

PINNACLE LIFE

26 February 2016

Financial Markets Policy
Ministry of Business, Innovation & Employment
P O Box 3705
Wellington
New Zealand

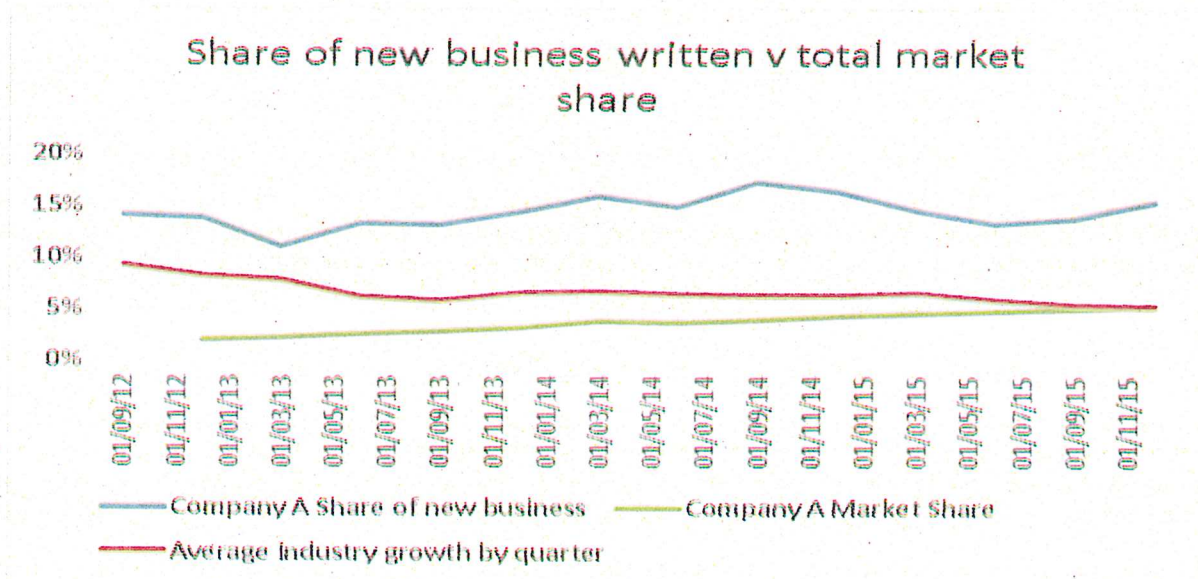
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Dear Sir / Madam

Submission on MBIE Options paper on the Review of the FAA

Please find attached our submission on the FAA Review Options paper. As mentioned in our submission, we are concerned that a review of commissions is not proposed in the Options paper. We have included below an example of the share of new business written versus market share for a life insurance company which has a high commission structure (reference: FSC Competitive data). It maybe that other factors such as product differentiation and additional services explain some of this growth, but there does seem to be a strong correlation, across a number of companies, where increases in commissions (soft or hard) seem to align to increased share of new business written.

Please note, that as a direct insurer, any reduction in the acquisition costs of competitors reduces our competitive advantage, as our acquisition costs will not decrease if advisor commissions reduce. Our concern comes solely from ensuring that consumers, who are under-insured in this market, are provided with the most cost-effective life insurance solutions possible.



While Life Insurance products have a degree of complexity, for the majority of New Zealanders, these decisions are driven more around affordability and price, rather than on understanding the nuances between product solutions, and / or a clear understanding of the best level of cover for



their needs – as they only buy what they can afford – sometimes irrespective of the advice they receive.

Many middle NZers will not be pursued by the existing advisor market. The excessive commissions available for large policy sales versus the commission available from a low value policy incents the advisor to focus on larger sales. Many advisors see this lower remuneration available from middle NZers, as inadequate for the value they see themselves adding to the sale. Therefore, it is even more important that access to information and channels such as robo-advice are enabled to support those most in need.

Our attached submission has a strong bias towards ensuring that the needs of middle NZ are considered and met, as we believe that these are those most in need of better access to information and cost-effective products that meet their life insurance needs.

Yours sincerely
Redacted

Michelle van Gaalen
Chief Executive

How to have your say

Submissions process

The Ministry of Business, Innovation and Employment (MBIE) seeks written submissions on the questions raised in this document.

- Submissions on the questions in Part 3 of this paper (relating to the Financial Service Providers Register) are due by **5pm on Friday 29 January 2016**.
- Submissions on the questions in Part 1 and Part 2 of this paper are due by **5pm on Friday 26 February 2016**.

Your submission may respond to any or all of these questions. We also encourage your input on any other relevant work. Where possible, please include evidence to support your views, for example references to independent research, facts and figures, or relevant examples.

Please include your name, or the name of your organisation, and contact details. You can make your submission:

- By filling out the submission template online.
- By attaching your submission as a Microsoft Word attachment and sending to faareview@mbie.govt.nz.
- By mailing your submission to:

Financial Markets Policy
Ministry of Business, Innovation & Employment
PO Box 3705
Wellington
New Zealand

Please direct any questions that you have in relation to the submissions process to:
faareview@mbie.govt.nz.

Use of information

The information provided in submissions will be used to inform MBIE's policy development process, and will inform advice to Ministers on the operation of the Financial Advisers Act 2008 and the Financial Service Providers (Registration and Dispute Resolution) Act 2008.

We may contact submitters directly if we require clarification of any matters in submissions.

Submissions are subject to the Official Information Act 1982. MBIE intends to upload PDF copies of submissions received to MBIE's website at www.mbie.govt.nz and will do so in accordance with that Act.

Please set out clearly with your submission if you have any objection to the release of any information in the submission, and in particular, which part(s) you consider should be withheld, together with the reason(s) for withholding the information under that Act.

If your submission contains any confidential information, please indicate this on the front of the submission, mark it clearly in the text, and provide a separate version excluding the relevant information for publication on our website.

MBIE reserves the right to withhold information that may be considered offensive or defamatory.

The Privacy Act 1993 establishes certain principles with respect to the collection, use and disclosure of information about individuals by various agencies, including MBIE. Any personal information you supply to MBIE in the course of making a submission will only be used for the purpose of assisting in the development of policy advice in relation to this review.

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Chapter 3 – Barriers to achieving the outcomes

1. Do you agree with the barriers outlined in the Options Paper? If not, why not?

While the barriers are those existing in the market, we disagree with the decision to exclude agent commissions from the current review given the conflicts apparent in the current model. Data available from the FSC shows a correlation between growth rates and commission levels paid. While some of the companies paying higher commissions have products with more features, the differences are not sufficient to explain the share of growth being obtained.

We have included a graph in our covering letter which shows the share of new business written by a life insurance company with top end commission structures. Even only looking at new business written (which will include churn from other companies), those companies with the highest %age commissions paid have growth that is significantly above their market share, or average market growth.

As a direct insurer this does not impact our business directly, but we are concerned that customers are unaware that their business is being placed at levels disproportionate to market share with those insurers who have the most lucrative incentive schemes. Given that these origination costs must inevitably be built into the cost of the product, and with commission rates that are out of sync with the majority of other international markets, we do not believe that allowing these levels of commissions to continue, and the conflict of interest that they represent, is in the best interests of consumers.

Our view is that the advisor dominated life insurance world has evolved to a point where it is providing distorted advice. There are two major strands of distortion and in looking to review authorised and registered practices, both need attention.

The first distortion is that, as mentioned above, the current level of initial commissions are amongst the highest in the world, and are a major conflict of interest in the client-advisor setting. The recent Australian solution would be a good compromise solution, although we also see opportunity in the NZ market to further refine the claw back periods and rules.

The second distortion is the competition between life insurance companies, where more and more features are added to improve their 'comparative rating', with little value being added to the consumer. Its foundation is a comparative rating of product by analysing the extent of

coverage, and claims wording on particular diseases, with most of the differentiation at the fringes of trauma cover, versus core life product features. For example, some trauma products cover relatively obscure risks such as Creutzfeldt-Jakob disease (CJD) “Mad Cows disease” and some don’t – yet from a consumer risk perspective there haven’t been a case of variant CJD (the British experienced this in the 90s) in NZ, and only about 5 deaths per annum of sporadic CJD. Therefore, unless customers are aware of the likelihood of some conditions, it is difficult for them to trade-off price v value between solutions.

Our view of the hierarchy of life product needs is firstly adequate health insurance, followed by income protection (particularly for the self-employed), followed by basic life cover, and then finally trauma cover. However, the majority of product differentiation is around the edges of trauma cover, and the features tends to dominate product comparison and decision making / advice to consumers. This needs to be challenged and resolved through industry guidelines around product comparison, and disclosure guidelines and requirements.

2. Is there evidence of other major barriers not captured in the Options Paper? If so, please explain.
No further comment.

Chapter 4 – Discrete elements

3. Which options will be most effective in achieving the desired outcomes and why?
The options which will best support the desired outcomes are:

4.2 Advice through technological channels, including robo-advice. As many of these channels use levels of data unavailable to an individual broker, and are based on statistical analysis, they have a higher probability of being relevant, and potentially more comprehensive to the consumer. While robo-advice will not meet everyone’s needs, for the younger generation, and for many middle NZers, this will be a channel of choice, and will enable them to make better decisions than they can currently.

The broker channel is also unlikely to be targeting these consumers, given that the level of cover being written will not generate the same income levels that can be gained from spending time with more sophisticated clients with greater needs. Also, these consumers are unlikely to want to pay for advice, given their financial situations. Research also shows that many middle NZers are nervous about being seen as not knowing enough about what they need, and so are not likely to approach an advisor that they do not have an existing relationship with.

4.3 Ethical and client care obligations. As mentioned previously, the treatment of conflicted remuneration is considered to be a major issue in this market, as can be seen by the level of business placed with those companies with the highest levels of commission.

4.6 Disclosure to consumers. As long as this is kept simple, and clearly shows any conflict, it will help consumers know the questions to ask. It not only needs to identify what solutions they are being offered but also what solutions they are not being offered.

4.1 Restrictions on who can provide advice. While challenging to get right, using terminology that is simpler and more apparent as to its meaning would be useful for consumers.

4. What would the costs and benefits be of the various options for different participants (consumers, financial advisers, businesses)?
Consumers – if the NZ commission structure was more transparent, and in line with overseas markets, the consumer could expect to pay lower premiums for their insurance going forward.

Also, the use of robo-advice would increase the accessibility of class advice, and potentially cost-effective personalised advice, for the middle NZ market, a market which is currently under-insured compared with overseas countries.

Financial Advisors – A change in commission levels would require a re-think of the business model for many small advisors, potentially causing an amalgamation into large broker companies, which could drive a more efficient operating model. There are advisors today who charge for their advice, and do not rely on high commission structures, and this model would need to further evolve to meet the changed circumstances of the distribution channels.

Insurance Companies – reduced cost of acquisition could be passed on by way of lower premiums to customers, thereby increasing product penetration as more NZers could afford insurance. It would also drive innovation, as insurers would need to better understand, and meet customers' needs to stand out in the market.

5. Are there any other viable options? If so, please provide details.

Reviewing commission levels in conjunction with other alternatives such as robo-advice, disclosure etc would be a viable option to achieve the desired outcomes.

4.1 Restrictions on who can provide certain advice

6. What implications would removing the distinction between class and personalised advice have on access to advice?

To answer this question fully requires there to also be a clear definition of 'sales' versus advice. Package 3 is the one that is most likely to create the best consumer outcome, but it is unclear from the Options Paper as to the definition of sales. If the argument is that class advice is inherently similar to 'selling' then a distinction would still stand, but be labelled in a way that made more sense to a consumer.

Keeping a distinction between class advice / selling and personalised advice is also in best interests of the consumer, as long as it is clearly able to be articulated and understood. For many consumers, their needs are relatively straight forward, and in the main are driven by affordability. They are often looking for a simple way to compare what is available in the market. An example of this is the current Life Direct aggregator site. It identifies differences between competing products, and enables people to gain some concept of value (ie the trade-off between price, features and risk) by comparing multiple offerings. That would of course improve if the current comparative rating structure developed by the industry was recast as suggested in the response to 3.1. Other websites such as www.sorted.org can help people determine what they need to think about around their life insurance, and the development of robo-advice type models will allow consumers to make even more informed choices. There will still be a need for personalised advice, as there will always be some consumers whose needs are more complex than others, and the financial products defined as requiring personal advice could be further refined (as proposed later in the MBIE options paper).

7. Should high-risk services be restricted to certain advisers? Why or why not?

Depending on the definition of high risk products, we agree in principle that these should be restricted to some advisors. For more complex products, where the risks are not commonly understood by consumers, having access to professional advice is advisable.

The definition of high-risk services also needs to be carefully considered, as not all products are highly complex and / or high risk for customers. Life insurance products are not high-risk, especially given the relative homogeneity of life cover insurance cover.

8. Would requiring a client to 'opt-in' to being a wholesale investor have negative implications on advisers? If so, how could this be mitigated?

This does not relate to Life insurance, and so no comment has been made.

4.2 Advice through technological channels

9. What ethical and other entry requirements should apply to advice platforms?

We agree that licencing for robo-advice type models is advisable. Entry requirements should include the ability to prove the validity and transparency of data being used, as well as external validation of the models to be proposed for use. Principles and guidelines for ensuring consumers are aware of the limitations and scope of technological channel advice should also be included.

10. How, if at all, should requirements differ between traditional and online financial advice?

Requirements should only differ in the regard that the technology channel / providing company needs to be registered versus individuals. Disclosure requirements will also need to be adjusted to reflect the different nature of this channel – whether for class or personal advice.

11. Are the options suggested in this chapter sufficient to enable innovation in the adviser industry? What other changes might need to be made?

The key is to ensure that the legislation is not so restrictive that it limits the continued innovation that comes with technology, while also not being so open as to enable exploitation of consumers. This is a balancing act that will need to be carefully worked through and considered.

4.3 Ethical and client-care obligations

12. If the ethical obligation to put the consumers' interests first was extended, what would the right obligation be? How could this be monitored and enforced?

Ethical requirements should be a standard for the entire industry, with a minimum standard required irrespective of the advice model or channel of delivery. However, as pointed out in Option 1 of the Options paper, these can be relatively subjective, and therefore difficult to monitor and enforce. The process of monitoring and enforcement would need to be relevant to the requirements that are defined, but disclosure and reporting requirements would be a good starting point for monitoring and control. This ethical obligation should apply to sales and advice, albeit that the requirements may differ by category.

13. What would be some practical ways of distinguishing 'sales' and 'advice'? What obligations should salespeople have?

Sales could be defined as being the provision of a product that meets the minimum needs of the customer, as defined and assessed by the customer, but does not take into account the majority of options in the market – and in most cases will only take into consideration the products of the organisation doing the selling eg Direct insurers, bancassurance etc.

Please refer to also to our answer to question 6. Class advice / selling still needs to recommend solutions that meet the needs of the customer, as defined by the customer. Personal advice needs to include a specific review of an individual's situation, and provide alternatives that meet those needs – in this instance the advisor needs to be able to demonstrate that they have considered at least a majority of the options available in the market, and how they have assessed the best solution for that customer.

Salespeople obligations will differ depending on whether they are selling, giving class advice or

personalised advice. Minimum requirements include levels of disclosure suitable to the level of sales / advice, around any remuneration other than salary – including commissions and other benefits that the individual or organisation obtains from that sale or relationship with a manufacturer of product.

14. If there was a ban or restriction on conflicted remuneration who and what should it cover?

Any restriction on conflicted remuneration should be based on a maximum for the industry – which would drive a more level playing field. It is then likely that the industry would normalise around this level, and so this would reduce the incentives for advisors to churn or write business to the company which offers the highest remuneration. Conflicted remuneration includes direct commissions, and any other sales incentives, or financial support provided by a manufacturer to a distributor.

4.4 Competency obligations

15. How can competency requirements be designed to lift capability, without becoming an undue barrier to entry and continuation in the profession?

Any specifics need to be considered in conjunction with the definitions and differences between the final categories eg selling, class and personal advice, as any competency obligations would need to align to those definitions. This also needs to be considered in the context of robo-advice type channels, as the more sophisticated ones will also be providing advice, but as individuals may not be involved in the advice process, then individual licensing and training models alone will not be sufficient.

It is also important to consider this in the context of what is a simple versus complex customer need. Competency requirements should be built around ensuring that customers with more complex needs can get access to advisors with more qualifications around complex products, but should not be restrictive for consumers who are looking for easy access to information and advice, and who may have more simple needs – especially given that at times product complexity is driven by the manufacturer looking to differentiate.

16. Should all advisers be subject to minimum entry requirements (Option 1)? What should those requirements include? If not, how should requirements differ for different types of advisers?

If an advisor excludes a sales person, then minimum entry requirements could be required. The existing requirements for class advice are considered adequate, what is needed is a better way to advice consumers around what the various levels mean (eg sales person, RFA, QFE and AFA – or the new definitions as they are determined).

4.5 Tools for ensuring compliance with the ethical and competency requirements

17. What are the benefits and costs of shifting to an entity licensing model whereby the business is accountable for meeting obligations (Option 1)? If some individual advisers are also licensed (Option 2), what specific obligations should these advisers be accountable for?

This is dependent on what levels of advice this applies to. Particularly as the ability to provide information to consumers looking for more generalist / class advice is enhanced and enabled through data and analytics, then any licensing model needs to be adapted to meet this change, as it is the quality of the models and data being used which will require review and disclosure for innovations such as robo-advice.

We consider that both entity licensing (similar to today's model versus adding significant cost

and overhead), supported by individual registration for advisors providing personalised advice is still required. This model could be enhanced by a Code of Professional Conduct, as long as it was clear as to how this would be monitored and enforced.

18. What suggestions do you have for the roles of different industry and regulatory bodies?

No further comment to be made.

4.6 Disclosure

19. What do you think is the most effective way to disclose information to consumers (e.g. written, verbal, online) to help them make more effective decisions?

Disclosure needs to be provided in multiple ways to meet the needs of the consumer. However, as it needs to be referred back to, (eg if required during a dispute), then it needs to be in writing at a minimum –whether that is disclosure on a website, on a form or by email /mail – and in a format that can be saved in relation to the timeframes it was used within. The critical element is simplicity and focus on the key disclosure issues, so that consumers can clearly see the key aspects of disclosure – not having to be presented with a long complex document.

20. Would a common disclosure document for all advisers work in practice?

As long as it defined the minimum disclosure requirements, and that these needed to be presented up front, with an allowance for advisors to add any other disclosure requirements they saw fit after the minimum level of disclosure. This would ensure that any disclosure around commissions, products reviewed and considered etc were clear up front across the industry.

21. How could remuneration details be disclosed in a way that would be meaningful to consumers yet relatively simple for advisers to produce?

From a life insurance perspective, most advisors work within a defined remuneration model that remains relatively stable over time, and so therefore should not need to be updated too often in terms of the calculations that sit behind any remuneration disclosure. Therefore, disclosure around the offer being proposed, and where this sits against other remuneration models the advisor has available should be relatively straight forward to disclose. This disclosure should also provide the consumer with information around how many offers have been considered, and what percentage of the offers available in the market that this represents / or which offers have not been considered.

4.7 Dispute resolution

22. Is there any evidence that the existence of multiple schemes is leading to poor outcomes for consumers?

Not that we are aware of.

23. Assuming that the multiple scheme model is retained, should there be greater consistency between dispute resolution scheme rules and processes? If so, what particular elements should be consistent?

No comment on this question.

24. Should professional indemnity insurance apply to all financial service providers?

No comment on this question.

4.8 Finding an adviser

25. What is the best way to get information to consumers? Who is best placed to provide this information (e.g. Government, industry, consumer groups)?

Information for consumers needs to be provided and managed by an independent third party, but one which has strong brand awareness and usage by consumers. It must also be publicly accessible and be an information channel only – versus being a channel that also provides reviews or advice on products or services. Existing vehicles like Sorted.org should continue to be optimised to ensure that consumers can easily find the information they need (which may involve an investment in paid online search / marketing spend given the changes in online search models) to become more accessible to consumers.

26. What terminology do you think would be more meaningful to consumers?

No comment at this stage.

4.9 Other elements where no changes are proposed

The definitions of ‘financial adviser’ and ‘financial adviser service’

27. Do you have any comments on the proposal to retain the current definitions of ‘financial adviser’ and ‘financial adviser service’?

We have no further comments to add.

Exemptions from the application of the FA Act

28. Are those currently exempt from the regime posing undue risk to consumers through the provision of financial advice in the normal course of their business? If possible, please provide evidence.

We do not see the existing exemptions pose undue risk to consumers, and have seen no evidence to support this.

Territorial scope

29. How can the FA Act better facilitate the provision of international financial advice to New Zealanders, without compromising consumer protection? Are there other changes that may be needed to aid this, beyond the technological options outlined in Chapter 4.2?

As this mainly relates to investment services, given the restrictions on life insurance sales to NZers, we have no comment on this section.

30. How can we better facilitate the export of New Zealand financial advice?

No comment.

The regulation of brokers and custodians

31. Do you have any comments on the proposal to retain the current approach to regulating broking and custodial services?

No comment.

Chapter 5 – Potential packages of options

32. What are the costs and benefits of the packages of options described in this chapter?

Package 1.

This is a minor change to the existing regime, with an increased focus on disclosure and consumer focus / ethical obligations. While it does help clarify some of the mis-perceptions driven by the current terms applied to the different levels of advisor etc, it does not address the changing landscape around technological channels, and that consumers have more access to information that enables them to make informed decisions on their own. The advantage is that it will drive little additional compliance cost into the model, but it does not address any of the inconsistency of remuneration that exists between manufacturers and distributors (particularly in life insurance), and which drives up acquisition costs, and inevitably cost to the consumer.

Package 2

Better reflects the changing needs and behaviour of consumers, who will have more access to technological advice and information over time. As long as disclosure around any advice given (as to whether it is class or personalised) is clear and uses simple terminology, this should enhance the ability of the consumer to understand the level of advice / information being delivered. The proposed language is simpler, and the removal of the classification of products, with a clearer list of high-risk financial services should enhance the accessibility of information, and advice to the mass market (especially if supported by technological channels such as robo-advice).

However, as this package does not clearly differentiate between advice and sales, it still places undue obligations on those providers who do not want to provide advice, but want to focus on the sale of straight forward, simple products and services to meet the needs of the mass market.

Package 3

We agree with, and support, the differentiation between advice and sales. Sales needs to include both white-label and manufactured product, to avoid any ambiguity. Any entity that retains a liability against products sold to a consumer should still be licenced, as per the proposal. The key to this, as addressed earlier is for simple and clear disclosure around any conflict, advice or remuneration. By differentiating between simple and complex customer needs, costs can be aligned to the respective models and this should hopefully drive increased accessibility of services to consumers.

33. How effective is each package in addressing the barriers described in Chapter 3?

As per above commentary, package 3 is the most effective in addressing the barriers outlined in Chapter 3.

34. What changes could be made to any of the packages to improve how its elements work together?

As per the answer to questions 32.

35. Can you suggest any alternative packages of options that might work more effectively?

As per the answer to questions 32.

Chapter 6 – Misuse of the Financial Service Providers Register

36. Do you agree with our assessment of the pros and cons of the options to overcome misuse of the FSPR?
No response.
37. What option or combination of options do you prefer and why? What are the costs and benefits?
No response
38. What are the potential risks and unintended consequences of the options above? How could these be mitigated?
No response
39. Would limiting public access to parts of the FSPR help reduce misuse?
No response

Demographics

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