ICNZ Insurance Council of New Zealand

Insurance Council of New Zealand
P.O. Box 474 Wellington 6140
Level 2, 139 The Terrace
Tel 64 4 472 5230
email icnz@icnz.org.nz
Fax 64 4 473 3011
www.icnz.org.nz

6 June 2019

Financial Markets Policy
Building, Resources and Markets
Ministry of Business, Innovation & Employment
PO Box 1473
Wellington 6140
New Zealand

Emailed to: FinancialConduct@mbie.govt.nz

ICNZ submission - Conduct of Financial Institutions Options Paper

ICNZ welcomes the opportunity to submit on the Options Paper titled *Conduct of Financial Institutions* ('Options Paper'), which was released by the Ministry of Business Innovation and Employment (MBIE) on 27 April 2019.

ICNZ represents general insurers that insure about 95 percent of the New Zealand general insurance market, including about a trillion dollars' worth of New Zealand property and liabilities. ICNZ members provide insurance products ranging from those usually purchased by individuals (such as home and contents insurance, travel insurance and motor vehicle insurance) to those purchased by small businesses and larger organisations (such as product and public liability insurance, professional indemnity insurance, commercial property, and directors and officers liability insurance).

This submission is in two parts:

- Part 1 – Overarching comments
- Part 2 – Responses to questions in the Options Paper

Part 1 - Overarching comments

Regulating conduct

ICNZ supports efforts to ensure good conduct in financial services. This is why we put in place the Fair Insurance Code in 2011. ICNZ ensures the Code evolves by reviewing and updating it every 3 years. Building consumer trust relies on being truly customer focused, communicating clearly and transparently with customers, and addressing poor customer outcomes in a timely and effective manner when issues arise. An efficient functioning insurance system also relies on insureds engaging honestly with their insurer and making reasonable efforts to understand the insurance policies they choose to purchase.

We recognise that a lack of conduct focussed regulation in New Zealand was identified by the International Monetary Fund (IMF) in its Financial Sector Assessment Programme of New Zealand in 2016/17 and by the Financial Markets Authority (FMA) and Reserve Bank (RBNZ) in their recent reviews of banks and life insurers. ICNZ supports the introduction of appropriate conduct regulation for financial services that creates positive outcomes for customers.

Many of the issues and proposals in the Options Paper are also being simultaneously addressed in other consultations currently open in the Review of Insurance Contract Law and the current Bill[1] amending the *Credit Contracts and Consumer Finance Act 2003* ('CCCFA') or in the financial advice reforms that are being finalised now and will be implemented over the next few years. Industry participants are also reviewing and upgrading their systems proactively and/or in response to the reviews being undertaken by the FMA/RBNZ. Given all this, the risks of regulatory overlap, confusion and gaps is real and pursuing new conduct regulation with undue haste and potentially no further consultation increases these risks. The Select Committee process is therefore not suited to resolving issues of this nature, which require further and more comprehensive consultation and consideration.

Concerns and issues with the Options Paper

Whilst we support conduct regulation being introduced, we have concerns with aspects of the Options Paper and the limited development of many of the options given no further consultation is planned.

Overall the case for intervention outlined in the Options Paper appears relatively limited. While the FMA/RBNZ's reports on their investigations into the banking and life insurance sectors identified weaknesses and areas of improvement to ensure good customer outcomes, they did not find the widespread issues that were identified in Australia. It is important that financial institutions carefully review the findings of the Hayne Royal Commission in Australia and ensure that similar concerns are addressed but it is also important to recognise the fact that its findings relate to Australian entities that operate in a different market with different products and under different laws.

Assessment of the need for specific regulation of the conduct of financial institutions in New Zealand needs to focus on what is occurring here. The Options Paper emphasises conceptual risks but does not contain much detail of substantiated evidence of consumer harm in New Zealand. A cost benefit analysis is required on the package overall and individual options within it to ensure that what is being progressed delivers overall benefits.

The Options Paper is focussed on a post-GFC context and does not recognise or acknowledge the increased level of awareness of the importance of consumer interactions and outcomes within the financial services industry over the last 18 months and the responses to this occurring currently. There is also a surprisingly limited explanation of the reforms associated with the recently passed *Financial Services Legislation Amendment Act* ('FSLAA') and its supporting instruments, which are targeted at improving the quality of financial advice but which will have wider impacts on financial services entities' interactions with their customers and the distribution of products (e.g. new duties and disclosure requirements). The cost benefit analysis of the proposals in this Options Paper needs to consider the extent to which the FSLAA reforms and the current Bill amending the CCCFA will address the issues identified. Insurers are also currently working on responding to the actions plans arising out of the FMA/RBNZ reviews and it would be worthwhile understanding the nature and implementation of these plans before finalising the shape of the new regulation.

While ICNZ does not consider these changes remove a need for wider conduct regulation, it is important to recognise the direction is already towards improving systems and processes to reduce risks and improve customer outcomes and the so the proposed conduct regulation needs to be assessed in this context. The question is how far it is appropriate to go, and how much complexity and cost government wants to introduce to the sector when financial institutions are already carrying out significant programs of work to improve.

[1] The *Credit Contracts Legislation Amendment Bill*, which was introduced on 9 April 2019.

Material related to claims management by insurers

We have particular concerns with the section of the Options Paper that discusses the handling of general insurance claims (pages 23 to 25). These include unsubstantiated statements, emotive language, factual inaccuracies and the uncritical repetition of allegations made against insurers without engaging with the industry to include balance or context in the Options Paper.

It is clear from the information drawn on that the conclusions are based almost entirely to the Canterbury Earthquake Sequence. A natural disaster, the scale of which had previously been unseen in New Zealand, and which pushed all parties beyond business as usual operations, should not be used as the basis for making broad statements about insurer behaviour. It was one of the world's largest and most complex insurance claims experiences and is simply not representative of day-to-day insurance claims experiences.

While drawing almost solely on the unique Canterbury situation, there is no consideration in the Options Paper of the insurance claims process that occurred in Canterbury. The dual insurance model that operates in New Zealand for natural disaster events, places private insurers as a second layer of cover, which is only triggered if the cost of repair exceeds the liability of the Earthquake Commission (EQC). The Canterbury earthquakes illuminated the inherent problems with a model that provides for multiple agencies (private insurers and EQC) to manage claims from a single customer. We also note that the Options Paper is incorrect in stating that there are over 2,000 outstanding Canterbury insurance claims. There were 1,293 unsettled properties as at the end of Q1 2019, of which less than 1,000 are with private insurers, noting also that a proportion of these were transferred to insurers for the first time by the EQC in the past 12 months.[2]

There were a range of factors that complicated the settlement of claims in Canterbury, some related to the dual insurance model, and these often contributed to significant changes in settlement costs between initial assessment and final settlement. These included insufficient skills or expertise leading to lower quality or incomplete initial assessments by EQC, delays and uncertainties in resolving the status and remediation of land (covered by EQC and not private insurance) and significant inflation in building costs over time. Cost estimates between EQC and private insurers often varied substantially, and it is highly likely that some of the initial assessments noted on page 24 were calculated by EQC before the insurer conducted its own assessment of loss. These and a range of other issues associated with the Canterbury earthquake sequence and the dual insurance model for residential dwellings will be addressed in our submission to the current Public Inquiry into the EQC.

Language such as insurer 'tactics' (as opposed to 'processes') and 'lowball' offers are emotive and not terms we would expect in a government report. As for being incentivised to make low offers to customers, insurers have the commercial reality of wanting to retain customers and to remove liabilities from their books, which lead them to want to pay customers what they are entitled under their policies so that claims are settled as promptly as possible. Voluntarily signing up to the Fair Insurance Code standards is also not the behaviour of entities seeking to 'lowball' offers or to leverage an imbalance of power.

There is no doubt that there will be examples of where an insurer should have done better. That is true of any sector. However the characterisation of the general insurance sector in parts of the Options Paper does little to reflect the scale of issues or context and certainly has not been open to

[2] Of the 1,293 open claims, 175 are in construction, 560 in resolution, 158 are where the claimant is undecided and 400 are in dispute. This data available on ICNZ's website at https://www.icnz.org.nz/natural-disasters/canterbury-earthquakes/.

the level of scrutiny we would have expected. We also note the large majority of Canterbury earthquake claims rested with government-controlled agencies (EQC and Southern Response).

For a wider and more representative view of claims experiences we refer MBIE to the evidence of complaints about general insurers which ICNZ publishes annually and the number of complaints upheld by the independent dispute resolution schemes as robust evidence of how general insurers manage their dealings with their customers and their claims. Given the purpose of this review it is quite remarkable that this evidence was not drawn on. We also note that MBIE commissioned a Colmar Brunton survey of public perceptions of insurers and their experiences that found net satisfaction with all successful claims at 78%, although this data was not included in either this Options Paper or the parallel one on the Review of Insurance Contract Law.

ICNZ fully supports the need for good, robust regulation that ensures consumers have trust and confidence in the insurance and other financial sectors. We have gone to considerable effort through our iterations of the Fair Insurance Code and its oversight to support this. We are therefore extremely disappointed with the inclusion of such pejorative commentary in the Options Paper, particularly without any efforts to verify such information with the industry. We will write to MBIE with further detail on this and can make this available.

The scope and nature of the regulatory regime needs to be more clearly defined to ensure that it works

While many of the individual options proposed in the Options Paper are broadly appropriate, more work needs to be done to consider and confirm the scope and nature of the proposed regulatory regime for conduct. Key questions to be answered include:

1. What **types** of customer interactions are trying to be regulated?
2. What **entities are subject to** the proposed regulatory features?
3. How does this new conduct regulation **relate** to existing frameworks and already planned frameworks (i.e. Financial Markets Conduct Act 2013 ('FMCA') (post FSLAA) and proposed CCCFA changes, and any changes resulting from the Review of Insurance Contract Law).
4. What is **the** role of the regulator in administering the new regime?

Some of the options proposed are pitched at a very high level in the Options Paper and not developed to any extent, making it difficult to determine what would be required. This would be less of an issue if further consultation was planned, but we understand it is not. Furthermore, the proposals, some of which in isolation are straightforward, interface with each other and a lot of other regulatory provisions. For this new regime to be effective and workable it should not be rushed or it risks unintended consequences.

What types of customer interactions are trying to be regulated?

The issues raised in the Options Paper are clearly focussed on interactions with consumers, however it uses the terms 'customer' and 'consumer' interchangeably in different parts of the document. The extent to which this is deliberate in different areas is unclear. For general insurers the distinction between consumers and non-consumers (i.e. business and other entities) is significant because different products are offered to these different groups and the distribution models also vary significantly (e.g. commercial insurance is largely intermediated). For some options the scope of conduct regulation will have a significant impact on compliance costs.

Given that the issues raised in Part 2 of the Options Paper are focussed on consumers, this is the logical focus of the proposed options. We agree with the statements in paragraph 216-217 that:

> "Under this option, the preferred package of options would apply to banks and insurers <u>in respect of all products and services offered to retail customers</u>.....We consider that the obligations should apply in respect of banks' and insurers' retail, rather than wholesale, customers as this is where the greatest evidence of risk exists and need for customer protection lies. Wholesale customers, by contrast, are larger, generally better resourced and able to inform themselves and therefore information asymmetries and power imbalances are less likely to arise."

The Options Paper then goes on to proposes that the scope of coverage of the conduct regime would be:

> "Our starting point is that the FMC Act definition of "retail investor" or proposed definition of "retail client" under the Financial Services Legislation Amendment Act should apply in respect of the proposed conduct obligations insofar as they may apply to both FMC Act-regulated financial products (e.g. KiwiSaver) and non-financial products (e.g. insurance, credit).These are shown in the table that is attached as an Appendix to this submission."

ICNZ's view is that it would be more appropriate to define the scope of conduct regulation to consumers in a way that was consistent with the *Fair Trading Act 1986* and the *Consumer Guarantees Act 1993*. Our rationale for this is:

1. The focus of issues and concerns outlined in the Options Paper is interactions with consumers and so the most proportionate response is to apply it accordingly.
2. Including smaller commercial entities and then trying to impose an arbitrary distinction between small entities and larger entities (i.e. using "retail client" or less than 19 FTEs etc.) creates uncertainty and compliance costs. Such distinctions are not factored into the provision of insurance because commercial policies are provided to different sized entities and insurers don't have general reasons to assess and monitor the size and turnover of their commercial customers.
3. Arbitrary distinctions based on the size and/or turnover of businesses do not necessarily reflect businesses sophistication.
4. Most business insurance is distributed through brokers and therefore is subject to financial advice.
5. If a distinction is to be drawn between consumers and businesses for the purposes of the duty of disclosure in the Insurance Contract Law Review then this would most logically and practically be on this clear consumer/business basis, as occurs in the United Kingdom (refer to the Appendix), rather than at some level of small business scale based on staff levels, turnover etc.

We have outlined in an Appendix to this submission, for reference, different approaches to drawing a distinction between smaller customers and larger non-consumers in different regimes in New Zealand and overseas. This shows that there are already three relevant distinctions in place in New Zealand (consumer/non-consumer, less than 19 FTEs or more than 19 FTEs, and retail client/wholesale client). This is confusing enough already and so introducing any more should be avoided. While we are recommending the application of conduct regulation to consumers, if interactions with small business customers was to be included, of the available distinctions, we would suggest that of entities with up to 19 FTEs as this would align with the scope of the external dispute schemes and the Fair Insurance Code. We note that while the using the proposed FMCA definition of "retail client" will be relevant to the provision of financial advice, none of the limbs of the definition are relevant to the provision of insurance.

An alternative option that could be applied in relation to insurance would be to adopt the Australian approach of explicitly stating the types of insurance policies that are subject to the regime, which are consumer type insurance policies (refer to section 761G(5) of the *Corporations Act 2001*). This provides a certain scope for all parties.

The approach taken here is not simply a definitional issue but is fundamental to the scope and application of the proposed regime and so needs to be carefully considered. Consideration also needs to be given to this in regard to each of the proposals specifically as the pros and cons of each will vary. We comment in Part 2 on specific areas where there are particular issues with how the distinction is drawn or implications from it. We also further comment on this in our response to question 19 below.

We note that while we use the word customer in many places in this submission, to align with the proposals in the discussion paper and recognising scope has yet to be confirmed, we recommend the scope is focussed on consumers.

What entities are subject to the proposed regulatory regime?

In paragraph 11 of the Options Paper, it states:

> "When we refer to financial institutions in this paper, we are primarily referring to banks and insurers. However, as discussed in section 7, there is a question regarding whether the regime proposed in this paper should apply more broadly to other types of financial institution."

The definition applied to "insurers" in the footnote to this paragraph is "all types of insurers: life, health and general (house, contents, motor vehicle)." We note this definition as written would not capture insurers that provide credit-related insurance product providers or warranty products.

As outlined earlier in this submission ICNZ considers that it is critical the scope of conduct regulation to providers and distributors is appropriately comprehensive. We are concerned there is a risk of an incomplete regime that also does not integrate effectively with the new regime for financial advice under the revised FMCA. From a consumer centric point of view the regime must impose similar requirements, controls and protections on the provision of financial services regardless of the distribution channel being utilised.

We note the only option proposed is to apply obligations at the entity level. While an entity-approach will require financial institutions to have regard to customer outcomes at all levels of their interactions with customers it opens up potential gaps in regard to entities that offer the same or similar products but are not subject to the regime. Key concerns here are policyholder protection and competitive neutrality between the regulated community and the unregulated community. Regulating entities also creates the issue that an insurer might for example offer predominately commercial products but might offer say one retail orientated product, which could bring them inside the regime.

For example in regard to insurance there is material insurance business carried on outside the scope of the *Insurance (Prudential Supervision) Act 2010* ('IPSA') (and the conduct regime if it applied to insurers licensed under IPSA) including types of contract that are currently deemed not to be insurance contracts under IPSA – including warranties, guarantees, and waivers and unlicensed (by RBNZ) foreign insurance firms that insure New Zealand policyholders.

It is important however that conduct regulation is not applied to re-insurers as this would be unnecessary and inappropriate. We note there are re-insurers licensed under IPSA so the definitions used will need to be carefully considered.

We comment further on these issues in our response to question 19 below.

Responsibilities for intermediaries

As identified in the Options Paper, financial services including insurance, are often distributed through intermediaries. In the case of insurance approximately half of all insurance (by premium paid) is conducted through intermediaries with the vast majority of commercial insurance put in place through insurance brokers, which vary from individual brokers to large international broking houses.

The nature of the intermediaries themselves and nature of their relationships with the insurer and customer vary widely. For some intermediaries insurance contracts are their core business (i.e. insurance brokers) whereas for others it is a more peripheral part of their business (e.g. travel agents providing travel insurance or retailers distributing consumer credit insurance). Some will be tied to the insurer whereas others will be acting in an independent capacity (regardless of the fact of whether they receive a commission from the insurer), working across different insurers to get the best deal for their customer (the insured). Some intermediaries will be banks or insurers.[3] Some brokers have their own policy wordings that insurers are required to use to place policies with the broker's customers.

In some cases there will be multiple intermediaries in the chain between the customer and the insurer, for example a customer who works through a broker to an underwriting agent that is issuing policies on behalf of an insurer. From a regulatory perspective a fundamental distinction will be that many intermediaries will in future be Financial Advice Providers (FAPs) and others will not. In introducing conduct regulation on top of the current financial advice reforms it is important to ensure that responsibilities fall where it is appropriate and where they can be effectively met.

As a matter of principle, insurers cannot be responsible for interactions between intermediaries and their clients when the insurer has no ability to interact with the client. We therefore support the pragmatic positions outlined in paragraph 177 of the Options Paper:

> "What is reasonable may differ depending on the sales channel for a particular product. For example, advisers (intermediated sales) are already subject to the requirements under the FSLAA to prioritise their client's interest, so the manufacturer would not be expected to take significant steps to oversee the sales of products through those intermediaries. However, it would be expected that a manufacturer undertakes more direct monitoring and reporting of the sales outcomes of non-advised sales."

The Option Paper does however largely assume a theoretical and hierarchical view of how the industry dynamic works, that the contract of insurance is between insurer and customer and therefore they are simply the insurer's customers to manage. This doesn't reflect the practical reality of how much of the sector works. To ensure that customers receive the same regulatory protections regardless of distribution channel and to reduce risks of regulatory arbitrage it will be necessary to put in place a level playing field so that both product manufacturers and distributors are responsible for achieving good customer outcomes in the area appropriate to their roles. This will require giving careful consideration to where it is necessary for intermediaries to be regulated directly and/or where it may be necessary for intermediaries to demonstrate to providers they

[3] For example banks distributing home insurance products from general insurers to their mortgage customers or general insurers distributing life insurance products from life insurers.

are delivering good customer outcomes. Finally, conduct regulation needs to recognise that where intermediaries provide financial advice to their customers it would be inappropriate for product developers to interfere with this and that a broker is likely to be advising on a range of different providers to their customers.

It will be important to align legal expectations across the new conduct regime, the financial advice regime and the planned changes to insurance contract law to ensure the law is consistent and integrated. In regard to the parallel Review of Insurance Contract Law we consider it is necessary to revisit the position that the payment of commission makes the intermediary the agent of the insurer. For the new conduct regulation there is a question as to the extent to which the legislation needs to apply directly to intermediaries to ensure no gaps or anomalies are created. This may require extending the duties directly to certain kinds of intermediaries or providing certain obligations on intermediaries to co-operate with product manufacturers in the exercise of their obligations. Ensuring such provisions are comprehensive and appropriate will require careful analysis and further sector engagement.

Defining the role of the FMA in administering the regime is fundamental to understanding that nature of the regime and its potential benefits, effects and costs.

What role is the regulator (FMA) going to undertake? An enforcer of serious breaches of regulatory bright lines or a more hands-on regulator who closely monitors and works constructively with entities on improving conduct and systems, taking enforcement action only when necessary? Based on the proposals, we expect it is something closer to the latter, but which of these, or something else, is not articulated clearly in the paper.

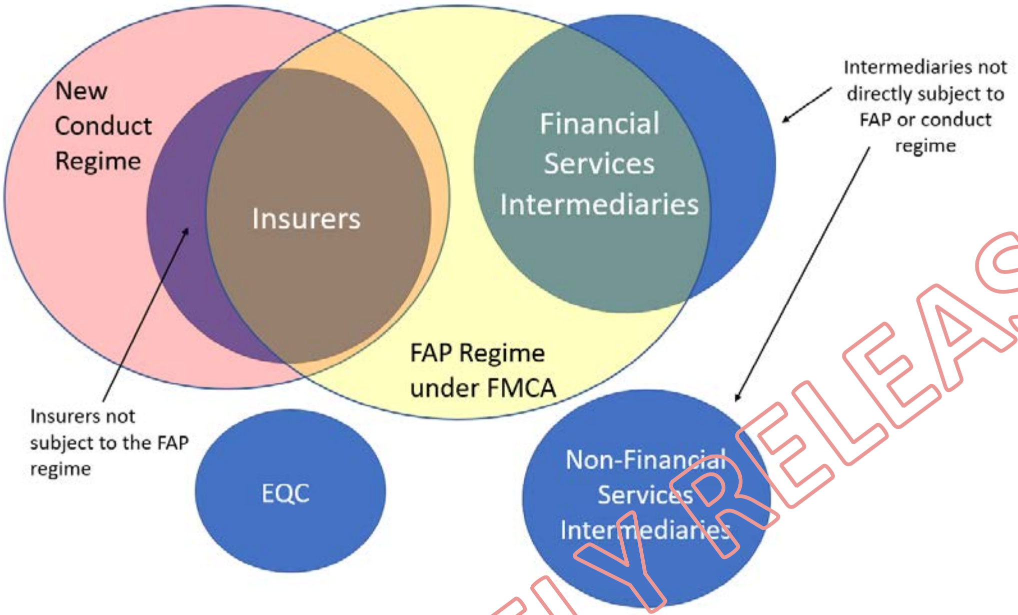
How this will work needs to be carefully considered before the legislation is passed as it is fundamental to the full design of the regime and the future setup and resourcing of the FMA. These questions should not be left for the FMA to work out after the legislation has been passed.

A high-level regime with principles rather than bright lines suggests the boundaries are established by an active regulator through sector engagement and guidance etc. High level duties and obligations need to be supported by more detail (in guidance, Codes, commentary etc.), otherwise a trial and error model will result. Clear expectations will need to be established that reflect a pragmatic compromise based on an assessment of the potential for harm as compared with the complexity (for entities and customers) and cost in performing actions. There will also be situations where any action brings risks, such as what to do when a customer can't be reached in regard to renewal of a policy. The answers will ultimately be found but it is much better for both customers and financial institutions for these issues to be addressed prospectively through constructive work between government and the sector rather than be determined later through enforcement action. To have a view on non-compliance the regulator will need to be willing to articulate what good looks like.

How the FMA would interact with other regulators (RBNZ and Commerce Commission in particular) and with external dispute resolution schemes also needs to be carefully considered.

Conduct regulation needs to be integrated with other regulation and over a workable timeframe

As discussed above for the new conduct regulation to work effectively it needs to align and integrate with existing and overlapping legislation that exists or is being developed simultaneously. Given this, rushing the creation of regulation risks creating an ineffective regime and/or creating unintended consequences. The following diagram outlines the scope of the proposed conduct regulation and the FAP regime under the FMCA in regard to entities operating in the insurance sector in New Zealand. This shows overlaps and gaps and whilst these are not unresolvable, they need to be very carefully thought through and tested.



It is notable that whilst many/most financial services intermediaries and many insurers will be subject to the financial advice regime under the FMCA (and be licensed FAPs) not all will be, and that few if any non-financial services intermediaries (e.g. airlines, travel agents, car dealers, retailers) will be. As discussed in regard to intermediaries and elsewhere in this submission it is necessary to address the gaps (e.g. distributor intermediaries that are not insurers and do not give financial advice). The above diagram also illustrates that it would be a significant and unprincipled gap if EQC is not intended to be subject to the conduct regime in regard to claims handling.

This means that the new conduct regime has to both stand-alone and integrate with the financial advice regime, notwithstanding that the latter was scoped broadly partially due to the absence of conduct regulation at that time. Similar overlap issues exist in regard to the CCCFA for insurers providing credit-related insurance.

For a variety of reasons but particularly to consider the scope and integration with other regulatory regimes, we consider it will be fundamental to release an exposure draft of the new legislation for comment prior to its introduction to Parliament. These sorts of complicated interface and integration issues do not lend themselves to being resolved solely through a Select Committee process.

Implementation of the conduct regulation regime

Careful thought is required in relation to how to introduce and implement the conduct regulation, both as a standalone new regime and also in regard to how entities will be simultaneously implementing changes in response to the financial advice reforms (including licensing) as they come into effect through to mid-2022, changes to insurance contract law and any changes from the review of IPSA that is expected to recommence later this year. Insurers are also currently working on responding to the FMA/RBNZ reviews and it will be costly if the new regulatory regime requires processes to be changed again in response.

Issues to be resolved in advance of conduct legislation coming into effect include:

- What the appropriate implementation period would be. Having regard to how much time would be reasonably required for entities to comply with the proposed elements of the conduct regime, as well as the cost impacts of a rushed implementation and uncertain implementation dates and other regulatory changes occurring across the period. This needs to recognise that insurance policies are generally renewed annually and the lead times in making changes to internal processes etc. More certain and longer lead times give entities the opportunity to minimise costs by working required change into planning cycles rather than having to commission standalone work programmes.
- Whether there is a staged implementation of different elements? For instance, changes to contractual remuneration structures between product manufacturers and distributors, or with staff, cannot simply be changed immediately and product design requirements would take time to implement across existing product lines and could only be undertaken once the detail of the regime is finalised.
- How and when the regulator will be rescoped and resourced to meet its new functions, once these are confirmed., and when it will be in a position to undertake its functions.
- Whether guidance or other supporting material, if part of the framework, is issued before the regime is brought into force (so that certainty of application is increased from commencement)? Noting this would require the regulator to have a level of relevant expertise and capability prior to the regime coming into effect.
- If the licensing of entities in relation to conduct regulation was be undertaken, which as discussed elsewhere we do not support being progressed at this time, how this would at a minimum be integrated with the existing or soon to be undertaken (i.e. FAP) licensing processes.
- How during any transition period to provide for both the continued smooth operation of existing financial institutions while also enabling potential new entrants?

We don't have fixed views on these matters at this time given the uncertainties associated with the scope and timing of these proposals and the other reforms being pursed simultaneously. It will however be critical for government to engage with the financial services sector generally and the insurance sector in particular in regard to how and when conduct regulation is introduced to ensure workability and avoid unnecessary compliance costs and disruption.

New conduct regulation within the context of wider regulatory reform and insurance in New Zealand

The proposed conduct regime is a further part of a period of continuous change in regulation of financial services generally and insurance in particular. At the present time our members are working out how best to comply with the almost completed FSLAA reforms, take action by 30 October on the FMA/RBNZ letter and input into this consultation, the parallel consultation on the Insurance Contract Law Review as well as the recently introduced Bill to amend the CCCFA.

This all puts increasing pressure and costs on businesses to both comply with changes coming and respond to regulator initiatives and policy/legislative consultations. The level of regulatory change and associated uncertainty also runs the risk of putting further pressure on insurance availability and pricing and potentially innovation and introducing complexity that could make it harder to offer simple, easy to buy and affordable insurance to customers.

We are mindful that New Zealand is small market in a risky country that is particularly susceptible to natural hazards, such as earthquake and flood, and has the potential to be affected by tsunami and volcanos. It was rated the second riskiest country in the world in a major international study released by Lloyd's of London, based on New Zealand's high level of risk exposure in terms of probable loss from natural disasters, which is second only to Bangladesh.[4]

New Zealand also has the highest prudential standard (1/1000 year event) in the world for domestic insurers. This ensures insurers have the means (capital or reinsurance) to meet a 1:1000 earthquake event but it also increases the costs of providing insurance in New Zealand relative to other countries with more modest prudential standards (e.g. 1/250).

Insurance plays a vital role in transferring these risks for New Zealanders and it is therefore important that the overall regulatory environment remains attractive to international insurance capital as a vibrant insurance market is critical to providing fairly priced insurance for consumers and businesses. Existing and new regulation needs to be carefully considered to ensure it delivers positive outcomes for customers and remains workable for insurers (who need to be able to clearly underwrite risks in order to remain sustainable). The additional complexities and costs associated with new conduct regulation need to be considered in this wider context.

Part 2 - Responses to questions in the Options Paper

In this part of the submission we respond to the questions posed in the identified sections of the Options Paper.

Section 3.2 - 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? Do you agree with the pros and cons of each duty? Do you have any estimates of the size of the costs and benefits of these options? Are there other impacts that are not identified?*
	Overall, we are supportive of a principles-based approach. There is a need to ensure that the duties are consistent and integrated with other legislation (e.g. FMCA, CCCFA etc). We also note the Options Paper does not set out what consequences would flow from breaching the duties. For instance presumably under Option 4 (Systems and controls) a firm would not be in breach simply because it failed to control or prevent unforeseeable risks, but a breach would occur if the firm had failed to take reasonable care to organise and control its activities responsibly or effectively? *Which overarching duties should and should not be included in the regime?* ICNZ considers five of the six proposed duties (Options 2 – 6) are, subject to the specific comments below, appropriate duties to be included in a conduct regime. They are similar to existing duties to be included in the FMCA and the *Code of Professional Conduct for Financial Advice Services* and which already exist in the Fair Insurance Code. We note they are also similar to those applied in the United Kingdom under the *Financial Services and Markets Act 2000* and the subordinate and detailed

[4] Refer to https://www.lloyds.com/news-and-risk-insight/risk-reports/library/understanding-risk/a-world-at-risk.

Financial Conduct Authority (FCA) Handbook of rules and guidance.[5] In contrast we consider change to Option 1 is required.

Option 1

In regard to Option 1, ICNZ considers that the concept of an entity paying '<u>due regard to the interests of its customers and treat them fairly</u>' would be more appropriate than the proposed duty to 'consider and prioritise customer's interest, to the extent reasonably practicable'. The language we have proposed is provided in section 2.1.1 of the UK's FCA Handbook and is in our view more consistent with the Code of Professional Conduct for Financial Advice Services, the FMA's 'A guide to the FMA's view of conduct', the Fair Insurance Code, the Code of Banking Practice, the FSC Code of Conduct and the IAIS Insurance Core Principles (ICP 19 Conduct of Business) than Option 1 is.

The reality is that an insurer, like any business, owes obligations to a range of parties (e.g. owners/shareholders, employees, the customers making up the insurance pools) and to put an overarching duty to prioritise customers sets up unrealistic and potentially impractical expectations. While that would inevitably be tempered by 'to the extent reasonably practicable', this will in turn be at the cost of creating uncertainty in the application of the regime. Insurers must treat all their customers fairly, but this is not the same as always prioritising the customer's interests. Whilst in paragraph 127 the Options Paper indicates the proposed Option 1 duty is not a 'best interest' duty, it is important to recognise that treating all customers fairly is not always going to be in the interests of particular customers.

We consider our proposed duty to have 'due regard to the interests of customers and treat them fairly' encapsulates what the conduct regulation is trying to achieve without the problems associated with the current Option 1. We also note that whilst the proposed Option 1 is ostensibly similar to the title of the new section 431K in the FMCA, the wording of that section is specific and limited to the provision of financial advice. As such it is materially narrower and different to the proposed Option 1.

Government must also be cognisant of the other duties on directors of companies under for example the *Companies Act 1993* (e.g. sections 131 and 137). If these overlap or create potential tensions, how these should be resolved needs to be carefully worked through.

The commentary on the current Option 1 refers in paragraph 128 to managing conflicts of interest, which are directly covered by Option 5 (duty to manage conflicts of interest fairly and transparently). To avoid duplication this would seem to be better addressed in the relevant specific duty.

Option 4

It is necessary to further assess the interaction between Option 4 (systems and controls) and the provisions of IPSA related to licensing and carrying on business in prudent manner to identify potential overlaps.

Options 5 & 6

We comment further on Option 5 (the conflicts duty) below in response to question 2. We also comment further on Option 6 (the claims handling duty) below in response to questions 8 and 9.

[5] https://www.handbook.fca.org.uk/

	Are there other duties that should be considered? We have not identified any further duties that are required. We note that some other similar regimes include an integrity focussed duty, though to an extent this is covered by the other duties. *Do you agree with the pros and cons of each duty?* The pros and cons of each duty are well outlined in this section of the Options Paper. *Do you have any estimates of the size of the costs and benefits of these options?* It is not possible to estimate the potential benefits of introducing such duties or the costs of complying with them given their inherently high-level nature. There will be costs (one-off and ongoing) and these will be driven ultimately by what is required to comply and how much change and resource each entity needs to undertake to achieve this on an ongoing basis. The benefits of introducing these duties will be to the extent that subject entities are not already following them.
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? What are some examples of conflicts of interest that arise outside of conflicted remuneration and incentives?*
	Based on the fact that the issues that have been most prominently identified by the FMA/RBNZ relate to remuneration we recognise there is a case for focussing on these. If a broader duty (as outlined currently) is to be provided it is important that it does not overlap or confuse the overarching Option 1 duty. Our proposed revisions to Option 1 discussed above in response to question 1 would reduce this risk.
Question 3	*Is a code of practice required to provide greater certainty about what each overarching duty means in practice?*
	As discussed above, in order to provide greater certainty it will be necessary to support the proposed high-level duties, with further material to expand both on what they mean <u>and</u> to indicate how an entity could be confident it was complying with them. We agree with the Options Paper that concepts such as 'fair' and 'timely' could be, and should be, interpreted differently in various circumstances. Whilst we consider it will be necessary to support the high-level duties with further specificity, our initial view is that a code would not be the best approach. If however a code of practice was the to be used, its role and scope would need to be carefully considered and confirmed and the process for developing it outlined. Other (non-exclusive) options for providing greater certainty include: • Commentary or guidance material provided by the regulator (ideally collaboratively developed with industry and other stakeholders) and with consultation on the development of this required by the legislation. • Sector developed codes such as the Fair Insurance Code. • Sector issued guidance outlining good practice in particular areas or contexts. All of the above have a potential place and involve various trade-offs (for example sub-sector specificity vs. cross-sectoral consistency) and regimes overseas suggest a variety of methods can successfully co-exist. The most appropriate combination, and whether regulator or sector led material is more appropriate for certain issues/areas, is something that can be determined over time.

We also consider that further work could potentially be done on providing more detail in the legislation to support the interpretation of the high-level duties. This would support those duties with an explanation of how they might be applied to provide more certainty, rather than leaving this open to interpretation or for this to be provided in subordinate legislation or guidance/commentary.

Section 3.3 - Options to improve product design

Question 4

Which options for improving product design do you prefer and why? Do you agree with the pros and cons of the options? Are there other impacts that are not identified? Are there other options that should be considered? Do you have any estimates of the size of the costs and benefits of the options?

ICNZ supports Options 1 and 3 being further developed. We do not support Option 2 (Ban certain products).

Care should be exercised in the development and implementation of any new legislative obligations relating to product design and distribution to ensure the appropriate scope and design and avoid unnecessary ambiguity, cost, regulatory complexity and unintended consequences (e.g. stifling innovation).

Option 1 (Give the regulator the power to ban or stop the distribution of specific products)

Based on experience, particularly in Australia rather than New Zealand, we recognise there is a case for giving the regulator the power to ban or stop the distribution of specific products. The basis for its use and surrounding process would need to be outlined clearly in legislation and we consider further work is required to develop this option before it can be introduced. Matters that need to be defined on how and when this power might be utilised include:

- What is the legislative trigger for the regulator to use the power, is "particular poor customer outcomes" the preferred test? We note Australia uses different wording in the form of "significant consumer detriment". Given the significant commercial implications for financial product issuers from intervention, the threshold for intervention must be set sufficiently high and the Australian test may be more appropriate.
- What would be the criteria/measures to be assessed by the regulator in reaching a conclusion to ban a product? The Options Paper notes that for example this might include if an insurance product were to be considered to have a 'particularly poor successful claims rate'. If so, what period would this be measured over as for some products claims rates can vary significantly year to year? Also precision would be needed as to what successful claims rate means, is the intention to measure the number of accepted versus declined claims or to look at the amount of claims paid versus premium collected, which might be high despite a large number of declined claims?
- What would be the scope of a potential ban on the distribution of specific products? Would this be limited to a specific product supplied by a specific provider or enable broader regulatory intervention? In the case of annual products would they be allowed to run their course or be cancelled immediately, which would result in significant impacts for customers and providers?
- Transparency around the reasons for intervention is also paramount, to provide industry with sufficient comfort that intervention will not occur where there has been misunderstanding about the impact of conduct or a product feature on consumers.

- Consultation would need to be undertaken with relevant product providers and industry groups before any ban is imposed to ensure that the regulator has a comprehensive understanding of product features, value of the product to customers, the sales process and the impact of the ban.
- Product provider/s should have the opportunity to adjust a product if it is considered to potentially have poor customer outcomes. This would help ensure that aspects of value to the customer could be retained.
- If the regulator stops the distribution of a product, are there prescribed steps that a product provider must take, for example, notification to customer, refunding of monies held/premiums, offer other alternatives etc?

Option 2 (Ban certain products)

As outlined above ICNZ does not support Option 2, which we note is not a preferred option for MBIE. This option would need a very strong evidentiary base and would likely be impractical and/or ineffective to apply. It is also largely redundant as Option 1 would provide an ability for the regulator to take similar action.

We agree with the cons outlined in the Options Paper. Even where products have issues they may be delivering value to some customers and the issues may be able to be addressed through product changes. A ban may leave vulnerable customers with less protection than they currently have and dissuade manufacturers from designing products for such customers.

The Options Paper states in paragraph 147 that "products that have been suggested as poor value in the insurance sector include payment protection insurance, add on car insurance, funeral cover, accidental death cover and specified injury cover as these often have limited benefits for customers, or are commonly misunderstood." We recognise that concerns have been raised with some of these products, in Australia particularly, however we question for instance what evidence exists for the assertion in paragraph 147 of the Options Paper that payment protection insurance and add on car insurance provide poor value to consumers. The provision of such cover is an essential aspect of responsible lending. To provide debt to consumers without offering them a way to repay that debt if something goes wrong other than falling into default, hardship, bad debt, poor credit history, bankruptcy or repossession is highly irresponsible. If as a result of the introduction of a conduct regime, an unintended consequence was to make access to responsibly sold credit-related insurance harder for consumers, particularly the more vulnerable ones in the community, this would be counterproductive in terms of good consumer outcomes for vulnerable customers.

We also note that some products are event dependent over time and so the value needs to be measured over an extended period and in light of relevant circumstances. For example, an assessment of domestic earthquake cover made prior to 2010 on suitability and pricing may be very different to an assessment made today.

Option 3 (Requirement for manufacturers to identify intended audience for products AND a requirement for distributors to have regard to the intended audience when placing the product)

Whilst we support Option 3 being further progressed, we recognise that the two limbs are quite separate obligations and therefore need to be considered separately.

Requirement for manufacturers to identify intended audience for products

In accordance with prudent business practice ICNZ supports product design and distribution that is appropriately tailored to an identified target market. The soon to be released revised Fair Insurance Code will require insurers to develop, market, and sell products responsibly.

This is an area where the scope of the requirement needs to be determined carefully, is this just for consumer products or all products? It is good practice in all cases but the context is different and the compliance costs will be greater if it is the latter, as well as the potential for unintended consequences. For instance, businesses are often required to hold certain insurances for commercial or regulatory reasons. That business may not be the target market and so could be unable to obtain this insurance meaning they can't comply. While the business community in New Zealand would likely recognise and resolve such an issue, it would cause businesses difficulties in the interim.

The product design phase will often use focus groups, local and overseas experience (often via competitor, intermediary and/or reinsurance feedback). Needs analysis conducted by direct and intermediated channels also provide insurers with insights that assist in developing optimised products for customer groups and individuals. While there is a cost for manufacturers in investing in the time and effort to ensure products are designed for suitable audiences, a well-designed product for an appropriate audience should be able to adequately offset these costs.

The nature of insurance as a risk transfer mechanism sets insurance products apart from other financial products, and this has important implications for how insurance products are designed. General insurers manage the transfer of insurable risks that are specified and predefined. Insurers will mitigate the risks they underwrite through pooling, by aggregating a number of individual risks into a pool thereby spreading the impact of unexpected loss from the individual insured to the group. Insurers also mitigate the risks they underwrite through pricing; by placing a cost on higher risks relative to lower risks.

Effective risk mitigation is the foundation of a sustainable insurance sector. A general insurance product's covers, exclusions and terms are all crafted to reflect the underwriting model's objective to sustainably manage risk. It is essential therefore that any legislative product design and distribution obligation does not interfere with insurers' ability to prudently underwrite risks and source reinsurance. Undermining underwriting integrity could have far broader and destabilising impacts on the insurance sector, the costs of which will ultimately be borne by consumers.

How such requirements would be applied to existing products and whether periodic reviews of products are required needs to be provided for in the framework. Reviewing products to ensure that the identified target market and distribution channel continues to be appropriate is good business practice. However, this needs to be applied in a risk-based manner in the context of the particular product and should be able to be undertaken at the discretion of the product issuer subject to policies and/or appropriate triggers, avoiding extra costs from meeting arbitrarily set deadlines for review.

This is another area where the duty may need to apply to both manufacturers and distributors as it would be impractical for a manufacturer to comply with the assessment of ongoing suitability without support and co-operation from distributors who in essence 'own' the customer relationship and the communication with the customer (e.g. brokers or retail banks that provide insurance products govern such communications and processes with their customers tightly). There is also the situation where the intermediary is involved in designing the product (i.e. policies with broker wordings).

For some general insurance products, any target or non-target market may be very broadly defined. For a home insurance policy that covers most of the generic risks that consumers commonly expect to be covered, the only non-target market may be consumers who are not homeowners. An explicit recognition in the legislation may be necessary that for some simple mass-designed products there may be limited target and non-target markets.

Finally, we note that the development of the requirements of this kind in Australia went through a number of steps and consultations before being implemented.

Requirement for distributors to have regard to the intended audience when placing the product

An obligation on distributors to have regard to the intended audience when placing the product is appropriate and helps to ensure that customers interests are being taken into account at the point at which the product is distributed.

Where the distribution is undertaken by an intermediary working for the customer (e.g. a broker working for a FAP) this obligation should rightly fall on that intermediary rather than the product developer. Obligations on providers should focus on what is within their control (e.g. the sufficiency of information provided to intermediaries on the product and the customers it is intended for). Overall, this needs to be consistent with the wider approach to the responsibility for intermediaries we have articulated.

The distribution obligations also need to apply proportionally and sensibly to the renewal of insurance policies in the context of the issues that have been identified. We don't consider insurers should be required to meet additional information collection requirements for the purposes of ascertaining whether a customer still falls within the target market. Otherwise this is going to substantially complicate the renewal process for both insurers and customers.

Care also has to be taken to ensure distribution obligations don't substantially limit consumer choice. Most general insurance products distributed directly by insurers are sold through channels providing limited or no financial advice. Consumers are provided with general information and tools, such as sum insured calculators, to assist them to make an informed choice. Insurers and distributors should through the provision of information play a role in assisting the consumer to make appropriate decisions, however, insurers and distributors should not be required to override consumer decisions when the consumer has been informed and clearly exercised choice in the matter.

As part of customers making an informed choice, it is also necessary for there to be disclosure of all remuneration associated with providing/distributing the product, whether or not financial advice is given.

In regard to the analysis underpinning the last con listed on page 39:

> "The process of a distributor determining whether a particular customer fell within the target audience and then choosing whether to sell the product to that customer may constitute financial advice. It is possible that this option could therefore result in all sales of financial products being deemed to be financial advice."

We consider that a sale can be made without financial advice. Determining eligibility criteria (e.g. outside target market?) and then making that product available to someone within that eligibility criteria would not necessarily constitute financial advice. It will depend upon the breadth of the obligation in determining whether the customer fits the intended audience as to whether this could constitute a recommendation for a financial product.

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.*
	General insurers provide a wide suite of insurance products in many different areas and to many different types of customers. These range from the common consumer products (home and contents, motor, travel etc) to speciality and/or complex commercial products that might be distributed to only small numbers of customers. The clear focus of these conduct reforms is interactions with consumers and so focussing on the products made available to consumers would be a proportionate and logical approach. Commercial clients are either sophisticated buyers and/or are usually represented by qualified brokers or financial advisers who will be experts acting on their clients' behalf in negotiating general insurance coverage. Accordingly, we consider a design and distribution requirement like option 3 is best applied to consumer products only. Any product review requirements should be risk based rather than subject to arbitrary review timelines for example.

Section 3.4 - Options to improve product distribution

Question 6	*Which options to improve product distribution do you prefer and why? Do you agree with the pros and cons of the options? Are there other impacts that are not identified – such as unintended consequences or impacts on particular business models? Are there other options that should be considered? Do you have any estimates of the size of the costs and benefits of the options?*
	ICNZ supports MBIE's preferred Options of 1, 2 and 5 being further developed. We do not support Options 3 and 4. *Option 1 - A duty to design remuneration and incentives in a manner that is likely to promote good customer outcomes* ICNZ supports Option 1 being further developed. We agree that rewards based on sales performance alone can create tensions with good customer outcomes, particularly for staff in customer facing roles. We do note that the examples identified by regulators in New Zealand of concern so far have not been in the general insurance sector and that increased disclosure requirements are also being introduced as part of the FSLAA reforms, targeting largely the same issue. It is also important that remuneration and incentives enable the provision of financial advice to be accessible for consumers. The introduction of this duty would need to be supported by further detail and expansion (e.g. commentary or guidance) to provide greater certainty to entities in its application. *Option 2 - A ban on target-based remuneration and incentives, including soft commissions (this would apply to both in-house staff and to intermediaries)* We support Option 2 being further considered and developed. Further clarity is however required on what is considered a 'soft commission' or non-monetary benefit (and therefore what is allowed or not allowed). For example, providing incentives such as professional development, training and compliance support to intermediaries based on sales volumes should be encouraged as this raises standards, increases product knowledge and contributes to good customer outcomes. The scope of this Option needs to be clarified in terms of which staff it would apply to (i.e. only those staff involved with distributing products to consumers?). Given the commentary and the issues this Option is seeking to address (i.e. removing incentives to

mis-sell products) it would be most appropriately focussed on those in direct customer facing or sales roles. The rationale for the prohibition outlined in the Options Paper would not apply to prohibit other staff (e.g. marketing or finance) from having company-wide (as opposed to personal or team) sales-based incentive targets.

Option 2 should only act as a ban on remuneration that is based purely on targeted sales. For example, it may be appropriate to have targets for other things, such as having conversations with customers on an ongoing basis. A balanced scorecard approach which includes measures of value, customer satisfaction, complaints, claims outcomes and broad financial performance should not be prevented.

There is also the issue of how intermediaries structure their own incentives (e.g. rewarding top sales staff) independent of the contractual relationship between intermediary and the product manufacturer. This is an example of where intermediaries need to be subject to the conduct duties to avoid gaps in the regime and prevent the ability for intermediaries to structure their involvement in a way that it is exposed to the lowest level of regulation. This risk could be compounded if some distributors are not subject to the planned disclosure regulations under the FMCA because they don't provide financial advice.

Clarity is also needed that in the absence of sales targets, a financial institution should not be prevented from fostering a good business relationship with its intermediaries, for example, by hosting them at social events.

Option 3 - Prohibit all in-house remuneration and incentive structures linked to sales measures

We do not support this option, largely for the reasons outlined against it in the Options Paper. This would treat financial services entities fundamentally differently from other parts of the economy and cut across standard commercial and organisational approaches.

Other options proposed here as well as the increased disclosure of commissions should significantly address concerns that have been raised with incentive structures, in the life insurance and banking areas in particular, with less of the problems and risks associated with Option 3.

Option 4 - Impose parameters around the structure of commissions (i.e. commissions paid to intermediaries)

We do not support this option for the reasons outlined against it in the Options Paper.

Option 5 - A duty on manufacturers to take reasonable steps to ensure the sales of its products are likely to lead to good customer outcomes

We support this option being progressed. It is important progressing this option does not have the unintended consequence of a significant increase in compliance costs (which may ultimately be borne by consumers) and does not slow down the process of customer onboarding, for example, the timely issue of an insurance policy.

The extent to which product providers would need to have oversight of intermediaries' activities is not clear from the proposed duty at this stage. A pragmatic approach as to what constitutes 'reasonable steps' will be needed so that there is not a dis-incentive for financial institutions to take on additional intermediaries as this could lead to less access to financial advice. It also needs to address the situation where an intermediary distributes products for many product manufactures, do all the manufacturers have to undertake the same reasonable steps, which could be very inefficient? How a pragmatic

	position is ultimately to be reached should be thought through before the legislation is made to ensure a degree of certainty. We note the concerns in the Options Paper regarding the lack of oversight of intermediaries. We acknowledge that the arrangements between the financial institution (that often manufactures the product) and the intermediary are to be determined between the parties. However, we consider that regulation which enforces the need for intermediaries to demonstrate to financial institutions that they are delivering good customer outcomes and to share information in this regard will be essential to support financial institutions in helping ensure good customer outcomes.
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 (i.e. what are common structures, average amounts of remuneration/commissions, qualifying criteria etc.?)*
	ICNZ members will have various structures in place for various insurance products. Insurers have teams of in-house staff and/or work with various distributors on an independent or tied basis. As there is no "one size fits all" remuneration model that would be appropriate a more principles-based approach taken to incentives and remuneration is better for ensuring that insurers can continue to offer their products in the way that is appropriate while avoiding stifling innovation in distribution models.

Section 3.5 - 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? Do you agree with the pros and cons? Are there other impacts that are not identified? Are there other options that should be considered? Do you have any estimates of the size of the costs and benefits of this option?*
	As outlined in Part 1 of this submission, while we have significant concerns with the content of the Options Paper related to claims handling, we are supportive of the introduction of a legislative duty to ensure claims handling is fair, timely and transparent. Our Fair Insurance Code already provides an almost identical duty to "manage your claims quickly, fairly and transparently". It is not obvious however based on the content of the Options Paper how this duty would be given effect to under legislation or what role the regulator would take in monitoring insurers handling of claims and the scope of this (e.g. consumer claims only?). The interaction of this with existing regulatory measures such as external dispute schemes also needs to be considered. We recommend further engagement is undertaken with the insurance sector and related parties such as external dispute resolution schemes on how this would be implemented before the legislation is finalised. Consideration also needs to be given to whether this duty is most appropriately provided for in conduct regulation for financial institutions or in insurance contract law.
Question 9	*If this option were to be adopted, should an attempt be made to clarify what fair, timely and transparent mean? Why? Why not? What are the benefits and costs of doing so?*
	In the Fair Insurance Code we set out what managing claims quickly, fairly and transparently entails (refer paragraphs 27 – 33 of the 2016 version). It will be necessary once the regime is in effect to establish clear and workable expectations for entities with regard to fair, timely and transparent claims handling because relying purely on high level principles could leave significant regulatory

	uncertainty in the application of the duty. How this is best done, and the role of existing self-regulation should be determined through further engagement.
Question 10	*What is your feedback on requiring the settlement of claims within a set time? Are there other impacts that are not identified? How do you think that exceptions should be designed? Should there be different time requirements for different types of insurance? Do you have any estimates of the size of the costs and benefits of this option?*
	There should not be a regulatory time limit for settling claims. Each claim has a unique set of circumstances and facts. As well as requiring the active participation of the insurer and the insured it also often involves third parties such as car repairers, builders, engineers etc. As such we agree with this not being a preferred option. Insurers are incentivised to settle claims because they need to reserve money against unsettled claims. When a claim is made, an insurance company will assign a claims reserve to each file reported, reflecting its best estimate of the eventual settlement amount. The outstanding claims reserve is an actuarial estimate, as the amounts liable on any given claim is not known until settlement. Claims reserves are future obligations of an insurance company and are classified as liabilities on the insurance company's accounting statements since they must be settled at a future date. The RBNZ also imposes a capital charge in regard to outstanding claims under the prudential requirements. Ultimately there is no sensible way of putting in place an arbitrary deadline for setting claims. For instance a 2-year deadline would be irrelevant for the vast majority of claims that are settled far quicker than this, but would as identified in the Options Paper require an exception for some of the more complex claims and/or where there are vast numbers of claims, such as following a major natural disaster. While we don't consider a regulatory deadline for claims to be an appropriate or useful addition, we note the revised Fair Insurance Code being issued this year will consider it a significant breach of the Code if a claim is not settled within 12 months, unless there is a good explanation. This is the sort of pragmatic requirement that can be introduced through an industry Code to signal expectations and improve outcomes for customers, without the challenges associated with an arbitrary regulatory deadline.

Section 3.6 - Options for tools to ensure compliance

Question 11	*Do you agree with this option to empower and resource the FMA to monitor and enforce compliance? Do you agree with the pros and cons? Are there other impacts that are not identified? Are there other options that should be considered? Do you have any estimates of the size of the costs and benefits of the options?*
	We are supportive of the FMA being empowered to monitor and enforce the proposed regime. It will need sufficient capability to undertake these functions. As discussed above in Part 1 of this submission, how this will function needs to be carefully considered <u>before</u> the legislation is passed as it is fundamental to the full design of the regime and the future setup and resourcing of the FMA. The pros and cons identified are appropriate. In regard to costs we note FMA fees for larger entities are already being increased as a consequence of the FSLAA reforms and so resourcing the FMA further to be a conduct regulator, if fee based, would represent another significant increase in fees for the sector in a relatively short period of time. These additional costs are ultimately passed through to customers.

	The increased scope of the FMA's role may also require it to revisit its name as regulating the conduct of financial services (including insurance) does not neatly fit within the scope of "financial markets".
Question 12	*What is your feedback on the option to require banks and insurers to obtain a conduct licence? Do you agree with the pros and cons? Are there other impacts that are not identified? Are there other options that should be considered? Do you have any estimates of the size of the costs and benefits of the options?*
	We do not support conduct licensing at this stage. Conduct regulation should be introduced first and licensing should follow if it is considered necessary. Insurers are already licensed under IPSA and a number will also become licensed FAPs. Introducing separate licencing in relation to conduct would lead to further complexity and compliance and oversight costs that will impact the cost of insurance in New Zealand. If licensing was to be introduced it would be critical that any licensing requirements are integrated with existing or planned licensing requirements (e.g. FAP licensing) to minimise this. For this not to be the case would be unacceptable given the likely overlap between these two regimes. Given the Government's desire to fast track conduct regulation, we also note licensing would likely slow this down. For example, despite the FSLAA changes having been in the pipeline for a number of years (and now passed into law), entities are still awaiting transitional licensing requirements which are supposed to be straightforward (not to mention the more detailed full licensing requirements).
Question 13	*What is your feedback on this broad range of regulatory tools? Do you agree with the pros and cons? Are there other impacts that are not identified? Are there other options that should be considered? Do you have any estimates of the size of the costs and benefits of the options?*
	We support the regulator having an appropriate range of tools to properly undertake its functions. If this requires a greater sector contribution to the FMA's funding, then that should be consulted on separately. Given the new and principles-based nature of the proposed conduct regime it is important that the regulator is able to work constructively with entities, particularly in the early years of the new regime, to ensure legal requirements are being met. This should include making recommendations on improvement actions where weaknesses are identified, rather than relying on enforcement action to pursue issues where problems have arisen. A proactive and constructive approach is best suited to addressing risks that have been identified, as opposed to situations where poor conduct has already caused customer detriment. Given the legislation will be principles based and the industry will take time to reach common standards, with product providers taking a good faith approach to compliance, we also suggest an initial grace period (say 2 years) for any enforcement action from regulators would be appropriate. One of the key parts of a new conduct regime will be the regulator's approach to monitoring and enforcement. This will need to reflect how it undertakes monitoring, how matters are identified for formal investigation, how the regulator decides what enforcement tools to use and how it interacts with regulated entities and others during enforcement actions. Clarity is also required on the extent to which the regulator will seek for customers to be remediated as opposed to seeking to punish contraventions of duties etc. Financial institutions should in any case be given a reasonable opportunity to respond before regulatory action is taken.

	With regard to the pros identified below paragraph 195. We agree with the first two bullet points. Given the high-level principles-based regime we are concerned that an approach that focusses on enforcement and with no proactive engagement by the regulator risks creating both significant uncertainty for regulated entities (e.g. find out they are doing something wrong after enforcement action is commenced) and reduces the potential for the regulator to engage with and understand entities activities, thereby missing opportunities for proactive identification of issues. As discussed elsewhere in this submission this is a fundamental element of regulatory approach that needs to be resolved before this legislation is progressed. In terms of cons not identified in the Options Paper, there will be an increase in costs for financial institutions in responding to (and potentially defending) regulatory action, on top of any costs of remediating conduct issues.
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? Is there a case for making the penalties higher?*
	The context of penalties for non-compliance with the proposed conduct regime is materially different to that applying to market related matters under the FMCA. The FMCA is relatively prescriptive in terms of requirements and therefore it is easier to understand the compliance requirements. Also, FMCA penalties are up to $5m, which is high and seems more appropriate for investment products rather than insurance products. Penalties for conduct regulation should reflect these differences and the penalty regime should be structured so it is proportionate to the seriousness of the breach. We also note that the scale of penalties in the regime, and whether they are insurable, could affect the future pricing of liability insurance, as has been seen in Australia.
Question 15	*What is your feedback on the option of executive accountability? Do you agree with the pros and cons? Are there other impacts that are not identified? Are there other options that should be considered? Do you have any estimates of the size of the costs and benefits of the options?*
	ICNZ does not consider that an executive accountability regime should be introduced as part of the proposed fast-track legislation on conduct regulation. ICNZ recognises the Australian Royal Commission has recommended extending Australia's Banking Executive Regime (BEAR) to cover both prudential and conduct obligations of all banks and insurers and that the proposed amendments to the *Credit Contracts and Consumer Finance Act 2003* contained in the current *Credit Contracts Legislation Amendment Bill* introduce liability for directors and senior managers of creditors. We note the introduction of BEAR in Australia was on the back of a degree of misconduct and breaches that were not identified in the Options Paper as occurring here. We broadly agree with the pros and cons that have been identified in the Options Paper. However, whether there is a gap in current behaviour in New Zealand that requires such a tool to be introduced, and if so whether the benefits would outweigh the compliance costs and potential chilling effects of such a regime is an entirely different question. This requires a clear cost benefit analysis that has not yet been undertaken and it will be necessary as part of this to assess what the additive value of this would be on top of the other proposed conduct regulation.

	Also, as noted above increased risk eversion is a particular issue if the regime is based on high level principles (as proposed) rather than clear legal lines and where establishing 'compliance' can be less clear cut.
Question 16	*What is your feedback on the whistleblowing option? Do you agree with the pros and cons? Are there other impacts that are not identified? Are there other options that should be considered? Do you have any estimates of the size of the costs and benefits of the options?*
	We agree with the pros and cons outlined in the paper. ICNZ supports appropriate whistle-blowing policy and procedures to be in place, though given the fact that most entities have them in place already, the value of a regulatory intervention in this area appears limited.
Question 17	*What is your feedback on the option of regular reporting on the industry? Do you agree with the pros and cons? Are there other impacts that are not identified? Are there other options that should be considered? Do you have any estimates of the size of the costs and benefits of the options?*
	ICNZ agrees that reporting on sector statistics improves transparency and enables public scrutiny and we already publish market data on various business lines (e.g. home and contents, motor, liability etc.).[6] We do not however support the loosely framed Option 7 (Require regular reporting about the industry) being progressed at this time based on the limited discussion included in the Options Paper. Both the scope and purpose of Option 7 is ambiguous. Firstly, what 'industry' is the Options Paper discussing here. The financial services industry is considerably more than just banks and insurers and to report on the entire industry would be a massive role for whatever entity was charged with doing so. Furthermore, whilst the scope of the Options Paper generally is financial services, based on the commentary in paragraphs 207 and 208 this aspect seems focussed on the insurance sector alone, although that is not stated. The Options Paper mentions potential statistics on remediation activities, loss/claim ratios for insurance products, reasons for declined insurance claims, number of complaints. Whether this is a deliberate signal of scope or simply reflects the fact that only insurance related metrics could be identified is unclear. We note some of these metrics are already published in various ways and others would need to be handled carefully to avoid drawing misleading conclusions. To consistently collect and report such statistics would therefore require detailed work on definitions and methods. For example, any statistics on claims declined would need to be based on precise definitions of when a claim is declined (e.g. the claim is excluded (or not covered) under the policy terms, but the policyholder believes that it should be covered, fraud by the insured etc) vs. when a claim is withdrawn (e.g. claim was under excess or the insured chose to preserve their no claims bonus, the insured accepted that the event was not covered under their policy etc.). Loss/claim ratios for insurance products also need to be considered carefully as they vary across products and time for a variety of reasons and simplistic but misleading conclusions can be drawn in the absence of context and understanding.

[6] https://www.icnz.org.nz/media-resources/market-data/

	We also note the annual telecommunications market monitoring report[7] prepared by the Commerce Commission under section 9A of the *Telecommunications Act 2001*, which is referred to in paragraph 209, provides market information at an aggregated sectoral level. It does not to our understanding publish information about specific companies, unless publicly available. Finally, new reporting requirements have the potential to create significant costs for financial institutions as data is collected and reported differently in each organisation and systems for this are expensive to change if consistency is required across the industry. A significant volume of reporting is already provided to regulators and industry bodies and any new reporting requirements should as far as possible be consistent with this to avoid duplication of work and costs. Any consideration of new reporting requirements needs to clearly identify what information is required, and for what purpose (i.e. what is the problem definition?) and should be underpinned by a clear cost-benefit analysis. It is critical to resolve the why before turning to the what and then how this might be collected or published and more detailed issues such as frequency etc. In summary we oppose Option 7 as we do not see the compelling case for progressing this in haste at this time as part of fast-tracked conduct regulation and suggest this is subject to further engagement, scoping and development before consideration is given to progressing it further.
Question 18	*What is your feedback on the role of industry bodies? Do you agree with the pros and cons? Are there other impacts that are not identified? Are there other options that should be considered? Do you have any estimates of the size of the costs and benefits of the options?*
	ICNZ has been working with its members and stakeholders for many years on developing and implementing the Fair Insurance Code. This Code aims to set and lift industry standards and operates either above regulatory minima, or in place of it. Voluntary codes like the Code are also agile and can be reviewed with changes made quicker than legislative change (e.g. a "reasonable" response to non-disclosure by insureds was introduced some years ago, with any legislative changes to this still some years away). While we recognise the limitations of self-regulation, its value cannot be simply discounted and we reject the fairly sweeping statements diminishing its role, such as in regard as to conflicts of interest in the 4th and 5th bullet points in the list of cons under paragraph 210. It also fails to reflect that sectors have a strong interest in their reputation and realise the damage that can be done to this from bad conduct by a single entity. We also note that if government overall took such a blanket view of the conflicts of interest associated with industry associations and sector bodies, self-regulation across a wide range of sectors might need to be significantly re-thought. In administering the Fair Insurance Code we let the external dispute schemes decide if the Code has been breached and we collect data on breaches of it. We have a Code Compliance Committee to oversee the Code that has included a former Ombudsman, a Governor-General and a Chief District Court Judge. This group has met with the

[7] https://comcom.govt.nz/regulated-industries/telecommunications/monitoring-the-telecommunications-market/annual-telecommunications-market-monitoring-report

	external dispute schemes, held in depth discussions with the schemes about breaches, the scale of breaches and significant breaches and not found issues of concern. Where significant issues have arisen, we have fined a member $100,000 and imposed requirements to report for 12 months giving assurances on good conduct. There has been a hugely positive change from that member. We consider there is an ongoing role that can be played by industry bodies in regard to improving conduct and consider they complement the regulatory drive for good conduct and culture. Industry bodies are also well placed to work constructively with regulators on setting and lifting industry standards. There will be a continuing role for industry bodies in providing Codes that both articulate what good conduct in line with the statutory duties looks like (noting a potential for overlap with regulatory guidance) and potentially imposing higher or additional standards to those that are created in regulation. ICNZ agrees however that currently there is no need to expand and formalise the role of industry bodies through legislation, which would fundamentally change the basis of voluntary organisations such as ICNZ. Proposals to do aspects of this in Australia are also highlighting some of the challenges with this. We note the comments in the Options Paper that this would require regulator supervision of industry bodies and we consider the cost and added layers of regulation may detract from the work that industry bodies are already undertaking in the conduct space.

Section 4.0 – who should the conduct regulation apply to?

Question 19	*What is your feedback on the options regarding who the conduct regime should apply to? In particular: Do you agree with the pros and cons of the options? Are there other impacts that are not identified e.g. do the proposed overarching duties conflict with existing regulation that applies to other financial institutions? Are there other options that should be considered? Do you have any estimates of the size of the costs and benefits of these options? Which options do you prefer and why?*
	What types of customer interactions are trying to be regulated? As outlined above in Part 1 of this submission we consider that the conduct regime should apply to interactions with consumers, as defined in the *Fair Trading Act* and *Consumer Guarantees Act*. ***Application of options to banks, insurers and other financial institutions*** As outlined earlier in this submission ICNZ considers that it is critical the scope of conduct regulation is appropriately comprehensive (both in terms of scope of entities covered and the nature of interactions covered). We are particularly concerned there is a risk of an incomplete regime that also does not integrate effectively with the new regime for financial advice under the revised FMCA. From a customer centric point of view the regime must impose similar requirements, controls and protections on the provision of financial services regardless of the distribution channel being utilised. The key gap, which is not discussed in this section of the Options Paper, is the application of the conduct regime, or parts of it, to intermediaries, particularly those that will be licensed financial advice providers. Overall, we support applying the preferred package of options to all those financial services providers that offer similar services to banks and insurers (Option 2) as this would mean an even playing field and help ensure consistency for customers. We

consider that the preferred package of options should also apply, at least to some extent, to those financial service providers that do not necessarily manufacture products. As discussed above in Part 1 of this submission, not all distributors provide financial advice so they will not be governed by the financial advice regime. If they are also not governed by conduct regulation, this would be a significant gap in regulation.

The conduct regulation should not apply to re-insurers. As re-insurers are also licensed by RBNZ this classification should not be used for conduct regulation, at least not without providing for this distinction.

Finally, we note that regarding the use of the term "insurers", footnote 1 on page 9 of the Options Paper in regard to general insurance lists only three classes of common retail insurance but does not include for example, travel, commercial, rural, or liability insurance.

Overlap with existing regulation

ICNZ could support either of the proposed options in this area. However, whichever is chosen it is critical that the overlay or carve-out is done thoroughly and effectively and this will take time and further engagement.

Option 1: Overlay preferred package of options onto existing regulation

As outlined elsewhere, it is critical that the new conduct regulation is integrated effectively rather than just overlaid on existing regulation (including most significantly the recently passed FSLAA amendments, which are not mentioned in this part of the Options Paper, and the CCCFA).

Option 2: Carve out overlaps from existing regulation

Given the highly overlapped nature of the regimes it will be necessary to clarify the overlaps clearly – either to carve them out or to test carefully whether they are compatible and integrated. In principle we could support carving out direct overlaps from existing regulation as this would reduce duplication and uncertainty as to the applicable legislation, so long as this did not create gaps or asymmetries (e.g. different entities being subject to different obligations or penalties in regard to certain areas) or undue confusion.

Entity vs product level regulation

Option 1: Apply obligations at the entity, rather than product, level

We note the only option proposed is to apply obligations at the entity level. We agree that an entity-approach will require financial institutions to have regard to customer outcomes at all levels of their interactions with customers. However, the issue with this approach is that, as discussed elsewhere in this submission, it opens up potential gaps in regard to entities that offer the same or similar products but are not subject to the regime. Key concerns here are policyholder protection and competitive neutrality between the regulated community and the unregulated community.

For example, in regard to insurance there is material insurance business carried on outside the scope of IPSA (and the conduct regime if it applied to insurers licensed under IPSA):

- **Types of contract that are currently deemed not to be insurance contracts under IPSA – including warranties, guarantees, and waivers.** IPSA has created the opportunity for people selling indemnity contracts for a fee to game IPSA by tailoring their contractual offering to be or look like a warranty, guarantee or waiver rather than an insurance contract.

- **Unlicensed (by the Reserve Bank) foreign insurance firms that insure New Zealand policyholders.** We understand that an increasing amount of insurance is being placed with this category of offshore insurer, and with disruptive technologies and purchasing through digital channels that may continue to increase in future.

There can also be consumer confusion about the use of the term "insurance". While section 219 of IPSA prohibits the use of specific words in names and section 16 of IPSA restricts representations of being a "licensed insurer", we have proposed in the review of IPSA that consideration should be given to extending this to a more general prohibition on activity and conduct by non-insurers representing themselves to customers as insurers. It is important for customers to be fully aware of whether they are engaging with an insurer or non-insurer (regardless of name and licensing).

As outlined elsewhere we consider the new conduct regulation should be focussed on interactions with consumers and so the extent to which entities that offer only commercial insurance products in New Zealand should be covered needs to be assessed.

Another specific issue to be determined is whether the Earthquake Commission (EQC) should be subject to the proposed conduct regime in regard to its handling of claims. As discussed in Part 1 above we consider it should be.

Thank you again for the opportunity to submit on the Options Paper. If you have any questions, or wish to discuss further the development of proposals contained within the Options Paper, please contact our Regulatory Affairs Manager on Privacy of natural persons or by emailing Privacy of natural persons.

Yours sincerely,

Tim Grafton
Chief Executive

Andrew Saunders
Regulatory Affairs Manager

Appendix – Consumer and commercial definitions and distinctions

Framework	Commercial/larger business	Consumer/small business
Financial advice regime (as per FSLAA) Both definitions being inserted into new Schedule 5 of FMCA Proposed distinction in conduct regulation Options Paper	A person is a **wholesale client**, in relation to a financial advice service or a client money or property service (unless the person has opted out from being a wholesale client under clause 5) if— (a) the person is an investment business under clause 37 of Schedule 1; or (b) the person meets the investment activity criteria specified in clause 38 of Schedule 1; (e.*g. owns or has owned, a portfolio of specified financial products of at least $1 million or has carried out 1 or more transactions to acquire specified financial worth at least $1 million*). or (c) the person is large under clause 39 of Schedule 1 (*e.g. net assets exceeded $5 million or exceeded $5 million*); or (d) the person is a government agency under clause 40 of Schedule 1; or (e) the person is in the business of being a product provider and receives the financial advice service or client money or property service in the course of that business; or (f) the person is an eligible investor in relation to the service under clause 5 of Schedule 1.	A **retail client**, in respect of a financial advice service or a client money or property service, is a client of a provider of that service who is <u>not</u> a wholesale client.
Dispute resolution schemes	Organisations with **20 or more full-time equivalent employees**.	**Individual customers** and organisations with 19 or fewer full-time equivalent employees.
ICNZ's Fair Insurance Code	Code does not apply to entities with **20 or fewer employees**.	Code applies to **individuals** and entities with 19 or fewer employees.
Fair Trading Act 1986 and Consumer Guarantee Act 1993	Not a "consumer".	**consumer** means a person who— (a) acquires from a supplier goods or services of a kind ordinarily acquired for personal, domestic, or household use or consumption; and (b) does not acquire the goods or services, or hold himself or herself out as acquiring the goods or services, for the purpose of— (i) resupplying them in trade; or (ii) consuming them in the course of a process of production or manufacture; or (iii) in the case of goods, repairing or treating, in trade, other goods or fixtures on land
Australia Corporations Act, section 761G(5) Insurance Contracts Act 1984	Not a retail client.	The following criteria must be met before an intending policyowner is classified as a '**retail client**' in relation to general insurance contracts: (a) the policyowner is either an individual, or the insurance is for use in connection with a small business, defined to mean one employing fewer than 100 people in the case of a manufacturer of goods, or one with fewer than 20 people in other cases; and (b) the contract of insurance is one or other of 7 specified types, 6 of which correspond to the description of prescribed contracts in the Insurance Contracts Act 1984 (IC Act) and its regulations, namely, motor vehicle, home building, home contents, sickness and accident, consumer credit, travel and medical indemnity insurance. There is provision for further kinds of contract to be prescribed by regulation.[8]

[8] From Background Paper 14 titled "General Insurance" to the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, June 2018. Available from https://financialservices.royalcommission.gov.au/publications/Pages/default.aspx.

Framework	Commercial/larger business	Consumer/small business
United Kingdom Consumer Insurance (Disclosure and Representations) Act 2012	"**non-consumer insurance contract**" means a contract of insurance that is not a consumer insurance contract;	"**consumer insurance contract**" means a contract of insurance between— (a) an individual who enters into the contract wholly or mainly for purposes unrelated to the individual's trade, business or profession, and (b) a person who carries on the business of insurance and who becomes a party to the contract by way of that business (whether or not in accordance with permission for the purposes of the Financial Services and Markets Act 2000)"