



REVIEW OF THE FINANCIAL ADVISERS ACT 2008 AND THE FINANCIAL SERVICE PROVIDERS (REGISTRATION AND DISPUTE RESOLUTION) ACT 2008

SUBMISSION BY SOVEREIGN¹

This submission is in three parts:

- PART 1** Introducing Sovereign
- PART 2** Key issues as identified by Sovereign
- PART 3** Responses to specific questions from the Issues Paper

Sovereign welcomes the opportunity to be part of the review, and looks forward to further discussion with officials.

Sovereign does not seek confidentiality for any aspect of this submission (though, for commercial or privacy reasons, it may request confidentiality of any further supporting information that the Ministry might seek).

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¹ "Sovereign" is defined as Sovereign Assurance Company Limited, Sovereign Services Limited, and associated entities.

PART 1 – Introducing Sovereign

- 1.1. Sovereign is New Zealand's largest life insurance company protecting over 741,000² New Zealanders and their families through the provision of life and health insurance using a range of distribution channels. Sovereign insures total sums insured of over \$120 billion³ and last financial year paid out more than \$330³ million in claims.
- 1.2. Sovereign has an A+ (superior) financial strength rating from AM Best. Our life insurance market share is 28.9%⁴ and our health insurance market share is 7.4%⁴.
- 1.3. Well established within the life insurance industry, Sovereign's vision is "*Being the difference in life's moments of truth by providing certainty and giving choice*". Our vision is fuelled by our values; *integrity* to build trust, *collaborate* to win together, *drive* to make it happen, *play* to explore possibilities and *wow* to impress our customers.
- 1.4. Sovereign has approximately 715 employees and as at September 2014, 195-205 employee⁵ roles were permitted to provide class and/or personalised financial advice as QFE employee advisers.
- 1.5. Sovereign, as a QFE, has a rigorous process for our QFE advisers, involving a customer management process and a dedicated risk team to monitor compliance. Sovereign's QFE advisers advise on products provided by Sovereign and other manufacturers (specified on Sovereign's approved QFE product list).

What is "life insurance"?

- 1.6. Life insurance is the cornerstone of financial planning⁶ and is provided under either "individual" or "group" policies.
- 1.7. Under an individual policy, consumers choose the insurance company, amount of cover and policy features to suit their circumstances. Consumers typically access individual policies through an independent adviser, a bank or direct from the insurance company. The interaction can be face-to-face or remote, such as through a company's website. The process might, but need not (e.g. in the case of a direct sales online channel), include the provision of class or personalised advice. In the case of third-party distribution, there is typically a commission paid by the insurance company.
- 1.8. Under a group policy (also known as "compulsory risk" or "workplace insurance") employees can access insurance through their employer. Group policies generally provide lower premiums, no medical underwriting up to specified cover limits, and opportunities to upgrade cover beyond the group minimum. Group policies are typically a multiple of salary.
- 1.9. New life insurance policies are almost exclusively "pure risk" policies. That is, they do not have any investment component. Traditional insurance policies (such as endowment and whole-of-life policies that earn "bonuses") and investment linked policies (that provide investment returns linked to specified pools of assets) are no longer widely offered, although there are many still in existence. Advice in relation to these types of policies generally is limited to decisions by consumers to vary, surrender or replace the policy.

² This includes policy owners, life assured, borrowers and workplace

³ Sovereign internal reporting as at 30 June 2015

⁴ FSC (Financial Services Council) Market Share Report March 2015

⁵ An approximate is given as staff turnover results in vacant roles which can fluctuate on any given day

⁶ Insurance Information Institute, iii.org, New York, USA

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- 1.10. The “life insurance” industry in New Zealand includes more than just life insurance in the legal sense. The industry generally is considered to encompass:
- a. Life insurance: a lump sum in the case of death (this represents 50%³ of Sovereign’s total claims by amount);
 - b. Trauma or critical illness: a lump sum in the case of specified illness or injury;
 - c. Income protection: a periodic payment in the case of an inability to work due to illness or injury; and
 - d. Permanent disability: a lump sum in the case of illness or injury that has left the insured person unable to work or function.

PART 2 - Key issues as identified by Sovereign

- 2.1. Sovereign recognises the positive impact that the Financial Advisers Act (FA Act) and the Financial Service Providers Act (FSPR Act) has made in the financial services advice industry.
- 2.2. Sovereign strongly supports the QFE framework and the level of regulatory scrutiny over existing QFEs. We believe that the existing regulations coupled with risk to corporate reputation are effective in assuring quality advice frameworks for consumers. For example, Sovereign values its reputation and customers and takes its compliance responsibilities extremely seriously, investing considerable resources into education and monitoring. In addition, Sovereign sees a need to grow the number of new advisers entering the industry, and believes that the QFE structure provides economies for education, training and experience of those who may aspire to operate their own adviser business.
- 2.3. The FA Act and FSPR Act are relatively young and the review should recognise the “bedding down” process that has occurred. The review should also recognise that the FA Act and the FSPR Act are parts of a wider suite of financial services regulations, including product and provider regulation under the Financial Markets Conduct Act. The industry has been through (and is still dealing with) a period of fundamental change. Given this, caution should be exercised in introducing further significant change, and such change should only be pursued if justified by evidence. The focus of the review therefore should be on aligning the existing financial services regulation and identifying incremental changes that can be implemented easily to make the current regime more workable, improve efficiency and enhance consumer outcomes.
- 2.4. In this submission, we address the following two key issues, proposing simple incremental enhancements to the regulatory regime:
- The role of advice in solving the problem of underinsurance; and
 - Removing inappropriate churn to help lift consumers’ trust and confidence in the financial advice industry.
- 2.5. The burden of underinsurance on individuals, families and communities**
- 2.5.1 In the last financial year Sovereign paid out more than \$330³ million in life insurance claim payments to help out customers in times of trouble. This is why we understand the positive consequences of being properly insured. Underinsurance makes New Zealand families vulnerable when their income earners die, or become permanently disabled, especially when it occurs unexpectedly. Financial burdens at a time of intense vulnerability add to personal and family stress, and have financial implications for New Zealand’s health and welfare systems.
- 2.5.2 A higher uptake of life insurance is therefore in the national interest because it provides financial security and peace of mind to individuals and their families, while reducing the potential burden on New Zealand’s health and welfare system.
- 2.5.3 Research continues to show that New Zealand has a substantial underinsurance gap which means unnecessary suffering may occur in the case of illness, injury or death. Recent research includes:
- a. OECD calculations showing that life insurance penetration within New Zealand is 0.9% compared to an OECD average of 4.7%⁷.
 - b. Swiss-Re research on life insurance penetration which ranks New Zealand 25th out of 88 countries⁸.

⁷ OECD 2015, Penetration is calculated by proportion of gross life insurance premium to gross domestic product.

⁸ “Sigma” No4/2015, a Swiss Re publication, 2015

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- 2.5.4 In 2013, Massey University in association with the Financial Services Council (FSC) reported that⁹:
- a. While nearly 60% of those surveyed had life insurance, only 20% had insured their income against the risk that illness or disability would prevent them from working - despite that being the greater risk.
 - b. There is evidence of widespread inadequate insurance with 54% of main income earners being more than 20% underinsured for life insurance and 43% being over 40% underinsured.
 - c. The wide range in insurance adequacy suggests that people are not regularly reviewing their insurance for changed circumstances.
 - d. Attitudes and peoples' approach to insurance play a significant role in being insured or having the right amount of insurance. While most people understand the benefits of insurance, 60% of the survey group could be described as finding personal risk insurance all too hard.
 - e. Ethnicity does not appear to play a role in personal risk insurance that cannot be explained by other demographic factors (e.g. age, income). However, this is not the case for Maori – a finding that needs further investigation.
- 2.5.5 Life insurance in New Zealand is concentrated in medium to high income families, and Sovereign's analysis highlights very low penetration of life insurance in provincial New Zealand, lower socio-economic and Maori and Pacific communities. So it is important to address underinsurance, for all of New Zealand. Sovereign seeks an opportunity to discuss these aspects further with MBIE.
- 2.5.6 Sovereign believes that a healthy financial advice industry (with a positive culture and strong values) is required if the underinsurance problem is to be solved. Increasing access to advice and improving the trust and confidence of consumers in the financial advice industry will help to lift levels of life insurance.
- 2.5.7 Access to advice will be promoted by ensuring that:
- a. Advice (and insurance) is affordable: It is important that all consumers can access both class and personalised advice for life insurance products. The current regime achieves that objective. It should be given time to develop further following the bedding down period over the first five years, without major disruption as a result of the review. Class advice can be delivered cost effectively and through multiple channels, thereby maximising the potential reach of advice. The current regime's two tier product categorisation for personalised advice works well and appropriately balances the cost of delivery against consumer protection depending on the relative complexity and inherent risk of different products.
 - b. Customers have multiple channel options: There must be no bias or preference to any single advice channel. It is essential that any measures introduced to address perceived problems with the current regime do not inadvertently create a bias against, or restrict, any particular advice channel. That could occur, for example, by imposing restrictions on the amounts of commission payable to advisers rather than addressing any underlying misconduct through enforcement of the current regulatory framework and enhanced disclosure by advisers.
- 2.5.8 Trust and confidence will be improved by lifting the transparency and quality of disclosure (addressed below). Consumers are more likely to seek financial advice when they have trust and confidence.

⁹ Financial Services Council (2013) The People Insurance Gap - Exploring Underinsurance in New Zealand

2.6. Addressing the issue of inappropriate churn

2.6.1 The Ministry's Issues Paper highlights that switching insurance policies can be positive for consumers and the industry overall if done in the customer's best interests. Sovereign believes that switching for the right reasons encourages product innovation and competition and supports a healthy insurance industry.

2.6.2 However, Sovereign does not condone inappropriate churn¹⁰ and supports measures to eliminate it. It is difficult to statistically determine the level of inappropriate churn in the New Zealand market, although anecdotally most advisers are acting in the best interests of the customer when they propose replacement of an existing insurance policy.

2.6.3 There are anecdotal examples of adverse customer outcomes from switching policies - such as previously covered health conditions ceasing to be covered under the new policy. However, Sovereign has seen no evidence of a systemic problem. The work underway by the Financial Markets Authority, using its statutory information gathering powers under s.25 of the FMC Act, should provide a solid baseline on the inappropriate churn issue.

2.6.4 There are adequate measures contained in the FA Act to address aberrant behaviour by a minority of advisers. In particular, it is beyond doubt that an RFA who advised or encouraged a consumer to replace his or her insurance policy leading to a direct adverse consequence for the consumer (such as a loss of cover) would have breached the adviser's duty of care, diligence and skill under the FA Act. Sovereign believes that greater enforcement of the current regulatory tools will significantly reduce, if not eliminate, that type of inappropriate churn.

2.7. Lifting transparency and quality of disclosure

2.7.1 Sovereign believes that one solution to the underinsurance and inappropriate churn issues is to level the playing field on disclosure of commissions. Currently, when they sell Category Two products, AFAs and RFAs do not have the same commission disclosure requirements. Sovereign believes that this unevenness provides a mechanism that could encourage inappropriate churn. Anecdotally, we have heard of instances of AFAs becoming RFAs to take advantage of the reduced disclosure requirements.

2.7.2 We also note that consumers perceive there is "value and impact in the need for financial advisers to disclose fees, commissions and affiliations", and that this disclosure promotes trust in the financial services sector.¹¹

2.7.3 Sovereign recommends that all advisers (regardless of channel) should be required to disclose the total amount of commission (if any) that they receive for each product sold as a result of their advice. Incentives and remuneration that is not directly attributable to the sale of a specific product and cannot be quantified as a dollar amount at the date of the advice (such as an annual performance bonus or a profit share) should continue to be disclosed by way of description only.

2.7.4 Sovereign would like to see more simple and standard disclosure documentation by advisers across the financial advice industry, making it more meaningful and easy to understand for customers and more cost efficient to provide.

¹⁰ Defined in the Issues Paper (P36, Box 3) as "the practice of advisers persuading clients to move from one financial product to another for the purpose of receiving a high up-front commission".

¹¹ FAA/FSP Review: Consumer groups, Colmar Brunton, 24 June 2015

2.8. Increasing levels of regulatory enforcement

2.8.1 Together with greater transparency and disclosure, Sovereign recommends consistent and public enforcement of existing regulatory obligations. We note that there is a provision in the FA Act imposing a duty of “care, diligence and skill” on all advisers.

2.8.2 We acknowledge that enforcement has likely been prioritised toward those whose misconduct is assessed to have the greatest potential adverse impact on consumers. We agree that some prioritisation is called for, especially where resources are limited. However, to maintain the integrity of the dual classification framework and provide trust and confidence to participants and consumers alike, consistency in the application of the existing regulation is important. We recommend that regulatory effort be focused across all parts of the industry.

2.9. The consumer of tomorrow

2.9.1 Sovereign’s research shows that consumer purchasing patterns and behaviours are changing, and that technology is changing customer expectations of how they access insurance.

2.9.2 Key future trends we foresee include:

- a) Changing demographics (age, ethnicity, family size) in New Zealand, which have the potential to exacerbate the underinsurance issue if not addressed.¹²
- b) Online methods of contact becoming increasingly important¹³, changing the nature and speed of customer interactions.
- c) An increasing demand from consumers to transact online, with 83% of consumers saying they would use the internet to research life insurance before purchasing a policy if they had the option¹⁴. Automated advice and underwriting will become more common.

2.9.3 Sovereign sees an opportunity to future proof the regulatory regime to cater for potential new channel and advice options. We recommend that the review seeks to clarify that targeted advice based on known or deduced characteristics that the consumer shares with others in a cohort meets the definition of “class” advice.

¹² Statistics New Zealand

¹³ Reimagining customer relationships: Key findings from the EY Global Consumer Insurance Survey 2014

¹⁴ 2014 Insurance Barometer survey, Life and Health Insurance Foundation for Education (LIFE) Foundation and LIMRA

PART 3 – Responses to specific questions from the Issues Paper

Question Number	Sovereign’s recommendation
9, 10, 16, 17, 24, 25, 36, 38, 39, 40, 45, 47	<p>Sovereign believes that one solution to the underinsurance and inappropriate churn issues is to level the playing field on disclosure of commissions. Currently, when they sell Category Two products, AFAs and RFAs do not have the same commission disclosure requirements. Sovereign believes that this unevenness provides a mechanism that could encourage inappropriate churn. Anecdotally, we have heard of instances of AFAs becoming RFAs to take advantage of the reduced disclosure requirements.</p> <p>We also note that consumers perceive there is “value and impact in the need for financial advisers to disclose fees, commissions and affiliations”, and that this disclosure promotes trust in the financial services sector.¹¹</p> <p>Sovereign recommends that all advisers (regardless of channel) should be required to disclose the total amount of commission (if any) that they receive for each product sold as a result of their advice. Incentives and remuneration that is not directly attributable to the sale of a specific product and cannot be quantified as a dollar amount at the date of the advice (such as an annual performance bonus or a profit share) should continue to be disclosed by way of description only.</p> <p>Sovereign would like to see more simple and standard disclosure documentation by advisers across the financial advice industry, making it more meaningful and easy to understand for customers and more cost efficient to provide.</p>
33, 76, 77	<p>Sovereign recommends consistent and public enforcement of existing regulatory obligations. We note that there is a provision in the FA Act imposing a duty of “care, diligence and skill” on all advisers.</p> <p>We acknowledge that enforcement has likely been prioritised toward those whose misconduct is assessed to have the greatest potential adverse impact on consumers. We agree that some prioritisation is called for, especially where resources are limited. However, to maintain the integrity of the dual classification framework and provide trust and confidence to participants and consumers alike, consistency in the application of the existing regulation is important. We recommend that regulatory effort be focused across all parts of the industry.</p>
22, 23, 24, 63	<p>Sovereign strongly supports the QFE framework and the level of regulatory scrutiny over existing QFEs. We believe that the existing regulations coupled with risk to corporate reputation are effective in assuring quality advice frameworks for consumers. For example, Sovereign values its reputation and customers and takes its compliance responsibilities extremely seriously, investing considerable resources into education and monitoring. Sovereign stands behind the conduct of its QFE advisers.</p> <p>In addition, Sovereign sees a need to grow the number of new advisers entering the industry, and believes that the QFE structure provides economies for education, training and experience of those who may aspire to operate their own adviser business.</p>

Question Number	Sovereign's recommendation
5, 37, 53	Sovereign sees an opportunity to future proof the regulatory regime to cater for potential new channel and advice options. We recommend that the review seeks to clarify that targeted advice based on known or deduced characteristics that the consumer shares with others in a cohort meets the definition of "class" advice.
12	Sovereign does not believe such statements are an unnecessary administrative burden. Having considered the guidance offered for their preparation, it seems that much of it is little more than good business practice that should be being followed anyway. Sovereign recommends the use of templates to reduce cost and would be happy to assist further.
21	<p>Sovereign believes that an important building block for growing the opportunity for more New Zealanders to secure life insurance is greater trust and confidence in the sector. Therefore the Committee should cover all advisers.</p> <p>Section 101(3) sets out a reasonable range of penalties and where imposed, the Committee should also have power to require them to be shown on the Register for a period determined by the Committee.</p>
47	Sovereign recommends that officials work with the financial services sector to develop "Plain English" disclosure documentation in template or sample form. It need not be compulsory to use it because for marketing reasons some advisers may prefer different formats; but templates could be a "safe harbour" where used appropriately. This would have the additional benefit of making disclosure more meaningful and easy to understand for consumers.
49	<p>Sovereign believes New Zealand is long overdue for a competitive annuities market, but there are many barriers, most outside the scope of this review, including:</p> <ul style="list-style-type: none"> • Lack of long term bonds and inflation adjusted tax treatment. • Tax reform for annuities. • Rest home subsidy treatment of the income of the elderly.
52, 59	The NZ National Certificate Level 5 is comparable to the Australian PS146; but they are sufficiently different that the appropriate unit for the country should be mandatory.
61	<p>Sovereign recommends that all advisers should belong to either a QFE or a professional body.</p> <p>There are two areas of note:</p> <ol style="list-style-type: none"> a) Different professional bodies have different professional standards and disciplinary processes. Anecdotally, some advisers believe this can lead to inconsistent disciplinary outcomes across professional bodies. This will be mitigated if our submission at 21 above to extend the jurisdiction of the Committee is accepted. b) Membership bodies do receive significant financial support from provider organisations and this is generally disclosed.

Question Number	Sovereign's recommendation
64, 65, 76, 77	<p>Sovereign supports the Register including additional information of value to consumers: a financial adviser's qualifications, any disciplinary record, any areas of specialisation (or exclusion), and potentially a short personal statement that describes themselves and any special features such as languages spoken. Other information that could assist regulators and the public include a declaration of professional indemnity cover and excess.</p> <p>We also believe there is considerable public good in making more consumers aware of the Register and encouraging them to access it. Sovereign recommends consideration of ways to raise awareness of the Register.</p> <p>We note that the Australian financial advisers' register details the following:</p> <ul style="list-style-type: none"> • The adviser's qualifications, experience and employment history. • What product areas the adviser can provide advice about. • Whether the adviser is a member of any professional bodies or industry associations that are relevant to providing financial services. • Whether the adviser has been the subject of disciplinary action by ASIC. • The name and number of the Australian Financial Services (AFS) licence holder who employs or authorises the financial adviser to provide advice. • Details about who owns or controls the licence holder.
66	<p>Sovereign believes alternative dispute resolution saves time and money for consumers, advisers and suppliers, and represents an accessible and cost-effective alternative to the court system. An efficient and effective disputes resolution process adds to consumer trust and confidence.</p> <p>Sovereign has a well-established and documented internal complaints process consistent with Code Standard 11. We believe provider's internal complaints processes are important part of early disputes resolution.</p>
75	<p>Sovereign recommends that Professional Indemnity Insurance be mandatory for all advisers and financial service providers including online advice providers and QFEs.</p>