarching duties should and should not be included in the regime? Are there other duties that should be considered?

We support the general approach to have a principles-based set of duties to apply to all aspects of a financial institutions' activities. It provides flexibility in how financial institutions deliver the outcomes required. It is important that there is consistency between this set of duties and other existing duties and Codes of Conduct across relevant pieces of legislation and regulation.

Regarding the overarching duties we generally support the following options:

- Option 2 - 'a duty to act with due care, skill and diligence';
- Option 3 - 'a duty to pay due regard to the information needs of customers and to communicate in a way which is clear and timely'; and
- Option 6 - 'a duty to ensure complaints handling is fair, timely and transparent.'

Regarding Option 1, we believe that this creates unnecessary complexity in the insurance sector. Our view is that good conduct is about doing the right thing by all stakeholders including customers, employees, shareholders and the public and ensuring good customer outcomes.

At Fidelity Life, we're in the business of paying claims and we must do this in a way that balances the interests of all policyholders. In providing life insurance, fair treatment is about ensuring consumers are accurately assessed for the risk they pose. We want to ensure that everyone is paying premiums based on their level of risk. In doing so, we try to balance the risk, making it fairer for all our customers. We propose 'a duty to treat customer's fairly' is a more appropriate duty. This is also consistent with international best practice, IAIS Insurance Core Principles (ICP 19), and the Financial Services Council (FSC) Code of Conduct.

The impact of Option 4 needs to be considered in line with the Insurance Prudential Supervision Act 2010 (IPSA) to avoid duplication of requirements. In addition, consideration must be given to any consequences that impact on legacy systems. The focus should be on having processes and controls in place that support good conduct and address poor conduct.

Consumers should be fairly treated during the product lifecycle. This means that as manufacturers, insurance companies should design suitable products, manage conflicts of interest appropriately and underwrite risk and handle claims and complaints fairly.

Consumers must be able to access independent financial advice. Considering this, we also suggest the specific duties could be captured under the overarching duties, if they are designed appropriately and are consistent with ICP 19.

Question 2

Do you think the overarching duty for managing conflicts of interest should be general (as it is currently worded) or focus on conflicts of interest that arise through remuneration?

Life insurance is often distributed through financial advisers and we recognise that conflicts of interest may exist in all distribution channels. We support a general duty, however, the need for such a duty should be reviewed once all other duties are determined. This will help avoid overlap with the new financial advice regime and its disclosure requirements which are yet to be finalised.

If Option 5 is to apply generally, it needs to align with current prudential regulatory licensing obligations.

Question 3

Is a code of practice required to provide greater certainty about what each overarching duty means in practice?

A Code of Practice or guidance is useful to set expectations for all participants about what each overarching duty means in practice. There are currently industry body Codes of Conduct (such as the FSC Code of Conduct) which should be leveraged if code development is needed. In addition, if there is any development of a Code of Practice, industry should be consulted.

Options to improve product design

Question 4

Which options for improving product design do you prefer and why?

We do not support Options 1 and 2, giving the regulator powers to ban or stop the sale of certain products. Firstly, this would be a difficult provision to apply across insurance products, with a wide variety of names, policy wordings, and acceptance criteria.

Further, the Life Insurer Conduct and Culture Report, January 2019 recognised that poor value products may be suitable for some customers in a limited range of cases. A ban could limit access to insurance for some people.

There are other ways to manage poor outcomes from such products. These include enhanced disclosure (risks, issues and limitations), training to improve transparency and ensure product suitability, and having strong processes and controls in place for ensuring the products are sold to the intended audience who have a need for such products.

Giving the regulator a power to ban or stop the distribution of certain products could also result in negative outcomes for some customers. While we do not support a regulator having this power, in any case, any provision should not apply retrospectively.

We support the general requirement for manufacturers to identify the intended audience for products under Option 3. Understanding of different distribution models is fundamental to this duty. We agree with the IAIS view that the insurer has a responsibility for good conduct throughout the insurance lifecycle and, where there is more than one party involved in the distribution of products, good conduct in relation to distribution is a shared responsibility of the insurer and the intermediary.

It is our view that the focus of this duty should be on manufacturers communicating and providing accurate information (including the intended audience for products) about their products to financial advisers who then have a responsibility to ensure product suitability. Financial advisers have a valuable and much needed role to play in ensuring consumers understand insurance, how it works and suitability.

Improving the financial education of New Zealanders to ensure that they understand the importance of being adequately protected in times of need is important.

Consideration of whether these specific duties could be captured under the overarching duties, and if they are designed appropriately and are consistent with ICP 19, is required.

Question 5

If a design and distribution requirement like option 3 were chosen, are there particular products for which this is more necessary than others? If so, please explain what and why.

No comment.

Options to improve product distribution

Question 6

Which options to improve product distribution do you prefer and why?

We comment on the options preferred by MBIE. We support Option 1, 'a duty to design remuneration and incentives in a manner that is likely to promote good customer outcomes'. Insurance is often distributed through financial advisers. We recognise that conflicts of interest may exist in all distribution channels and agree that remuneration structures need to be designed with customer interests in mind.

We generally support Option 5, 'a duty on manufacturers to take reasonable steps to ensure the sale of its products are likely to lead to good customer outcomes'. As noted, we distribute our insurance products through financial advisers who are independent of Fidelity Life and recommend products based on customer needs.

As such, we agree with IAIS view that while the insurer has a responsibility for good conduct throughout the insurance lifecycle, where there is more than one party involved in distribution of products, good conduct in relation to distribution is a shared responsibility of the insurer and the intermediary.

It needs to be clear what oversight means at a practical level to ensure that such a duty is not overly burdensome or imposes undue compliance costs on manufacturers. It is our view that the role of the financial adviser is to ensure individual customer needs are considered, including suitability.

Consideration of whether these duties could be captured under the overarching duties, and if they are designed appropriately and are consistent with ICP 19, is required.

Question 7

To assist us in comparing the pros and cons of various options, please provide information about remuneration and commission structures currently in use.

No comment.

Options relating specifically to insurance claims

Question 8

What is your feedback on imposing a duty to ensure claims handling is fair, timely and transparent?

We support Option 1, MBIE's preferred option. At Fidelity Life, we're in the business of paying claims. We want fair outcomes for our customers in their time of need. Not paying

claims leads to a lack of consumer confidence and ultimately to negative commercial outcomes for our business. We have claims management frameworks in place to ensure claims are managed fairly and transparently.

Premiums are set based on the expectation that only claims that meet policy terms and conditions of cover will be paid. Prudential management requires us to not pay claims that do not meet these terms and conditions, so over the long-term funds are available to pay claims that do.

For circumstances outside the specified terms and conditions of cover, our reinsurance arrangements restrict our ability to pay claims. We also have an internal complaints process in place which can in turn be escalated through to our external Dispute Resolution Scheme (IFSO), allowing customers the opportunity to have any decision reviewed.

Consideration of whether these specific duties could be captured under the overarching duties, and if they are designed appropriately and are consistent with ICP 19, is required.

Question 9

If a duty to ensure claims handling is fair, timely and transparent were to be adopted, should an attempt be made to clarify what fair, timely and transparent mean?

It should be left to the industry to define how claims are handled. We note section 41A of the Life Insurance Act 1908 incentivises life insurers to pay claims within 90 days. The complexity of some products means some claims are subject to ongoing review, for example income protection claims.

Question 10

What is your feedback on requiring the settlement of claims within a set time?

We do not support Option 2 and note it does not form part of MBIE's preferred package. It does not align with the principles-based set of duties approach that provides some degree of flexibility.

Options for tools to ensure compliance.

Question 11

Do you agree with the option to empower and resource the FMA to monitor and enforce compliance?

If the FMA has the power and resources to monitor and enforce compliance, then consideration should be given to the International Monetary Fund's recommendation that the FMA should review its requirements for increased insurance-specific expertise and overall insurance resources.² Further consultation on the impact on fees and levies would be required.

While empowering the FMA provides a clear divide between conduct and prudential regulation, here in New Zealand, consideration should be given to international best practise, for example in the UK, where a separate Conduct Authority monitors and enforces compliance.

Question 12

² International Monetary Fund, New Zealand Financial System Stability Assessment, April 10, 2017, page 88

What is your feedback on the option to require banks and insurers to obtain a conduct licence?

Before there is consideration of any licensing requirements there must be a review of all existing licensing obligations and requirements across all regimes, including prudential licensing (IPSA) and conduct regulation (Financial Markets Conduct Act (FMCA)). This will avoid duplication of obligations. We support a consistent licensing regime for the whole of the financial service industry.

Question 13

What is your feedback on the option which discusses a broad range of regulatory tools?

We support regulatory tools that are: consistent with current FMCA powers that the FMA already has for some participants; and aligned with penalties for comparable offences under other legislation.

Question 14

Do you think that the maximum pecuniary penalties available for breaches of any conduct duties should be the same as the existing FMC Act penalties?

Any penalty regime should be proportionate to the seriousness of the breach.

Question 15

What is your feedback on the option of executive accountability?

We do not support an executive accountability regime and believe there is limited justification for one.

Question 16

What is your feedback on the whistleblowing option?

We support the concept of whistleblowing. However, any whistleblowing options needs to ensure alignment with current prudential regulatory licensing obligations. This option could be dealt with under the overarching duties such as having processes and controls in place that support good conduct and address poor conduct.

Consideration also needs to be given to any proposed changes to the Protected Disclosures Act 2000 currently being reviewed.

Question 17

What is your feedback on the option of regular reporting on the industry?

Regular reporting should be appropriate, beneficial for consumers, and not apply undue compliance costs on the industry and the regime. Further understanding and consultation with industry as to what reporting may look like is required. It is important that the industry and regulators work together to provide appropriate information to consumers.

Consideration should be given to whether industry bodies and other independent industry bodies such as Dispute Resolution Schemes are best placed to provide regular reporting on the industry.

Question 18

What is your feedback on the role of industry bodies?

At Fidelity Life, we take conduct and culture seriously. Alongside our industry peers we've worked collaboratively with the FSC to define its Code of Conduct and set consistent standards to promote good customer outcomes.

To ensure we achieve the right outcomes we want to ensure adequate thought and consideration is given to the important role industry bodies play. Any conduct regime should be able to align to and work in collaboration with current industry codes.

Who should the conduct regulation apply to?

Question 19

What is your feedback on the options regarding who the conduct regime should apply to?

The high-level objective of this conduct review is to ensure that conduct and culture in the financial services industry is delivering good outcomes for all customers. To maintain standards across the industry, the conduct regime should apply to all comparable activity. Consideration should also be given to other market participants who have a consumer impact, including the role that independent rating houses play in influencing the industry and how products are sold to consumers.

Life insurers are not regulated by one industry regulator and there is a network of regulation that controls every aspect of an insurers business. For example, life insurers are regulated:

- As a licenced insurer by the Reserve Bank of New Zealand;
- By the Commerce Commission (for example, refer to the recent action taken against Youi for the mis-selling of insurance policies³);
- As a financial service provider by the Financial Markets Authority, particularly by Part 2 of the Financial Markets Conduct Act 2013;
- By Financial Markets Authority guidance including the Guide to Good Conduct;
- As a financial advice provider under FMCA when the regime takes effect.

We believe further consultation is required on the overlay of options onto existing legislation and/or regulation, including a full review of existing obligations to understand the overlap or duplication of requirements across all industry participants involved in a product lifecycle.

Duplication of any requirements causes confusion for the industry and consumers. Consideration should also be given to whether regulatory powers that already exist under the FMCA can be expanded upon.

We reiterate the importance of thoughtful consideration being given to the design of any changes to mitigate the risk of unintended consequences for the sector and for consumers.

Thank you for the opportunity to make this submission.

³ <http://www.comcom.govt.nz/the-commission/media-centre/media-releases/2016/youi-insurance-fined-320000-for-misleading-sales-techniques>