



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

7 June 2019

## **Submission on Options Paper: Conduct of Financial Institutions**

The New Zealand Society of Actuaries (“NZSA” or the “Society”) welcomes the opportunity to comment on the above Options Paper.

The NZSA is the professional body for actuaries practising in New Zealand. Our purpose includes establishing, promoting and maintaining high standards of competence and conduct within the actuarial profession and providing a source of reference on actuarial matter for government and various official and interested bodies.

The form of this submission is to make some specific comment on the matters we wish to highlight in the body of this letter and to attach our responses to some of the questions raised as an Appendix to this submission (including repeating points from the main section where relevant).

### **Legislate overarching duties to govern conduct**

**A duty to consider and prioritise the customer’s interest, to the extent reasonably practicable**

Actuaries are intimately involved in pricing insurance products. Pricing products of necessity involves striking a balance between customers (policyholders) and shareholders (or other policyholders in the case of a mutual). We believe the ambiguity in this duty is unworkable for our members as no guidance is given on how to balance these two competing interests when setting premium levels.

At a basic level policyholders appear to be advantaged by low premiums, but ultimately this may lead to poor service and/or reduction/withdrawal of capacity in the market.

Shareholders are willing to provide capital to bear the insurance risk of providing a product to policyholders. Various insurance products present different insurance risks and therefore may warrant higher or lower profit margins in order to generate the equivalent return on capital. In the absence of being able to generate a sufficient return on capital it is logical for insurers to withdraw from the market or segments of it.



In this context “prioritising the customer’s interest” is open to differing interpretations, as requiring premiums to reduce to meet customers’ interests may result in a decline in the availability of insurance. This decline is unlikely to be in customers interests in the longer term.

We suggest a duty to treat “customers reasonably” will achieve the policy intent with less confusion.

In our view treating customers “reasonably” would mean balancing their interests with those of the insurer’s shareholders and from a pricing perspective, customers would pay a price (i.e. a premium) that provides for:

- The expected cost of the risk being insured,
- The costs associated with the distribution and administration of the policy; and
- Profit such that the insurer generates a reasonable return on the capital necessary to provide the insurance cover.

It’s important to recognise that capital is necessary to support an insurer’s solvency position. That is, to provide the financial security such that the insurer will be able to meet the policyholders’ claims when they arise. It is also important to understand that the Insurance (Prudential Supervision) Act requires insurers to hold minimum amounts of capital and that without capital insurers cannot operate.

In addition, while it may be an issue of grammar, we believe the focus should be on the customers’ interest rather than customer’s interest. That is, focus on the interests of customers as a collective rather than individually. By definition insurance operates as a collective pooling of risk and essentially provides a subsidy from customers who do not claim to those that do claim. Actions that are in the interest of an individual policyholder may not be in the interests of the collective of policyholders. A simplistic example illustrates this:

Most car insurance policies will not provide cover in the event of an accident if the driver has excess breath alcohol at the time. It would undoubtedly be in the best interests of such a customer for the insurer to meet their claim. However paying a claim to them (and any other similar motorists) increases the overall cost of claims and ultimately will increase the cost of the insurance to all policyholders.

It is our view that it in the example above it is in the interests of the collective policyholders not to provide cover for drivers with excess breath alcohol, even though it is arguably not in that customer’s interest. It is also arguably not in society’s interest to remove a disincentive to driving with excess breath alcohol.

## **Products are suitable for customers**

Give the regulator the ability to ban/stop the distribution of specific products if they have particularly poor customer outcomes (e.g. specific insurance policies with particularly poor successful claims rates)



The term good “customer outcomes” is used frequently in the Options Paper. In this circumstance the term used is poor customer outcomes. The meaning of “good customer outcomes” is unclear and open to differing interpretations and measurement. We believe it likely our members will be asked how to measure good customer outcomes and there are a range of different views on what good customer outcomes might look like.

A natural starting point when considering outcomes for customers is the ratio of claims to premiums paid (known as the loss ratio) over a period of several years. This will be appropriate in some instances for example insurance products that have more frequent and smaller claims (e.g. health insurance that provides for doctors’ visits and prescriptions). However other insurance products are characterised by infrequent and large claims (e.g. life insurance). In these instances an individual policyholder will have either no claim or possibly a very large claim, for the policyholders as a group the loss ratio each year may still be considered a “good customer outcome” For other forms of insurance (earthquake insurance) the loss ratio may run at a very low level for considerable periods of time and the value of insurance to these policyholders is the “peace of mind” they have and the protection they are afforded in the event that an unlikely but catastrophic event occurs.

If a requirement for good customer outcomes is to be legislated we believe guidance will be required. The Society would welcome the opportunity to work with you to develop this and believe actuaries are ideally positioned in regards to this.

### General Comments

It is the Society’s view that changes in the areas addressed in this consultation are required however any such changes must be considered very carefully as there is potential for unintended consequences to arise. As an example: simplifying the product and acquisition process to facilitate ease of purchase and understanding for the customer. One way this can be achieved is to reduce the information requested on the insurance application form. While this will make the application form shorter and the process simpler, this will reduce the ability of the insurer to assess the underlying risk and as a consequence some customers will end up paying higher premiums than they otherwise would have.

Similarly requiring insurers to identify and sell to target markets may result in a sales process that discriminates against some elements of society, for example older customers for life or health insurance where the expected cost of the risk increases with age, and younger (male) customers for car insurance.

Yours sincerely  
for **New Zealand Society of Actuaries (Inc)**

A handwritten signature in black ink, appearing to read 'John Smeed', is written over a large, faint red watermark that says 'PROACTIVE PREPARED'.

John Smeed  
President



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?

As noted above the Society believes a duty to prioritise the customer's interest is unworkable. However the Society believes the other duties outlined are in general terms reasonable. The key consideration however will be the details of guidance that brings such general principles to life in practice.

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?

The Society has no comment on this question.

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

It is our view that the duties as expressed are very general and would benefit from greater guidance.

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?

If the regulator has the power to ban a product then any such ban would presumably be based on some objective measures. Before determining any preference for Option 1 or Option 2, it would be beneficial to understand the measures that could lead to such a ban being implemented. Publishing these measures should assist insurers to avoid bans being implemented. Care will be required as insurance policies vary widely in their coverage and the nature of the insurance provided. As noted above, some policies provide for relatively frequent claims of small amounts, while others provide for infrequent but very large impact events.

For these insurances that cover large and "infrequent" claims simply reviewing a customer's claims history relative to the premiums paid is not a useful measure of the value the customer has received. In general terms most customers do not want to claim on their insurance and it is typically the "unlucky" customers who have had an accident or illness that have claimed. Lucky customers who have not had to claim on their insurance have however had the peace of mind that if it was needed, the insurance cover was there for them, or their dependents. Assessing the value of these insurance policies for individual customers is extremely difficult and as will codifying it in regulation.



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.

The Society has no comment on this 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?

Others are better placed to comment on the appropriateness of different sales remuneration approaches.

In our view high quality, independent financial advice is beneficial for many customers. Any area that does not seem to have been considered in detail is the impact that the proposed options will have on this.

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, seems a logical and reasonable starting point to us.

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?)

The Society has no comment on this 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?

The Society has no comment on this 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?

The Society has no comment on this 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?

A set time frame for settlement may create a perverse incentive for customers to delay settling their claim in order to try and force insurers to increase the settlement amount and thereby meet the settlement deadline. Similarly a customer without a legitimate claim may attempt the same tactic.

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?

The Society has no comment on this 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?

The Society has no comment on this 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?

The Society has no comment on this 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 Society has no comment on this 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?

The Society has no comment on this 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?

The Society has no comment on this 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?

In general terms the Society is in favour of industry reporting and improved availability of information. However care will be required as some information will currently be considered confidential. We note that the industry reporting provided by the Reserve Bank is very high level and in many ways this diminishes the usefulness and very limited comparative information is provided.

The Society would be happy to work with the Ministry or regulator to assess the information that would be useful in this context.

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?

The Society has no comment on this 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?

The Society has no comment on this question