IAG New Zealand submission

to the

Ministry of Business, Innovation and Employment

on the

Options Paper Conduct of Financial Institutions

7 June 2019

Contents

1. Introduction

1.1 This submission is a response by IAG New Zealand Ltd (IAG, we) to the Ministry of Business, Innovation and Employment (MBIE) on the Options Paper: Conduct of Financial Institutions, April 2019 (Options Paper).

1.2 IAG is New Zealand's leading general insurer. We insure more than 1.8 million New Zealanders and protect over $650 Billion of commercial and domestic assets across New Zealand. We receive more than 650,000 claims a year and pay $1.365b in settling them. IAG brands include State, AMI, NZI, and we also underwrite the general insurance provided by some of New Zealand's leading financial institutions, including ASB, BNZ, Westpac and The Cooperative Bank.

1.3 We support the positions put forward in the submissions of the Insurance Council of New Zealand.

1.4 IAG's contact for matters relating to this submission are:

Bryce Davies, Executive Manager Corporate Relations
T: Privacy of natural persons
E: Privacy of natural persons

2. Summary of recommendations

2.1 For ease of reference, IAG sets out our recommendations in full in this section. More detail, including the reasoning and background to these recommendations, is provided under the applicable section headings below.

Overarching Duties

2.2 We recommend implementing the overarching duties, as set out in the Options Paper, provided that:

- the duty applies to the organisation as a whole;
- there is an absence of overlap or conflict with other similar duties;
- the duties are subject to a reasonableness test; and
- there is sufficient certainty in how they will be monitored and enforced.

2.3 To achieve further direction on how to comply with the duties, we recommend the FMA develops a code of practice, in consultation with the industry, and subject to the approval of the Minister.

Product Design

2.4 We recommend not pursuing options that would allow for banning of products.

2.5 We recommend developing a reasonable duty for the manufacturer to identify the intended audience for products and for distributors to have regard to that audience;

2.6 We recommend empowering the regulator to work with industry participants to identify any problems with products in the market and provide participants with an opportunity to modify their product, with regulatory intervention as a back-stop option.

Product Distribution

2.7 We recommend removing soft commissions and other sales incentives that may not achieve good customer outcomes but agree that a total ban on commissions would be counter-productive. We recommend against regulating the parameters of commissions.

2.8 We recommend implementing a duty on manufacturers to take reasonable steps to ensure the sales of its products are likely to lead to good customer outcomes. However, this duty should be clearly defined so as to prevent manufacturers being held directly accountable for the actions of distributors.

2.9 We recommend regulating the distributors directly, requiring them to inform the applicable manufacturer of the customer outcomes they have achieved.

Insurance Claims

2.10 We recommend against implementing specific (and additional) insurance duties. We instead support empowering the regulator to enquire into the conduct of insurers in their settlement of claims, if concerns are raised.

Ensuring Compliance

2.11 We recommend empowering the FMA to assist in enforcement. Any enforcement should consider a grace period to allow the regulator and industry time to develop a shared understanding of what compliance requires.

2.12 We recommend against introducing an entity licensing regime but are comfortable with the broad range of regulatory tools for enforcement, provided these are used in a proportionate and flexible way.

2.13 We recommend against implementing maximum penalties that align with those set out in the Financial Markets Conduct Act 2013 (FMC Act), and consider that penalties set out in the Credit Contracts and Consumer Finance Act 2003 (CCCFA) are a more appropriate benchmark.

2.14 We recommend against the introduction of executives being held personally accountable for ensuring the business complies with conduct duties.

2.15 We recommend introducing obligations on providers to implement whistleblowing procedures.

Application

2.16 We recommend that duties should be applied at the entity, rather than the product level, and should be applied only to insurers' retail customers. Care should be taken to ensure that parallel obligations are consistent.

3. Introduction and Context

3.1 Confident, fair, and efficient transactions between insurers and their customers are a key feature of a healthy insurance market. But we cannot achieve this in a bubble. Many vital factors influence if and how these outcomes occur. It is important that the review reflect this.

3.2 The review currently focuses on the interaction between consumers and insurers. But consumers and insurers are not the only actors to consider. And the outcomes from their interactions are not the only ones to consider. The review must take a wider perspective in deciding on reforms.

3.3 The review should also take care not to redesign the system for the exceptions, but for the normal day-to-day activity. The exceptions are important, and the system must accommodate them, but they should not gain a prominence in the design that is out of step with or out of proportion to their presence in the market.

3.4 In this section we set out some important context. We will reference elements of it throughout our submission.

Start with remembering what insurance is (and isn't)

3.5 Insurance is the way that we, as individuals or businesses, can swap the risk of suffering a large loss for the certainty of paying a small cost. It does this by sharing amongst the many the losses that come to the few. Often called 'pooling'.

3.6 To understand how insurance does this, its easiest to think of it as a pot of money with some rules of access attached. Everyone that wants to receive help from this 'pot', the insured, pays money in and those who suffer a loss get money paid out to them.

3.7 The insurer owns the pot and so makes its rules and looks after the money coming in and going out. These rules control what losses the pot will pay for and are set out in a document called a 'policy'. The insurer also has responsibilities as a custodian. It must make sure that there is always enough money in the pot and that anything paid out is within the rules.

3.8 The insureds also have responsibilities. They must accurately describe the risk to be insured, pay into the pot the amount asked, and then do their best to reduce what the pot needs to pay out. As the pot is there for everyone, these are responsibilities insureds have to the other insureds, not to the insurer.

3.9 If everyone meets their responsibilities, then the insureds continue to get money to pay for their losses and the insurer gets to take money out of the pot to cover its costs and keep a little for itself and its investors. If they don't meet their responsibilities the insured may have to pay more or receive less, and the insurer may not make any money.

3.10 From this we can see that insurance exists on two levels. One is commercial and individualistic. Insurers contracting with insureds to indemnify their financial loss by providing access to the 'pot'. The other is social and collective. Still a contract of sorts, but one in which the ideas of solidarity and responsibility prevail. Insurers and insureds doing the right thing for the benefit of all.

3.11 Consumers increasingly see insurance through the narrow commercial view. Some see it as a necessary burden to be meet with least effort and cost. Others, like buying a utility, an unthinking task. But many still see it through an emotional view, as a safety net and a promise to be there for them. Most consumers do not view it as a social contract with each other. This change is due to many factors. Changes in societal norms, social and economic outcomes, customer expectations, and insurance practices all contribute.

3.12 It is essential that the review doesn't just see insurance in a narrow commercial or transactional way. It must not lose sight of the social contract between insureds or, for example, fail to see that conduct is both how insurers treat the insured (and vice versa) and how the insureds treat each other. If it does, then we will lose something important. Where the insured once policed themselves, the insurer as custodian and keeper of the rules will take on a greater role with consequences for how the 'pot' works.

The role that insurance plays

3.13 Insurance certainly helps those who have suffered a loss by replacing the risk of ongoing hardship with the prospect of a swift and more certain recovery. Doing this brings wider benefits for the individual and, importantly, for the economy and society. How?

3.14 **Insurance promotes investment and trade** by unlocking capital and enabling confident investment in assets and commercial exchange. It mobilises precautionary savings into more productive pursuits, helps the flow of credit and protects trade, and brings depth and stability to capital markets.

3.15 **Insurance helps smooth financial shocks** by accelerating post-loss recovery, getting people and businesses back on their feet sooner. This reduces the call on the public purse via grants and demands on social programmes.

3.16 **Insurance improves risk management** by improving risk awareness and decision making by signalling, through underwriting and pricing, the presence and scale of risk faced. It also can encourage and incentivise societal preferences for behaviours and activities that reduce undesirable outcomes.

3.17 **Insurance fosters a sense of certainty** by meeting peoples' basic need for security, contributes to their overall feeling of wellbeing, offers independence, and enhances self-reliance.

3.18 **And insurance creates economic activity** by employing people and fostering the wide range of professions and trades needed by insurers to run their businesses and to settle customers' claims. As a profit-seeking and highly competitive industry, insurers also look to grow and become more efficient, which has positive knock on effects in other parts of the economy.

3.19 Why is this important to the review? Because insurance is not just about individual transactions. Insurance underpins our way of life and the wealth and wellbeing of the country.

The prerequisites for a healthy insurance market

3.20 Insurance only works, and customers and the country only get the benefit of insurance if people buy it. The more people who take part the better it works – especially if they live in various places and face different risks. This diversity helps to ensure not everyone will be seeking money from the 'pot' at the same time.

3.21 But for people to buy insurance, it must have four essential characteristics. And we're not talking about product features, or slick brands. To ensure as many people and business benefit from insurance as is possible it must be:

- **Available.** We don't get all these individual and collective benefits if it isn't available.
- **Affordable.** We don't get these benefits if people can't afford to buy it
- **Relevant.** People need to know that insurance will respond to the losses they expect to suffer
- **Reliable.** People need know that the policy does what it 'says on the tin' (or in the contract); that it pays when they suffer a loss that is within the 'rules'

3.22 But these things don't just occur. The needs of investors, reinsurers, customers, and regulators must be carefully balanced.

3.23 Start with **investors**. Insurance is a business and so needs capital to exist. Indeed, the Reserve Bank has detailed rules for how much capital insurers must hold. But there is one simple point. More capital equals more insurance (and vice versa). Getting this capital requires investors to be confident that their money is safe and getting them the right return.

3.24 But investors aren't the only people investing in insurers. **Reinsurers** provide insurance to insurers, to protect them against the possibility of having to cover a large loss, typically from natural disasters or the loss of high value assets. Like investors, reinsurers want to be confident that they can make the right return on the reinsurance they provide.

3.25 New Zealand is profoundly reliant on the confidence of reinsurers to be able to offer the (unique) ground-up cover for earthquakes. Our high exposure to natural hazards adds volatility and therefore requires New Zealand to engage in good risk management to ensure that we continue to secure the cover provided by reinsurers. A loss of reinsurer confidence would have massive consequences for New Zealand's resilience to earthquakes. Over time this will also increasingly become the case for large scale storms and floods.

3.26 To maintain the uptake of insurance **consumers** and business owners must be confident that they can obtain cover at an acceptable price and that insurers will fulfil the contractual entitlement within the insurance contract. If consumers and business owners are unwilling or unable to take part in the insurance market, this exposes them to the risk of significant loss and the Government to increased welfare and reconstruction costs.

3.27 **Regulators** must calibrate their policies and interventions to minimise distortions and facilitate confidence in the market. They need to guard against altering the market so that it becomes less attractive to one or more participants: insurers, reinsurers, investors, or policyholders.

3.28 Lastly **insurers** need to be disciplined in executing their core insurance and actuarial processes to maintain the viability of the insurance 'pot'. They must be able to balance the demands of investors, reinsurers, regulators, and customers. This is essential to ensuring the ongoing functioning of the insurance market.

3.29 It requires investment in high levels of customer service, technology, and large complex claims management supply chains. Bringing all this together requires insurers to attract, develop, and retain skilled professionals to operate their businesses. Inevitably this also requires a degree of scale, diversity, and sophistication that is hard to maintain in New Zealand given that it is by world standards a very small market.

New Zealand's unique challenge

3.30 New Zealand is a high-risk county. New Zealand sits just below the 'roaring forties' and atop the collision zone of two major tectonic plates. These shape our dramatic and beautiful landscapes. They also create the natural hazards that imperil our homes, businesses, and livelihoods.

3.31 Each year we feel the jolt of over 150 earthquakes; are battered by storms and tornadoes; inundated by floods and tides; see our coastlines erode and our hills slip; and face the threat of eruptions and tsunamis.

3.32 Earthquakes are the most devastating shocks we face from nature. Their impacts can have profound consequences for communities. Canterbury and Kaikoura attest to that. But a major earthquake or volcanic eruption could affect the entire country's prosperity and wellbeing

3.33 But it is the smaller shocks, the floods, storms, droughts, landslips, and fires, that are most common. And while smaller than earthquakes and eruptions, they often have just as great an impact for those affected. And then there are the slow disasters of coastal erosion and inundation from the sea.

3.34 None of these shocks are static. The ceaseless tectonic forces below our country add pressure to our fault lines that must eventually release. The warming climate will cause extreme weather to occur more often and with greater force. And our oceans are rising.

3.35 According to Lloyds[1], New Zealand has the third highest level of natural risk in the world surpassed only by Chile and Bangladesh. As such it needs a high-capacity, high-functioning insurance industry.

3.36 That occurs now, in part, because we can attract a large amount of reinsurance, indeed the nature of our risks, particularly the Wellington earthquake risk, are a significant determining factor in IAG's reinsurance programme and we are the third largest purchaser of reinsurance world-wide.

3.37 And it is our earthquake risk that makes us so different from the countries we most often compare ourselves to. For instance, the materiality of the age and construction type of a house in Essex, where the greatest natural risk might be a storm is completely different to its significance in Wellington.

3.38 The nature of New Zealand's natural disaster risks directly affects what products and service we offer our customers and how and cannot be disregarded in a consideration of any reforms.

Sustainability of the insurance market

3.39 It is vital that the regime can evolve in response to changing circumstances, trends, threats, dependencies, opportunities, and innovations emerging in the industry and related markets, regimes, and jurisdictions.

3.40 To this end we see several critical issues and trends that should be actively considered, as these will increasingly affect the general insurance industry over the coming years and decades. These include:

- The physical, economic, and social impacts of climate change
- Underinsurance and the future insurability of high-risk locations
- The ability of the industry to meet the needs of customers in the face of new and emerging risks, like cyber-attacks and security breaches
- The impacts of technical disruption on insured risks and service delivery.

[1] *Lloyds Global Underinsurance Report*, Centre for Economics and Business Research Ltd, 2012

3.41 We acknowledge that some of these factors are outside the scope of the review. While that may mean the review cannot consider how changes to insurer conduct might address these issues, it should not prevent consideration of how conduct and insurance contracts might need to evolve in the face of them.

4. Purpose

4.1 We encourage and support the outcome sought by the review, specifically to ensure that conduct and culture in the financial sector is delivering good outcomes for all customers. We also support the objectives identified in paragraph 19 of the Options Paper. We are therefore comfortable that MBIE uses these objectives as the high-level criteria for the proposed regime.

4.2 It is in the specific context described above that conduct should be reviewed, and guidance implemented. Any change to how conduct is regulated will not be implemented in isolation, but will impact the prerequisites and sustainability of a healthy insurance market. This is not to say that poor conduct should be accepted because other operational outcomes are more important, rather that the conduct of insurance providers should be a proportionate consideration in how we sustain a well-functioning general insurance market.

4.3 We also note that there are risks in seeking to use regulation to achieve the desired outcomes. There is a diverse range of financial institutions, providing differing products under different models. While it is right to expect financial institutions to consistently provide good outcomes for their customers, what that means in practice will be different depending on the institution, product and customer.

The nature of the duty

4.4 IAG believes that the specific characteristics of general insurance products (described above) impact on the assessment of what good outcomes for all customers means in any given case. In particular, and as described above, the nature of the insurance 'pot' means that consumers do not transfer risk to IAG but share it with each other. It is therefore important to recognise that customers also have responsibilities. They must accurately describe their risk, pay the amount required, and do their best to mitigate what is paid out. Insurers therefore also have obligations to the 'pot' that extend beyond the individual consumer.

4.5 The conduct of insurers must be consistent with their duties to *all* participants in the pool. This means that it is not just the direct relationship between consumer and insurer that counts when deciding on how claims should be settled. Sometimes a decision that may look like a poor outcome for an individual customer in fact delivers good outcomes for all customers.

The nature of the risk

4.6 Further, New Zealand's unique peril context will inevitably have a material impact on what it means to deliver good customer outcomes. Earthquakes are far more costly, unpredictable, and open ended than threats and perils faced in other insurance markets (such as cyclones, bushfires or floods – which are more predictable and time constrained).

4.7 The scale and complexity of some events will inevitably affect some elements of what defines a good customer outcome, for example, the speed and certainty with which claims can be settled. This is no excuse for poor conduct or poor outcomes, but it does demand the regulator take a pragmatic and flexible approach to assessing the customer outcomes achieved.

The nature of the product

4.8 Finally, it needs to be recognised that there will be limitations on what good conduct by insurers can achieve in terms of delivering good outcomes for all customers.

4.9 There is often a difference in the substantive outcomes consumers expect and what their insurance contract entitles them to. By its very nature the wording and coverage of the contract, combined with the facts that pertain to their claim, defines an insurers ability to deliver outcomes sought by customers.

4.10 The challenge is that consumers tend to treat insurance as a commodity product and tend not to engage with the detail when they sign up but expect it to work when they need it. So care is needed not to conflate a difference between what a customer expects and is contractually entitled with poor conduct.

4.11 That of course does not excuse poor conduct from insurers (eg failing to take reasonable steps to ensure the customer understands what they are buying), but the point is that under a new principles-based duty regime, there will be challenges in defining the practical steps an insurer must take to comply, and at what point the customer must take responsibility for his or her decisions. This is why, as discussed below, guidance to provide certainty on duties under a new regime will be very important.

5. Problems Identified

5.1 IAG agrees that it is important to ensure there is a high standard of conduct, that there is room for improvement across the sector, and supports a principles-based approach to lifting outcomes.

5.2 A key message from Financial Markets Authority (FMA) and the Reserve Bank of New Zealand (RBNZ) conduct and culture reports as that firms didn't have a focus on customer outcomes built into the way they work or have management information and mechanisms to give them a view of whether they were achieving good outcomes. This is different to customer having routinely poor experiences

5.3 So, IAG does not support MBIE's approach without issue. IAG is concerned that:

- Some of the problems are exaggerated, poorly defined, focus on rare exceptions, or lack evidence.
- This is yet another set of proposed reforms designed to influence conduct in the financial sector (e.g. in addition to regulation of matters such as financial advice, insurance contracts, unfair business practices, and responsible lending). This development is occurring in silos, yet the regulation is overlapping. There is a risk of new regulation introducing material uncertainty.
- It is now clear that the Government is working towards a regulatory system that includes overarching conduct duties to help deliver the consumer outcomes sought by various pieces of regulation. Yet there is no clear parameters or principles to guide the ultimate outcome or ensure that it fits in with other elements of the overall regulatory system such as that dealing with product, markets, and prudential supervision.

5.4 The uncertainty this creates strongly supports a cautious and incremental approach to implementation of conduct obligations (i.e. proportionate regulation), and not sweeping or wholesale reform (we discuss this in the context of enforcement and transition).

Problem definitions

5.5 IAG encourages MBIE to think more carefully about some of the assertions of problems in the Options Paper and take into account the nuanced features of the insurance sector. For example:

- For insurance it is not so clear that there is a significant imbalance of knowledge and power. IAG appreciates that insurance products can be relatively complex, and that this may limit customer knowledge and understanding.[2]

  The imbalance is not insurmountable, but is exacerbated by low engagement, a purchase decision often driven by considerations of brand and price (and not cover), and a 'set and forget' approach to insurance that means it can be a while before customers undertake a proper review of products they have purchased.[3]

  IAG actively encourages customers (or potential customers) to keep us informed, as they know more about the 'risk' defined in their insurance policies, based on their understanding of their specific circumstances. We understand that the corresponding duty on insurers is to keep our customers informed of the matters and issues that we know more about.

- There are limits to reducing product complexity. IAG agrees that customers do not always fully understand what their policy covers.[4] IAG is actively striving for greater product simplification, with policy documents being designed and drafted to assist customer understanding. However, it is not possible to avoid all complexity, as the 'product' being sold is the right to exercise a contract. Providing a contractual ability to claim for loss is not a simple transactional service, but an exercise in interpreting how a contract applies to a specific set of facts. Consequently, there will always be a requirement for customers to read and understand the contract, which due to its inherent nature will always include some complexity. We agree that any information asymmetry should not be exploited by insurers,[5] but disagree that any information asymmetry amounts to a conduct problem.

- It should not be assumed that weaknesses in governance and management identified by the FMA) and RBNZ also exist in general insurers to the same extent.[6] IAG is continuously working to improve culture and governance.

- IAG designs its products with good customer outcomes in mind and seeks to avoid poor value products.[7] IAG strongly believes that its success as a business depends on it delivering strong customer outcomes – that is, designing and providing high quality products that customers will value and trust.

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[2] *Ministry of Business, Innovation and Employment,* Options Paper: Conduct of Financial Institutions ("**Options Paper**"), April 2019, at [39] and [66].
[3] Options Paper, at [39].
[4] Options Paper, at [66].
[5] Options Paper, at [67].
[6] Options Paper, at [42].
[7] Options Paper, at [60] and [63]

- It is important for MBIE to consider conduct along the entire product distribution chain and the role that intermediaries play within it. IAG agrees with MBIE in this respect.[8] If there is a "chain" of product distribution, then all links in that chain must be directly covered by conduct obligations to ensure good customer outcomes.

- IAG does not prioritise sales over good customer outcomes. The Options Paper refers to issues identified in the FMA and RBNZ reports, and the Australian Royal Commission Misconduct report.[9] IAG does not condone or conduct pressure sales, and has removed sales incentives from sales staff. Our focus is on quality customer outcomes. We note that various obligations apply to the sale of insurance products and services,[10] so caution against large or wholesale changes.

- IAG is focussed on improving clarity, consistency, and frequency of communications with customers at all parts of the claims process, and particularly when a claim is taking longer to settle than we would hope.[11] Typically, this is the point in the process where our customers are most distressed (given the circumstances that trigger the claim), and where we can provide them with the most value. This is therefore a key opportunity to reduce information asymmetries and strengthen an ongoing consumer relationship.

5.6 IAG is also concerned about the assertion that insurers have an incentive to underpay claims and sometimes use questionable tactics to settle.[12] In particular, the Options Paper states that 'it appears that systematic underpayment has occurred following the Christchurch earthquakes'.[13] We strongly disagree and support the comment made by the ICNZ in its submission. The evidence cited to support this claim is not robust, does not present a fair and balance picture, and suggests some shortfalls in understanding of how the general insurance sector works.

5.7 IAG did not pressure customers to settle their claims or do anything other than work to meet entitlements under the contract. More than that, in making cash settlements we paid more than their entitlements. The financial, reputational, and moral interest of IAG was and still is the fast and full settlement of claims.

5.8 It is also worth remembering the unique and complex nature of the Canterbury Earthquake Sequence and the many factors that caused delay and refer you to our submission on the Review of Insurance Contract Law Issues Paper where we described these in detail.

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[8] Options Paper, at [70] and [85].
[9] Options Paper, at [73].
[10] Such as under the Financial Markets Conduct Act 2013, the Fair Trading Act 1986, and the Consumer Guarantees Act 1993.
[11] Options Paper, at [106/107].
[12] Options Paper, at [98].
[13] Options Paper, at [101].

5.9 We acknowledge that the Christchurch earthquakes generated many customer complaints. We used our existing complaints processes to manage these, supporting the development of the Residents Advisory Services, and engaging directly with Breakthrough, Fairways Mediation and Property Pathways Limited to work with customers to assist with dispute resolution. We consider that this gives customers ample ability to challenge IAG's decision where they disagree with our assessment of a claim.

5.10 For further detail on Christchurch, we refer to the more detailed comments made in correspondence between IAG and MBIE.

Regulatory problem solving

5.11 When considering whether there is a case for the imposition of new regulation, it is important to carefully consider whether there is empirical evidence to support change, and avoid generalisations based on studies overseas or for other sectors in New Zealand. We are concerned about the speed with which the Government is seeking to advance potentially far-reaching regulation in the general insurance sector, based mostly on an assumption that issues identified by the Reserve Bank and Financial Markets Authority for life insurers and banks also apply to general insurers.

5.12 For general insurance, the Paper does not provide empirical evidence of problems, or clearly identify where and what type of improvement is required. That contributes to the risk that new regulation will not have a clear purpose, will not be easily understood, and is implemented in a manner that could have unintended consequences – including adverse outcomes for consumers. This is not to say that problems do not exist and/or there is no room for improvement – the point is that there is a risk that without fully understanding the nature and extent of issues, the costs of regulation could be high. In the absence of this clarity, change should be cautious and incremental, and not sweeping and wholesale.

Principles of best practice regulation

5.13 We therefore encourage MBIE to more carefully consider whether Treasury's principles for best practice regulation have been appropriately applied, as it has indicated it will do. Based on Treasury's framework, we have identified the following indicators of concern:[14]

[14] *Treasury*, Principles for Best Practice Regulation, Appendix A, Tables 8 and 9.

Attribute	Indicators
Proportional	There is a risk that the burden and costs of the new rules are not proportional to the potential benefits. The establishment and implementation of the regime must be targeted to identified problems and risks. For the general insurance industry, the Options Paper does not provide strong evidence of identified problems. Caution is needed to ensure that the proposed regime is not being designed for the 'exception', which, specifically in the insurance industry, is a major catastrophic event. IAG understands the importance of the system working seamlessly in the aftermath of a major event. However, the significance afforded to this should be weighed against the frequency for which it occurs, and should not unnecessarily impact upon business as usual.
Flexible, durable	The proposed regime has the potential to provide regulated entities with scope to adopt least cost and innovative approaches to meeting their legal obligations, given that it is principles based. However, this will ultimately depend on the enforcement approach. It will be important for the regulator to work collaboratively with the sector on flexible implementation. A cautious and incremental approach to establishment and implementation of the new regime should contribute to a durable regime over time.
Certain, predictable	There is a high risk with principles-based duties that insurers' legal obligations will be uncertain and unpredictable. It will be important that the regulator works with the sector to develop a clear understanding of how duties can be met, so that insurers have means of being sure that they comply. Where possible, safe harbours should be established. The regulator's enforcement criteria and processes must also be clearly established, and consistently applied. Again, avoiding wholesale and sweeping change will assist to provide predictability under the new regime.
Transparent, accountable	It will be important for the regulator to transparently communicate with stakeholders on its expectations for compliance, and enforcement approach. Its decision-making must be clearly and transparently explained, to allow the sector to appropriately respond and adapt to the new regime.
Capable regulators	The regulator will need to be resourced for its new responsibilities, with the requisite skills. This will be particularly important for establishing enforcement practices that effectively encourage and assist the sector to achieve ongoing compliance.

6. Options for overarching duties

IAG supports the intent of the overarching duties. To a large extent, our current practices reflect the substance of the duties outlined by MBIE in its Options Paper, but we acknowledge that there may be room for improvement in some areas.

The main costs of the proposed legal duties will arise from uncertainty and unpredictability on what it means to comply, but this can be mitigated by a sensible enforcement approach.

A code of practice that provides a non-mandatory safe harbour for compliance should assist to provide greater certainty.

Overarching duties

6.1 IAG understands the need to apply and is comfortable with the concept of principles-based legal duties to better promote good customer outcomes.

6.2 It is right that a minimum standard of conduct and accountability applies to selling insurance. Consumers should receive insurance products and services that are right for their needs, that accord with what they thought they were getting, and that come with easy means of redress if things go wrong.

6.3 The duties suggested by the Options Paper appear sensible, in principle, for a conduct regime. We do not object to any of them, or believe that further duties should be included. We do, however, consider that the proposed legislative wording should be consulted on (via an exposure draft), as it will be important to ensure that the legislative drafting imposes obligations that are balanced and reasonable.

6.4 We support the intent of the proposed duties, which generally align with IAG's current internal policies and principles. We note for example that our internal Code of Conduct specifically addresses making "our customers' worlds' safer", and includes not only respecting who they are, but understanding their individual circumstances. We communicate with our customers openly and present our products and services in simple, accessible language, recognising that disability and cultural differences should not be barriers to receiving clear information. We speak to the customer, not to the policy. Many of our customers feel already that we do a good job, but we are open to exploring evidenced gaps found through the review.

6.5 On this basis, IAG does not anticipate the costs of aligning our current practice with new duties to be high, as we are already aware of the principles, and operating accordingly.

6.6 IAG makes the following comments on specific matters that we believe will need to be taken into account when considering application of and compliance with the duties in practice:

- **A duty to consider and prioritise the customer's interest, to the extent reasonably practicable.** A duty to prioritise the customer's interest needs to reflect the nature of the insurance industry (which we described in detail above). While we support the policy aim of the duty, we do not consider that the requirement to 'prioritise' can be treated as an absolute. An insurer has an obligation to protect the interests of ***all*** customers, which will influence what is reasonably practicable when dealing with a single customer.

  We also consider that this option requires greater definition and guidance of what 'reasonably practicable' means – and must focus on what is practicable for the organisation as whole, and not for each individual transaction (which could be unworkable).

- **A duty to act with due care, skill, and diligence.** As noted in the Options Paper, this duty will overlap with duties that already apply to financial advisers. It will be important to ensure duties are consistent. It will also need to be clear that this duty applies to the institution.

- **A duty to pay due regard to the information needs of customers and to communicate in a way which is clear and timely.** This duty will require more direction and certainty as to what constitutes 'due regard'. The duty should also be subject to a reasonableness test. That is because:

  - in some instances, it may not be practical to determine the financial sophistication of the customer or other behavioural biases (and therefore their information needs and preferred communications methods), which would make it difficult to adjust our offering accordingly;

  - as discussed above, despite our best efforts to communicate in a way which is clear and timely, it is sometimes difficult to get customers to engage or, given the complexity of some products, to understand.

  - the circumstances may influence the extent to which it is possible to engage with customers. For example, after a large event, insurers do not have the resources to meet all of the requirements set out in paragraph 134 of the Options Paper, on an individual basis for every customer and may employ group or community meetings as was the case following the Canterbury and Kaikoura earthquakes.

  In that context, we agree that a prescriptive duty will not be practicable.

- **A requirement to have the systems and controls in place that support good conduct and address poor conduct.** While IAG operates under systems and controls that support good conduct and address poor conduct, we do not consider that meeting the requirements set out in paragraph 138 of the Options Paper will be reasonable in all circumstances – it should not become a prescriptive list. We note, for example, that prioritising investment in these systems and processes will compete against other customer and non-customer facing demands (including other regulatory compliance projects) for finite resources.

- **A duty to manage conflicts of interest fairly and transparently.** As part of IAG's ongoing efforts to focus on delivering customer outcomes, we recently removed sales incentives from our sales staff. In response to question 2, we think it will be more workable – and will deliver the greatest benefit – for this duty to focus on conflicts of interest that arise through remuneration and incentives. Otherwise, there will be much confusion and uncertainty in terms of identifying conflicts between the insurer and customer (given that, after all, they are two parties to a contract).

- **A duty to ensure complaints handling is fair, timely and transparent.** Subject to our concerns on certainty and implementation, IAG supports the intent of a duty to ensure complaints handling is fair, timely and transparent.

6.7 Our understanding is that the intent is for the duties to apply to an institution at a systemic level. That is, insurers will need to develop processes and systems designed to produce outcomes consistent with the duties, but cannot be expected to apply them on a strict basis in each individual case (we note that other duties will apply to individual customer interactions). We expect that success of the regime will be measured by improvement in customer outcomes as a whole over time (bearing in mind the context set out above).

A code of practice

6.8 As identified in the Options Paper, the overarching duties will introduce significant uncertainty into the sector. IAG is concerned that what it means to comply with these duties will be different for different institutions, and that it will depend on the circumstances. This will present a challenge for industry participants, who will be required to align their operations with undefined regulator expectations, even where they consider they are already best serving their customers. This will also present a challenge for regulators, in providing clarity, consistency and guidance to industry participants, and in deciding when and how to enforce.

6.9 IAG therefore agrees that greater certainty on what each duty means is required. Consistent with Treasury's position on strong regulatory principles, IAG seeks certainty and predictability upfront. Any framework that seeks to implement and enforce duties should not be reactive, but further direction, guidance or regulation should be provided in advance of issues arising. This will likely require an incremental approach to implementing the new regime over time.

6.10 A model could be developed for duties in the insurance industry that reflects the model for lender responsibility principles set out in the Credit Contracts and Consumer Finance Act 2003. The principles are set out in full in section 9C of the Act, which also provides for the development of a Responsible Lending Code (ss 9E-9I). The Act makes it clear that the Responsible Lending Code is not binding, but that evidence of compliance with the Code will be treated as evidence of compliance with the principles in section 9C, when deciding whether there has been a breach.[15]

6.11 A code could be developed by the Financial Markets Authority, who would be required to consult with the industry. It could be approved by the Minister. It should not be binding but would act as a safe harbour (i.e. compliance with the Code is evidence of compliance with the overarching duties). The effect of this is that not complying with the code would not constitute a breach of the duties (or of the law), but it would give direction and certainty to industry participants on how it is possible to comply with the law, and to regulators in deciding when to enforce. A code would also provide greater consistency in conduct and enforcement over the longer term. It is important that the Code is not binding as sub-sector specificity means that its guidance cannot be equally applicable to all insurers in all contexts.

Recommendations relating to overarching duties

6.12 We recommend implementing the overarching duties, as set out in the Options Paper, provided that:

- there is a further opportunity to comment on proposed legislative drafting
- duties apply to the organisation at a systemic level;
- there is an absence of overlap or conflict with other similar duties;
- they allow for reasonableness and practicality in implementation; and
- there is sufficient certainty as to what they require, and how they will be monitored and enforced. Development of a non-binding Code could assist in this respect.

[15] Credit Contracts and Consumer Finance Act, s 9E (2) and (3).

7. Options to improve product design

IAG supports a proportionate and targeted approach to regulating product design.

The outcome we seek is a regulator to work with industry participants where concerns exist with products in the market and provide them with an opportunity to modify their product, with regulatory intervention as a back-stop option. This should encourage participants to create quality products with relevant information for customers.

Banning products would only be a proportionate response in extreme circumstances.

7.1 IAG opposes the suggestions in the Options Paper to ban, or provide a power for the regulator to ban, products. This is on the basis that it is too difficult to establish objective and fair criteria to provide clarity and consistency in application.

7.2 The better approach is to encourage and empower the regulator to proactively work with the sector to encourage design of better quality products and address any concerns with existing products. In that context, Option 3 is the better option - to require manufacturers to identify the intended audience for products, and for distributors to have regard to this audience when placing the product (which is addressed in more detail below).

7.3 The Options Paper provides little or no detail on what compliance with this requirement would look like in practice. We do not understand it to require a product specific disclosure. Instead, an insurer would be required to ensure its internal systems and processes embed the requirement. For example, they can clearly identify who the product is designed for and outcomes sought and make those features clear to sales persons.

7.4 On that basis, the cost of complying with this option should not significant for IAG as it is confident it already complies. The core question for most, if not all, IAG products is whether the customer (or potential customer) has an insurable interest in an asset. If so, there are very few consumers for whom our products would be unsuitable.

7.5 In response to question 5, we think that there are some products for which this requirement will be more necessary than for others. We would support a differentiated approach to its application to 'lower risk' products. If all products are treated the same, then there is a high risk of a compliance regime that adds little value at high cost. This is because, for many products, the intended audience is evident and the risk associated with the product is obvious and/or minimal – such as car insurance or contents insurance. In the absence of complaints or other evidence of concerns, such products should be presumed to be of value to customers (but that does not take away the need for insurers to be continually assessing the suitability of their products). On the other hand, specialised or novel products (such as repayment insurance) may demand more extensive compliance requirements.

7.6 For completeness, we note that any requirements on product design should not be retrospective but should only apply to new products or existing products that are materially altered or modified. This is on the basis that the principles of good law making require a prospective approach, and the cost of reviewing all products for technical adherence would outweigh any benefits to consumers.

Recommendations relating to product design

7.7 We recommend:

- not pursuing options that would allow for banning of products;
- developing a reasonable duty for the manufacturer to identify the intended audience for products and for distributors to have regard to that audience;
- empowering the regulator to work with industry participants where concerns exist with products in the market and provide participants with an opportunity to modify their product, with regulatory intervention as a back-stop option.

8. Options to improve product distribution

IAG supports the intent of ensuring that remuneration and incentives support good customer outcomes.

We support the removal of soft commissions and other sales incentives that may not achieve good customer outcomes, but agree that a total ban on commissions would be counter-productive. We are not convinced that regulating the parameters of commissions is justified.

Any new requirements to take steps to ensure good customer outcomes must be reasonably practicable for an insurer to implement, and in particular should not seek to make them responsible for the actions of intermediaries which are outside their control.

A positive duty

8.1 IAG supports the intent of Option 1 - a duty to design remuneration and incentives in a manner that would promote good customer outcomes. As the Options Paper notes, this would require institutions to positively engage with customer outcomes, and would not allow them to tweak incentives to get around banned forms.

8.2 Clearly, however, this cannot be a "one size fits all" approach. We do not think it will be possible, or desirable, to prescribe detailed requirements for how to comply with this duty. Institutions should be encouraged to adopt innovative approaches that are suitable for the size and nature of the institution, and the type of products that it sells. For those institutions that excel, there is likely to be a competitive advantage – both in terms of attracting quality employees, and providing products in a manner that attracts customers.

8.3 Accordingly, we think there will need to be a nuanced approach to assessing compliance with this duty. As indicated in the Options Paper, the focus should be on the insurer explaining to the regulator why it believes its approach is aligned to good customer outcomes.[16] Enforcement action should be reserved to situations where the insurer is unable to demonstrate that it is taking steps to comply – but otherwise the focus of the regulator should be ongoing feedback to promote improvement where required. Over time, based on its experience engaging with participants in the industry, the regulator may be able to develop general guidance on what a duty entails, and how to comply.

[16] Options Paper, at [163].

Sales incentives and targets

8.4 IAG is computable with Options 2 and 3. However, given the focus on mis-selling it would benefit from clarifying that prohibitions would only apply in respect of staff directly involved in sales.

Parameters on the structure of commissions

8.5 Similarly, imposing parameters around the structure of commissions (Option 4) should not be pursued at this time. IAG considers this to be a disproportionate response to an undefined problem that is not well understood. In the context of New Zealand's risk based regulatory environment, the focus of any regulatory intervention should be on improving understanding of practices, to determine whether there is a problem to be addressed (and then designing an appropriate solution).

8.6 We agree that a total ban on commissions is not required and note the complexities in restricting incentive structures altogether. A total ban on commissions would likely reduce the amount of financial advice delivered to New Zealanders, thereby making the advice more expensive and difficult to obtain.[17]

8.7 For further understanding of IAG's current practices with regard to commissions, we refer MBIE to the briefing we have previously provided on this matter.

A duty to take reasonable steps

8.8 IAG appreciates the view in the Options Paper that financial institutions should not be able to avoid any degree of responsibility for their intermediaries. Equally, it is correct that they should not be directly responsible for the actions of their intermediaries.[18] An institution can only be responsible for the actions of others to the extent that the institution can exercise control over those actions. For example, IAG accepts that it can be held liable for failing to adequately vet distributors, failing to report distributor misconduct, or failing to take reasonable steps with the distributor. However IAG rejects being held responsible for the poor conduct itself.

8.9 The balance may not be easy to achieve in practice. A duty on manufacturers to take reasonable steps to ensure the sales of its products are likely to lead to good customer outcomes sounds acceptable in principle, but ultimately it will depend on what the duty actually entails:

[17] Options Paper, at [157].
[18] Options Paper, at [173] and [174].

- Our concern is that this duty will impose obligations on manufacturers that they are unable to fulfil, because it will require action or an outcome that is outside their control. A manufacturer's ability to influence the sale of its products is, in many instances, limited. While manufacturers can design the products, indicate target customers, and choose their distributors, they ultimately have little direct control over the behaviour of intermediaries. IAG accepts a duty in relation to its products, but opposes a duty in relation to how these products are sold by those further down the supply chain.

- The implication of this option is the regulator setting expectations on the extent to which manufacturers should have oversight of distributor conduct. There is risk in this option that law or regulation will unnecessarily intervene in commercial relationships, dictating business models and contractual arrangements that have been negotiated and agreed between the parties.

- As for all other duties suggested by the Options Paper, IAG is concerned about the uncertainty in what it means to comply with the proposed duty, and how the duty would be enforced. The examples of 'reasonable steps' set out in the options paper are helpful, but still lack objective criteria. This uncertainty, combined with its overlap with other duties leaves an unclear picture of what applies, and to whom.

- We consider that this is particularly unnecessary, given the size of the problem (or lack thereof) that MBIE is trying to solve.

8.10 An alternative approach, which we consider would be more effective, would be to regulate the distributors directly, requiring them to inform the applicable manufacturer (and/or the regulator) of the customer outcomes they have achieved. We consider that (consistent with our comments in the application section below), all participants in the value chain should be regulated to the same minimum standard. All regulated entities should therefore be able to demonstrate to the regulator the process, and the results, of their attempts to deliver strong customer outcomes.

8.11 This consistency in regulation should be taken into account where the regulator finds a breach in the distribution phase of the insurance product cycle. In circumstances where a manufacturer has contributed to the effects of distributor misconduct, the penalty on both parties should reflect the respective actions being remedied – that is, the shortcomings on the manufacturer's behalf should be seen as considerably less harmful (and afford a lesser penalty) than that of the distributor.

Recommendations relating to product distribution

8.12 We recommend removing soft commissions and other sales incentives that may not achieve good customer outcomes but agree that a total ban on commissions would be counter-productive. We recommend against regulating the parameters of commissions.

8.13 We recommend implementing a duty on manufacturers to take reasonable steps to ensure the sales of its products are likely to lead to good customer outcomes. However, this duty should be clearly defined so as to prevent manufacturers being held directly accountable for the actions of distributors.

8.14 We recommend regulating the distributors directly, requiring them to inform the applicable manufacturer of the customer outcomes they have achieved.

9. Options relating specifically to insurance claims

IAG is not convinced that specific insurance duties and requirements are justified.

For ensuring that claims handling is fair, timely and transparent, rather than a broad and ill-defined proactive duty, it would be better to have a more limited power for the regulator to inquire into the conduct of insurers in their settlement of claims in specific circumstances, if concerns were raised. This would be a more targeted, proportionate form of regulation.

We do not support statutory requirements to settle claims within a set time, as it risks adverse customer outcomes.

9.1 As a procedural point, IAG suggests that this section would be more appropriately dealt with in MBIE's parallel review of insurance contracts. This is to achieve consistency with the remainder of the Options Paper, which covers general duties in the financial sector, but does not specifically address any issues in the operation of other products.

9.2 As indicated above, IAG strongly refutes the assertions made by MBIE in relation to insurance claims made in response to the Christchurch earthquake. It is very rare that there is an unprecedented event on the scale that we saw in Christchurch. Given the constraints of the circumstances, IAG is proud of the way that it handled the claims and appreciates MBIE's acknowledgement of the exceptional circumstances, and legitimate reasons for the delay in settling some claims.[19] We will always work to improve our systems, resources and capability with new knowledge that comes to light with these events. However, we expect MBIE to carefully consider designing a regulatory system to cover for the unprecedented, at the expense of administrative effectiveness in the day-to-day.

9.3 In light of this, and consistent with Treasury's objective of delivering a targeted regulatory solution, IAG is concerned about the proposal to introduce duties that relate specifically to insurance claims. Depending on how they are designed and targeted, this could result in significant duplication of the overarching duties.

Duty to ensure claims handling is fair, timely and transparent

9.4 The intent of a duty to ensure claims handling is fair, timely and transparent is not problematic - many insurers already meet this standard as part of their commitment to the ICNZ Fair Insurance Code.

[19] Options Paper, at [181].

9.5 However, given that the primary concern appears to be the settlement of claims under exceptional circumstances, in practice the only way to assess whether the claims settlement is fair, timely, and transparent is through careful inquiry after the fact.

9.6 Therefore, rather than having an uncertain proactive duty, it would be more proportionate and relevant to empower the regulator to inquire into the conduct of insurers in their settling of claims in circumstances where issues had been raised, such as in the aftermath of a major disaster.[20] This would help to ensure that conduct was examined in light of exceptional and complex circumstances, and could take into account legitimate reasons why claims handling may not have met the expectations of individual customers.

9.7 We also caution that assessing compliance with such a duty will be more complex than the example given by MBIE of a breach of certain credit disclosure obligations. Above, we discussed the 'pot' concept of insurance, and the obligations and duties that members within the claims pot have to each other. It goes without saying that there may be disparity in the interpretation of 'fair' between insurers and customers. However, there will also be disparity between customers as to what is 'fair' in the handling of individual complaints. For example, one customer may interpret 'unfairness' as not getting the pay-out they were hoping for, primarily because it is not covered by the policy (and the customer has not read the policy), or because it is tied to something outside of that customer's control. As a result, another customer would likely see the decision to protect the pot (by not granting the pay-out) as very fair.

9.8 IAG therefore does not support the application of statutory damages (as is provided for in the CCCFA).[21] At the very least, there would need to be clear and unequivocal evidence that an insurer has intentionally sought to circumvent the duty.

Requirement to settle within a set time

9.9 A requirement to settle claims within a set time (as set out in Option 2) is not workable in the insurance industry. The nature of the perils reflects significant and wide ranging risk and can result in situations where insurers receive many claims unpredictably and all at once. The focus on settling claims should be on quality, and on meeting the needs of the specific customer in the specific context of the claim. Requiring quick settlement would lead to rushed decisions, and a higher risk of outcomes that were counter to the customer's interests individually and collectively.

[20] Options Paper, at [181].
[21] Options Paper, at [183].

9.10 The Options Paper suggests that, given New Zealand is particularly prone to natural disasters, the hard deadline would likely need exceptions where settlement within that timeframe was impossible. Unfortunately, the unpredictable nature of the risk will make it very difficult to determine when an exemption to a set time frame should or shouldn't apply. This would not come without significant cost to the regulator, in time and resource. It will also make it very difficult to give clear guidance to insurance participants at the outset, around what is and is not acceptable.

9.11 A possible consequence of a statutory deadline is a reform of the way policies are drafted in the insurance industry. Insurers will offer and grant a policies that they consider they will be able to deliver on, within the constraints of the legislative background. Where additional legislative constraints are added, insurers may be required to adjust their policies to ensure that they are able to comply. So as to mitigate the possibility of not being able to settle a claim in time, insurers may be required to change the nature of the risk covered by their policies.

9.12 For completeness, we note that the timely settlement of complaints is a common interest of insurers, customers and regulators alike. For IAG, there are financial, reputational, and moral incentives in favour of the fast and full settlement of claims. It is our commercial imperative for our customers (and their friends) to continue to choose us to insure them. We do not consider that requiring a specific statutory timeframe for response would change our incentives or produce better customer outcomes.

Recommendations on insurance claims

9.13 We recommend against implementing specific (and additional) insurance duties. We instead support empowering the regulator to enquire into the conduct of insurers in their settlement of claims, if concerns are raised.

10. Options for tools to ensure compliance

IAG is comfortable with empowering the FMA to assist in enforcement. A cautious and incremental approach to enforcement of the new regime is warranted. The enforcement focus should be on requiring the insurer to explain to the regulator why it believes its approach implements the duties and is aligned to good customer outcomes.

Enforcement action should be an action of last resort and reserved for situations where the insurer is unable to demonstrate that it is taking steps to comply – but otherwise the focus of the regulator should be ongoing feedback to promote improvement where required.

IAG disagrees that a licensing regime and/or executive accountability is necessary to ensure good conduct and duty compliance in New Zealand's insurance industry.

Empowering and resourcing the FMA

10.1 We agree with the pros and cons with this option identified in the Options Paper.

10.2 We consider that the FMA's focus, in deciding when and how to enforce, must be on educating and encouraging compliance. This is particularly important in the context of a transition to a new and uncertain regime. It would be helpful if legislation directed the FMA to give effect to the regulatory principles of proportionality and flexibility when undertaking its enforcement activities. The FMA should also be required to develop an enforcement policy that is specific to the new regime – what works for promoting fair, efficient and transparent financial markets may not work for promoting good customer outcomes.

10.3 We also expect that legislation will include a transition period, to provide the regulator and industry with time to develop a shared understanding of what the duties require (including the development of a code), and to allow institutions to develop and implement any new systems and processes that are required. In the absence of evidence of the risk of harm in the general insurance sector (particularly when compared to the life insurance sector), it is better to take the time to ensure the approach is 'fit for purpose', rather than implementing a hasty approach to enforcement.

10.4 In enforcement, the FMA should exercise pragmatism, and be conscious of the following:

- There is a distinction between operational change, and a change in culture and outcomes. While operational change can be achieved relatively promptly, cultural change is often a consequence of operational change, and can take longer to come to fruition. This supports a longer implementation timeframe, and more flexibility in assessment as to whether outcomes are being 'met', by also encouraging 'progress toward'.

- The industry is currently in a state of flux. There are a number of changes and reviews taking place at the moment, including in relation to unfair business practices, insurance contracts, prudential supervision, and the Christchurch earthquake. IAG, being a trans-Tasman entity (along with many other similar providers), is also subject to change from Australian regulators, and internal change instigated by the Australian arm of the business. The FMA should give some leeway in enforcement, given the size of the entity, and the split focus in adjusting for compliance.

10.5 In that context, the success of the regime should be measured by overall improvement in customer outcomes over time, which will reflect positive standards and behaviour achieved by institutions. While it will be important for institutions to be able to demonstrate that they have processes and systems designed to promote outcomes consistent with the new conduct duties, it is unlikely to be productive to seek granular compliance with the duties and/or compliance on an individual basis. Indeed, institutions should be encouraged to innovate in their methods to comply with the duties and promote good customer outcomes.

Entity licensing

10.6 We agree that licensing is costly in time and in resource – especially for a new regime. This was our experience when prudential licencing was introduced for insurers. The introduction of licensing should not be considered as a subset of enforcement options in a broader discussion of whether to introduce duties. Given the significance of the change that entity licensing would instigate, it should be subject to a separate review, and corresponding consultation.

10.7 Unlike prudential licensing, it is difficult to identify benefits from a conduct licencing regime that would outweigh the costs. The Options Paper suggests that guidance available through the licensing regime can help an institution understand what is required and expected of it. That assumes that the regulator has formulated clear guidance at the time licensing is introduced – and it is unclear why the benefits of guidance, backed by enforcement action when required, would not be available in the absence of a licensing regime.

10.8 Particularly in the case of general insurance, IAG is not convinced that there are conduct or culture issues in the sector that are so significant as to require a 'fix' of this magnitude. We acknowledge that Australia and the United Kingdom implement a dual licensing regime, but do not consider this to be sufficient reason for New Zealand to implement the same. A licensing regime should not be imposed in New Zealand without strong evidence to indicate that it would lead to better customer outcomes. MBIE's Options Paper specifically identifies two jurisdictions that operate under a dual licensing regime, without consideration of any other jurisdictions that successfully achieve good conduct and culture, without requiring the insurers (and regulators) to bear the additional cost of a second licence.

10.9 A dual licensing regime does not come without its challenges, as has been discovered in the Australian example. In particular, there has been a lack of consistency being applied by the prudential and conduct regulators, which has added to the cost of compliance for participants.[22] An example is the "conflict of interest" duty that is required under the two licensing types, under which a breach means two different things. Where a regulator finds a breach of duty, the course of action in the dual licensing regime is to revoke a participant's licence. However, where this duty is reflected in legislation, and backed by guidance, the regulator could take conflicting duties into account, when deciding an appropriate course of action.

10.10 In short, we do not see how conduct licensing can provide additional benefits in terms of promoting good customer outcomes.

Regulatory tools

10.11 IAG is comfortable with introducing a range of regulatory tools (as set out in Option 3), on the understanding that the proposed overarching duties would not be effective if there was no means to enforce them.

10.12 We would expect these responses (and the specific tool chosen for enforcement) to be proportionate, and to consider the intent behind the breach. In particular, penalties should distinguish between a reckless breach and an unwitting breach. Any legislative provision that empowered the regulator to effect penalties should include a requirement for the regulator to (among other things) have regard to proportionality to the breach.

10.13 As mentioned above, the FMA should be required to develop a specific enforcement policy that covers how its available tools will be used in a proportionate and flexible way.

Maximum pecuniary penalties

10.14 IAG considers that the maximum pecuniary penalties available for breaches of conduct duties should be less than the corresponding penalties in the Financial Markets Conduct Act.

10.15 Under the FMC Act, it is important to deter conduct that can have a widespread negative impact on capital markets, affecting many market participants.

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[22] *Michael A Adams, Angus Young and Marina Nehme,* Preliminary review of over-regulation in Australian financial services, (2006) 20 Australian Journal of Corporate Law, at 19.

10.16 However, the complexities in the insurance industry and what it may mean to breach a conduct duty, distinguish the insurance industry from the financial markets industry. Essentially, if an insurer complies with all other relevant legal obligations, it is difficult to see how breach of a conduct duty can cause harm to an extent that the public interested demands penalties at the same level as under the FMC Act.

10.17 We instead consider that the penalties under the Credit Contracts and Consumer Finance Act provide a more appropriate benchmark where, for example, a failure to include information in a disclosure statement could result in a fine of up to $10,000 for an individual, and $30,000 for a body corporate.[23] We consider that this level of penalties is more appropriate than those set out in the FMC Act on the basis that insurers sell policies set out in contracts (not unlike credit contracts), which is markedly different to the offer of securities to the market. Similar to credit contracts, insurance contracts are sold to consumers to look after their current, or potential (in the case of insurance), financial needs. Both insurers and creditors are investing in the customer as an individual, rather than offering an investment to the market at large. The information asymmetry is therefore not as significant as for products sold under the FMC Act, where the consequences of non-compliance can be more widespread.

Executive accountability

10.18 IAG opposes the option of executives being held personally accountable for ensuring the business complies with conduct duties. We do not consider that there is a need for such a heavy-handed measure, especially where there will be a high level of uncertainty as to what is required for an institution to comply with new conduct duties.

10.19 We are not opposed to all forms of executive accountability, as we appreciate that there should be incentives for directors and senior managers to promote good culture and conduct within institutions. We understand the intention behind executive accountability – to build awareness and ensure that customer interests (as part of duty compliance) is front of mind in director decision-making.

10.20 If MBIE remains of the view that some type of executive accountability is required, we believe that a more appropriate measure would be to require directors to certify (annually) that, to the best of their knowledge, there are processes and policies in place for the institution to meet its conduct duties. There could be penalties for making a declaration known to be untrue, but there should not be individual liability if is found that an institution has not complied with a duty. We believe such an approach will provide sufficient incentives for executive accountability, without needing to resort to the heavy-handed approach of imposing individual duties for directors and senior managers.

[23] Credit Contracts and Consumer Finance Act, s 102A.

10.21 We agree with MBIE's suggestion in the Options Paper that a more stringent executive accountability regime would make directors and mangers more risk adverse, which could impede innovation and good decision-making. It could involve significant cost. We also agree that the indirect impact of this would be to discourage people from taking on these roles. We also note that:

- the proposal to introduce duties for directors and senior managers under the Credit Contracts and Consumer Finance Act is in response to identified non-compliance with obligations that have applied for some years. We believe institutions should be given a reasonable opportunity to comply with new and uncertain conduct duties – with personal liability for directors and managers being introduced only if problems with compliance are identified (that cannot be remedied with other enforcement mechanisms);

- the FMC Act does not provide a particularly useful precedent or analogy. There is a stronger case for imposing individual liability in relation to product disclosure statements, which are what the market at large relies on to assess risk of investment. Breaches of duties can have widespread systemic consequences, which is why there is a need for a stronger deterrent.

Whistleblowing procedures

10.22 IAG supports the option of requiring whistleblowing procedures, and already implements its own whistleblowing protections. This includes a "Group Whistleblower Procedure" policy document, created in 2016, and reviewed every three years.

- Employees are encouraged to first discuss with their managers and colleagues, but IAG also provides a confidential whistleblowing service administered by an external service provider.

- The Whistleblower Service Provider will write a report, and categorise it based on its significance. This will determine whether the report goes to the Whistleblower Executive Committee, the Group CEO or the Group Chief Risk Officer. A nominated and trained Whistleblower Investigation Officer then conducts an independent and confidential investigation into the report.

- IAG's policy provides protections for its whistleblowers, and specifically addresses the best course of action in the event of a conflict of interest. IAG would be happy to provide further detail on its policy if this would be helpful.

Regular reporting

10.23 IAG supports the option to require regular reporting on the industry. We consider that this option would provide greater information and transparency, which could be more effective at lifting conduct in the industry than strictly enforcing duties.

10.24 We do, however, note our concern about the time and resource that may be required from the industry in responding to requests from the regulator for information and data.

Industry bodies

10.25 IAG supports the position set out in ICNZ's submission on the role of industry bodies in regulation.

Recommendations relating to ensuring compliance

10.26 We recommend empowering the FMA to assist in enforcement. Any enforcement should consider a grace period to allow the regulator and industry time to develop a shared understanding of what compliance requires.

10.27 We recommend against introducing an entity licensing regime, but are comfortable with the broad range of regulatory tools for enforcement, provided these are used in a proportionate and flexible way.

10.28 We recommend against implementing maximum penalties that align with those set out in the FMC Act, and consider that penalties set out in the Credit Contracts and Consumer Finance Act are a more appropriate benchmark.

10.29 We recommend against the introduction of executives being held personally accountable for ensuring the business complies with conduct duties.

10.30 We recommend introducing obligations on providers to implement whistleblowing procedures.

11. Application

IAG supports the Insurance Council's submission on the entities to whom the conduct regime should apply.

Duties should be applied consistently and, to the extent possible, without overlap to all participants in the production chain.

Application

11.1 Option one would apply the duties to retail banks and insurers. We agree that:

- The obligations should only apply in respect of insurers' retail customers. The proposal to use relevant definitions from the FMC Act and Financial Services Legislation Amendment Act as a starting point appears sound – as consistency in definitions across regimes is desirable – subject to the need to carefully work through which definition will apply to which type of product (eg general insurers have "retail clients", and not "retail investors"), and whether the appropriate delineations between retail and wholesale customers are made.

- a phased approach to implementation should be adopted. The FMA and RBNZ have identified risks of harm in the life insurance sector, and it makes sense to focus on that sector first. As set out above, there is no clear evidence that the same level of risk exists in the general insurance sector.

11.2 If the duties were applied to all providers that align with banks and insurers (Option 2), we consider that in order to effectively promote good customer outcomes, it is important that all participants in the production chain are subject to the same expectations of conduct – not just insurers. It is not clear from Option 2 that this is the intent.

11.3 As noted above, all participants in the value chain – manufacturers and distributors in all their various forms, should be regulated to the same standard. All regulated entities should therefore be able to prove to the regulator the process, and the results, of their attempts to deliver strong customer outcomes. This reduces the risk of regulatory arbitrage and ensures that consumer receive equal conduct protections regardless of how the engage with the industry.

Overlap with existing regulation

11.4 IAG is conscious that implementing the proposed conduct regime will introduce overlap in regulation, as identified in the Options Paper. The risk is that this will create a system where multiple duties apply to a given activity, but the understanding of what each duty requires is not clear and/or there are conflicts between them.

11.5 IAG therefore agrees that care needs to be taken to ensure parallel obligations are consistent. Our position is that if done well, this approach should be less complicated, and provide greater clarity, than trying to establish carve-outs for certain participants to avoid overlap with other regulation.

11.6 As discussed above, the potential for overlap also supports a cautious and incremental approach to implementation of the new regime.

Entity versus product-level regulation

11.7 We support the duties being applied at the entity, rather than product level. This is consistent with our view above that the duties should apply to an entity at a systemic level.

11.8 As also indicated in this submission, we believe the new duties will bring significant uncertainty, as institutions work to understand what is required to comply. This uncertainty will be compounded, for no apparent benefit, if the regime seeks to impose specific requirements for different products.

Recommendations relating to application

11.9 We recommend that duties should be applied at the entity, rather than the product level, and should be applied only to insurers' retail customers. Care should be taken to ensure that parallel obligations are consistent.