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Financial Markets Policy
Building, Resources and Markets
Ministry of Business, Innovation and Employment
PO Box 1473
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By email: FMALevyReview@mbie.govt.nz

2021 REVIEW OF THE FINANCIAL MARKETS AUTHORITY FUNDING AND LEVY

This submission is made on behalf of AIA New Zealand Limited and its related entities (together "AIA NZ"). It relates to the Ministry of Business, Innovation and Employment's October 2021 discussion document on proposed changes to the Financial Markets Authority's funding and levy to reflect the introduction of the Conduct of Financial Institutions ("CoFI") regime, Insurance Contract Law ("ICL") regime, and Climate-Related Disclosures ("CRD") regime.

About AIA NZ

AIA NZ is a member of the AIA Group ("AIA"), which comprises the largest independent publicly listed pan-Asian life insurance group. It has a presence in 18 markets in Asia-Pacific and is listed on the Main Board of The Stock Exchange of Hong Kong. It is a market leader in the Asia-Pacific region (excluding Japan) based on life insurance premiums and holds leading positions across the majority of its markets.

Established in New Zealand in 1981, AIA acquired Sovereign Assurance Company Limited in 2018, and we have been protecting New Zealanders and helping them to lead Healthier, Longer, Better Lives ever since.

AIA NZ is committed to an operating philosophy of *Doing the Right Thing, in the Right Way, with the Right People*. AIA NZ launched the New Zealand Conduct Framework in January 2019 to help ensure the consistent delivery of good customer outcomes across the organisation.

In addition to being a licensed insurer, AIA NZ (through its subsidiary AIA Services New Zealand Limited) is a licensed financial advice provider and provides financial advice services through two authorised bodies: AIA Thrive Limited and AdviceQual Limited. AIA NZ is also a prominent member of the Financial Services Council ("FSC").

Key submission points

AIA NZ supports the FMA's work to promote and facilitate the development of fair, efficient, and transparent financial markets. New Zealand needs a strong, well-resourced financial markets regulator and we agree the FMA will need a substantial increase in funding to ensure the full benefit of these new regimes are obtained.

The key points of our submission are:

- There are challenges in commenting meaningfully on the detail of the proposals when there is uncertainty as to the final form of the new regimes. At this stage, funding should only be set for the implementation of each regime. Ongoing funding requirements should be considered in the future when the detail of each regime is known. Alternatively, funding should be set for a two-year period then revisited.
- The FMA (and MBIE) need to be cognisant of the likely challenges in recruiting the proposed number of staff (particularly for the CoFI regime) in the current environment. This might impact on the options chosen. We also question whether the proposed resourcing for CRD will be enough to deliver the work contemplated to the desired standard.
- More time is needed for implementation of the CoFI regime. While the regime has been well-signaled, implementation will be a significant undertaking.
- The cumulative effect of the proposed levy increases is significant. An additional Crown contribution to the FMA funding is needed to offset some of the increase, and to correctly balance the private and public benefits which will flow from these new regimes.

Our full submission is **attached**, and follows the format outlined by MBIE. In addition to our own submission, we contributed to and support the FSC submission on this discussion document.

We would be pleased to discuss any questions you have on this submission and we would welcome the opportunity to collaborate or consult further with MBIE as it considers the next steps.

Yours sincerely



Kristy Redfern
General Counsel and Company Secretary
AIA New Zealand

Submission on 2021 Review of the Financial Markets Authority Funding and Levy

Your name and organisation

Name	Kristy Redfern (General Counsel and Company Secretary)
Organisation (if applicable)	AIA New Zealand Limited

Responses to discussion document questions

Introduction

1 *Do you have any feedback on the objectives of the review?*

AIA NZ supports the FMA's work to promote and facilitate the development of fair, efficient, and transparent financial markets. New Zealand needs a strong, well-resourced financial markets regulator and an increase in the FMA's funding is needed to ensure that the FMA can continue to operate as a credible and effective financial markets regulator, having regard to its greatly enhanced remit under these new regimes.

However, there are challenges in commenting meaningfully on the detail of the proposals (particularly as they relate to ongoing funding requirements) when there is uncertainty as to the final form of the new regimes. As at the time of writing, the CoFI Bill is yet to pass its second reading and no exposure draft of the ICL Bill has been released. While the CRD Bill has passed, consultation on XRB climate standards has only just begun so there is still a lot of analysis to be done.

We understand (and appreciate) the desire to minimise ongoing consultation, and the need for the FMA to have certainty of funding so that it can begin to plan for its new roles. However, given the degree of uncertainty, we consider that at this stage funding should only be set for the implementation of each regime. Ongoing funding requirements should be considered in the future when the detail of each regime is known. Alternatively, funding could be set for an initial two-year period then reviewed.

The funding options

2 *Do you have any feedback on the criteria for assessing the funding options?*

AIA NZ does not have any feedback on the criteria for assessing the funding options.

Funding options – Conduct of Financial Institutions

3 *Do you agree with the analysis of the FMA funding options for CoFI? Which option do you consider to be most appropriate and why?*

AIA NZ generally agrees with the analysis of the FMA funding options for CoFI. We prefer option 1. We see real benefits for both market participants and consumers in the FMA being resourced to undertake the activities outlined in paragraph 84 of the discussion document, when compared to what is contemplated for option 2.

As highlighted in the discussion document, the key risk for achieving either option (but particularly option 1) is staff recruitment and retention. The current tight and highly competitive labour market coupled with border restrictions (accepting these will likely ease) will make filling these roles (with quality candidates) a challenge. We understand the FMA

intends to use its graduate recruitment and training programmes to recruit and train staff with transferrable skills. While this will build capability at the lower levels, this will take time to complete and will likely not be appropriate for roles at more senior levels. In addition to the FMA's proposed headcount increase, it is inevitable market participants will want to hire additional staff (with similar skillsets), adding to the recruitment challenge.

None of this is to suggest that option 1 should not be selected. However, we think the FMA (and MBIE) need to be realistic about the resourcing challenge. Ultimately this may influence the option chosen, or how it is implemented (for example, by reducing the headcount currently proposed). It may also mean that it is preferable to only consider the resource requirements for a shorter period, such as the initial implementation phase. This approach would align with our concerns about the practical challenges in assessing ongoing funding requirements while substantial uncertainties remain.

4 *How would CoFI Option 1 impact you/your business compared to CoFI Option 2?*

There are significant downsides with option 2 when compared to option 1. However, AIA NZ (as a large and well-resourced insurer) should be able to adapt. We have already set up dedicated teams to review and consider aspects of the CoFI Bill which stem from the FMA / RBNZ Conduct and Culture review. Subject to the CoFI Bill being finalised, we expect we will be able to seek guidance and engagement with our FMA relationship manager on key areas. We are also well placed to obtain support from external consultants where needed. Therefore, if option 2 is adopted, we anticipate that we would be able to manage and address some of the gaps when compared to option 1. However, this may be more of a challenge for smaller institutions, and those who were not directly involved in the FMA / RBNZ Conduct and Culture reviews. We consider these institutions will benefit more from the greater degree of FMA support that is contemplated under option 1.

Regardless of the option chosen (but more so with option 1), the FMA should carefully consider the burden placed on the industry when planning industry engagement via onsite monitoring visits and thematic reviews. Given the frequency and complexity of regulatory reforms in the financial markets sector in the next three years, the industry is under significant pressure to adapt. Adding frequent onsite visits, which require considerable time and resource to prepare, would increase this burden.

5 *If you were to make material changes to the CoFI options, how would you do so and on what basis?*

AIA NZ submits that CoFI should initially be funded for a two-year implementation period. We believe this would provide sufficient funding for the FMA to develop the licensing process, application questions and guidance, and licensing standard conditions. After two years, there will be a clearer idea of the funding required to assess licence applications and perform ongoing "business as usual" activities under the regime. This approach would also allow account to be taken of final changes in the regime as it moves through the Parliamentary process (given that, as noted elsewhere, significant uncertainty remains).

Implementation – Conduct of Financial Institutions

6 *Do you have any feedback on the objectives for the implementation of the CoFI regime?*

AIA NZ agrees with the objectives for implementation of the CoFI regime outlined in the discussion document. However, as will be apparent from our comments below, we are concerned that there may not be a full appreciation of the amount of work involved in implementing the regime (and therefore the time needed for financial institutions to prepare), even with key aspects of the regime being well sign-posted.

7 *Do you agree that the CoFI licensing window should begin after financial advice provider*

transitional licensing window has closed?

AIA NZ agrees that the CoFI licensing window should begin after the financial advice provider transitional licensing window has closed. If the two licensing windows were to overlap, this would raise practical challenges for both the FMA and industry. Further, we suggest there should be a risk-based approach taken to conduct licensing for those entities that have obtained a full FAP licence, reducing the burden for those entities licensed under the Financial Markets Conduct Act 2013, as amended by the Financial Services Legislative Amendment Act 2019 (FSLAA), CoFI and the Insurance (Prudential Supervision) Act 2010.

8

Are there other areas of regulatory reform in the financial services sector, where implementation overlaps with the proposed timeframes above, and that you consider it would be preferable to align CoFI implementation with those timeframes from an efficiency perspective? If so, please provide examples.

Care should be taken to avoid overlap with other substantial changes affecting insurers, including implementation of IFRS-17 and the associated solvency standards, and changes arising out of the review of the Insurance (Prudential Supervision) Act 2010. At this stage there does not appear to be a direct overlap, but this should be kept under review.

9

Do you have any feedback on the proposed 18 month window between applications for a conduct licence opening and all the obligations of the CoFI Bill coming into force (including having a conduct licence)?

AIA NZ believes a longer transitional period is needed. In our view, a two-year licensing window is the minimum needed for financial institutions to get themselves ready.

The new financial advice regime introduced by FSLAA has a two-year window for full licensing. While that regime was significant in its own right, it only affected one aspect of our business. By comparison, the CoFI regime will have a significant impact across many areas of our business and will therefore require at least as long to prepare. The need for a longer implementation period has also been recognised by the Finance and Expenditure Committee in expanding the back-stop commencement periods as part of their consideration of the Bill.

It appears from the discussion document that the proposed 18-month window is considered achievable at least in part because the CoFI regime has been clearly signalled. While that is true, and significant work has been done across the industry to mature conduct and culture frameworks, there is a limit to how much financial institutions can do to prepare at this stage.

As an example, until the CoFI Bill passes and supporting regulations / FMA guidance / licensing requirements are known, it is difficult to begin work on a fair conduct programme. Similarly, without knowing the final form of restrictions on incentives, we are unable to consider the specific changes that might be needed to our arrangements with intermediaries. These may require major shifts in business processes and spending. In AIA NZ's view, the proposed 18-month window significantly underestimates these challenges.

10

Do you think a phased approach to CoFI licensing would be preferable, compared to a single licensing window for all types of financial institutions? Please provide reasons.

AIA NZ does not support a phased approach to CoFI licensing.

11

If a phased approach to CoFI licensing would be preferable, what factors do you think should be considered in determining the order of phasing?

AIA NZ does not support a phased approach to CoFI licensing and, as such, does not have any

comments on this question.

12 *Do you have any other general comments regarding the implementation timing of the CoFI regime?*

AIA NZ does not have any other general comments regarding the implementation timing of CoFI.

Funding options – Insurance Contract Law

13 *Do you agree with the analysis of the FMA funding options for ICL? Which option do you consider to be most appropriate and why?*

The comments we have raised elsewhere regarding our ability to comment meaningfully on funding requirements for regimes that remain in development are particularly pronounced for the ICL Bill. The ICL reforms are not sufficiently developed for an appropriate funding analysis to be undertaken at this time. This point is acknowledged at paragraph 137 of the discussion document itself. As a result, our comments in this section are based solely on the commentary included in the discussion document. In order for informed feedback to be provided, we strongly believe that funding for ICL should be revisited once more is known about the regime.

While important, the ICL regime will have a much smaller overall impact than CoFI and CRD, and the differences between the two options are much less pronounced than for CoFI. For that reason, we think there is a case to be made for option 2, on the basis that it would allow resources (including likely staffing challenges) to be prioritised for CoFI.

14 *How would ICL Option 1 impact you/your business compared to ICL Option 2?*

AIA NZ does not consider there will be a materially different impact between options 1 and 2, as they are explained in the discussion document.

15 *If you were to make material changes to the ICL options, how would you do so and on what basis?*

Compliance with the existing unfair contract terms regime and the plain language requirements of the Credit Contracts and Consumer Finance Act 2003 and Responsible Lending Code are monitored by the Commerce Commission. While we acknowledge this is a submission best made on the ICL Bill itself, we consider that the existing knowledge and expertise within the Commerce Commission should be leveraged for the purposes of the ICL regime, rather than recruiting additional resource into the FMA. Duplication of materially similar roles across two regulators can lead to inefficiencies and creates a risk that insurers will be held to a different standard compared to either general businesses (UCT) or lenders (plain English requirements). In our view, consideration should be given to consolidating these requirements within the Commerce Commission rather than the FMA.

Funding options – Climate-related Disclosures

16 *Do you agree with the analysis of the FMA funding options for CRD? Which option do you consider to be most appropriate and why?*

CRD is a significant, complex, and world-leading regime. AIA NZ is committed to the regime's success, and as a result prefers option 1.

AIA NZ's expectation is that implementation of the CRD regime will raise a range of novel issues and be much more time consuming than expected for both market participants and the FMA. As a result, we are concerned that the headcount proposed for option 1 may not

provide the FMA with the resources needed to complete the work contemplated to the desired standard. If this concern is shared by the FMA and MBIE, we would support a modest increase in the headcount (and resulting cost) of option 1.

Alternatively, and consistent with our comments elsewhere, we would support a review of funding requirements after two years (when more is known about the regime) to ensure they are appropriate.

17 *How would CRD Option 1 impact you/your business compared to CRD Option 2?*

AIA NZ does not consider there will be a materially different impact between options 1 and 2, as they are explained in the discussion document. We note that, as proposed, there is a difference of only two FTE between options 1 and 2.

18 *If you were to make material changes to the CRD options, how would you do so and on what basis?*

As noted in our response to question 16, we would support a modest increase in the headcount (and resulting cost) of option 1 if it was felt this would better support successful implementation of the CRD regime.

Funding recovery options

19 *Do you think that the proposed additional funding for the FMA should be wholly levy recovered or should the Crown contribute towards the increase? Why?*

AIA NZ's view is that there should be a Crown contribution towards the increase in FMA funding. We acknowledge the private benefit that financial institutions receive from well-regulated markets that promote consumer confidence. However, these new regimes will also deliver substantial public benefits. One of the stated objectives of the review is to ensure that levy settings are "proportionate to the benefits received" (paragraph 16 of the discussion document). In AIA NZ's view, this objective will not be met unless there is a Crown contribution towards the increase.

20 *Do you think that the Crown should contribute relatively more to any of the regimes than others? If so, please explain why.*

AIA NZ does not believe the Crown contribution should differ across regimes. Arguments can be made that the CRD regime in particular has a greater public good component. However, we consider that the simplicity of a flat-rate contribution is to be preferred.

21 *What is the appropriate Crown/levy split of the FMA's appropriation and why?*

AIA NZ does not have a particular view on the appropriate split. However, we suggest it should be higher than the current split of 17% Crown and 83% levy. In our view, the current split does not reflect the relative private and public benefits arising from efficient and well-regulated financial markets. We consider the Crown contribution should be increased back to 25% to reflect the Crown's commitment to these regimes being successfully implemented, particularly the CRD regime where New Zealand will be the test case for the rest of the world to analyse.

The current FMA levy model

22 *Do you have any feedback on the objectives underlying the levy model?*

AIA NZ agrees with the objectives underlying the levy model.

23

Do you agree that larger entities should pay a relatively larger portion of any levy increase? If not, please explain why.

As a general proposition, AIA NZ agrees that levies should be proportionate, based on the size of entities. As a large insurer, AIA NZ recognises its social licence to operate depends in part on making a meaningful contribution to the costs of operating the regime. We also recognise that levies can be a particular burden for smaller financial institutions that may have already been hit hard by the COVID pandemic (and with the full economic impacts of the current lockdowns still unknown).

However, this does result in an increased burden on large entities. Care must be taken not to set levies at a level which drives up compliance costs for larger entities to the extent where it is no longer viable for larger entities (which are typically overseas owned) to operate in New Zealand. New Zealand (and its financial markets) are small by global standards. If compliance costs become disproportionate to market size, there is a risk of overseas parent companies exiting the market. This would have the effect of reducing competition and accessibility of insurance to Kiwis. Similarly, shareholders of New Zealand-owned financial institutions may choose to redeploy capital if they feel greater returns can be obtained from investing in other sectors.

Proposed changes to the FMA levy

24

Do you think the proposed levy changes meet the objectives?

AIA NZ agrees that the proposed levy changes meet the objectives, except insofar as that (as outlined in our response to questions 19 to 21) we consider a greater Crown split is needed to correctly balance the private and public benefit from these new regimes.

25

Do you have any comments on the proposed new levy classes/tiers? Should further classes be considered?

AIA NZ considers there may be some unintended consequences resulting from the levy classes/tiers. There is a significant increase in levies for an insurer that records \$499 million in annual gross premium (\$136,000) as opposed to an insurer that records \$501 million in annual gross premium (\$370,000). This could represent a disincentive for growth, which may contribute to underinsurance in New Zealand and would hinder the insurance industry's goal of protecting more New Zealanders. As noted in the RBNZ's January 2020 "Overview of the life insurance sector in New Zealand" report, studies and surveys in the last ten years have shown that New Zealanders underinsured for personal risk, which exposes New Zealand households to risks.

AIA NZ submits that a percentage of annual gross premium may be a fairer method for calculating annual levies.

26

Do you have any feedback on the impacts of the proposed changes to the levies presented in Annex 1? How would the proposed changes impact your business? Please provide examples.

The proposed levy increases for CoFI are substantial (in broad terms, the proposed new levy for retail insurers after implementation is more than double the proposed levy for non-retail insurers). Even for a large, well-resourced financial institution like AIA NZ, the increase is a material amount that may have implications for business planning. In addition, AIA NZ anticipates incurring significant internal implementation costs associated with the CoFI regime.

The levies associated with the ICL and CRD regimes are more modest, but it is important to note the cumulative effect of the proposed additional levy classes.

Together, the above factors add weight to our view that a greater Crown split is needed to correctly balance the private and public benefit from these new regimes.

27

Do you think any of the levy classes in Annex 2 should pay an increased levy as a result of these new regimes? If so why?

AIA NZ does not believe any of the levy classes in Annex 2 should pay an increased levy. In our view, the costs of the additional regimes should be met by those affected by them (and the Crown). It is not appropriate for entities that are outside of the scope of the regimes to meet these costs.

Other comments

AIA NZ does not have any other comments to make on this consultation.