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From: Tenancy No Reply
Sent: Friday, 7 June 2019 3:31 p.m.
To: Insurance Review
Subject: Response to Review of Insurance Contract Law quick form

What is your feedback on the overarching duties? Which option do you prefer and why?

MAS supports the strengthening of conduct expectations in the New Zealand financial service industry.

Our preference is for a principles-based regime, which is the approach proposed. This would recognise that it is difficult to apply a prescriptive model against a diverse range of financial products and financial institutions, and also avoid conflict with the provisions of existing conduct related legislation (e.g. the Financial Markets Conduct Act (FMCA) and Credit Contracts and Consumer Finance Act (CCCFA).

MAS is broadly supportive of the six overarching duties proposed. It is important that these duties are supported with clear guidance for participants as there is potential for uncertainty when applied to a diverse range of financial institutions. Clear guidance is essential to ensure that entities have confidence in understanding their compliance obligations. Without it, there is risk of overly conservative approaches being taken which could result in barriers to innovation within the financial services sector. This is a factor which could ultimately lead to poor customer outcomes.

Care must be taken that conduct duties imposed on directors and senior managers do not unduly overlap or come into conflict with existing duties such as those under the Companies Act, or the integrity focussed duties in respect to the provision of financial advice under the Financial Services Legislation Amendment Act.

Issues identified by completed reviews – the Australian Royal Commission, the FMA/RBNZ joint conduct and culture review of the New Zealand life insurance sector and the FMA's thematic report into replacement life insurance practices, provide a strong case for there being a basis to strengthen regulation of remuneration and incentive structures.

The options paper highlights some of these issues. "When staff or intermediaries are incentivised to prioritise sales over good customer outcomes, this can encourage the mis-selling of financial products, irrespective of whether financial advice is provided" (paragraph 80). This is further elaborated as "remuneration tied to sales targets (either volume or value) is particularly problematic because as the target is approached it creates an increasingly strong incentive to sell the product. Sales targets can result in staff pursuing sales in order to avoid being performance managed by their bosses" (paragraph 81).

The extent to which conflicted remuneration was an issue identified with intermediaries makes it important that they are within scope of the regime.

MAS supports the recommendation to impose a duty on entities to "design remuneration and incentives in a manner that is likely to promote good customer outcomes" (paragraph 117). However, we express the need for caution around the second part of the recommendation, being "a ban on target-based remuneration and incentives, including soft commissions (this would apply to both in-house staff and to intermediaries)".

Clarification should be made as to the intent being to ban 'sales' (volume and/or value) targets. Incentives structures built around targets of achieving quality or compliance gateways may align well with supporting and incentivising staff to achieve good customer outcomes.

What is your feedback on the options to improve product design? Which option do you prefer and why?

MAS supports that a combination of options 1 and 3 be explored.

We do not support option 2 for the reasons noted in the options paper - the complexity in managing customers affected by a product ban and particularly the note that "bans are usually reserved for things that are unequivocally bad, which is not necessarily the case here. For poor value products there are a portion of customers for whom these products are useful" (paragraph 147). More flexible regulatory powers such as those proposed in option one, which we assume would only be used in extreme cases, provide a more workable approach to managing customer outcomes where poor value products are identified.

The requirements proposed in option 3 for manufacturers to identify intended audience for products and to have regard to the intended audience when placing the product are reasonable requirements to incorporate into the product design phase. We view it as important though that each requirement is viewed as a distinct obligation in its own right.

Whilst there is a cost for manufacturers in investing time and effort to ensure products are designed for suitable audiences, a well-designed product for an appropriate audience should be able to adequately offset these costs. It does need to be recognised though that the target, or non-target audience for some products can be quite broad. For example, a home insurance policy that covers most of the generic risks that consumers commonly expect to be covered, the only non-target market may be consumers who are not homeowners.

An obligation on distributors to have regard to the intended audience when placing the product is appropriate and helps to ensure that customers interests are being taken into account at the point at which the product is distributed. This obligation should also extend to intermediaries where they are undertaking distribution of financial products.

Care also has to be taken to ensure distribution obligations don't substantially limit consumer choice. For example, general insurance products distributed directly by insurers are typically sold through channels providing limited or no financial advice. Tools and information are provided by the insurer to assist consumers in making an informed choice. However, insurers shouldn't be put in a position where they are expected to hindsight and potentially override consumer decisions when the consumer has been informed and clearly exercised their own choice in selecting a product and appropriate level of cover.

What is your feedback on the options to improve product distribution? Which option do you prefer and why?

MAS supports that a combination of options 1, 2 and 5 be explored further.

Rewards based on sales performance alone are not conducive to good customer outcomes. There should be, and we support, as option 1 proposes, a duty on entities to design remuneration and incentives in a manner that is likely to promote good customer outcomes.

MAS also supports further development of option 2 but with a caveat that "target-based remuneration and incentives" is intended to capture 'sales' (volume and/or value) targets. Other targets based on factors such as quality, professional development, customer experience and compliance can incentivise the 'good behaviours' that will lead to and foster a culture focussed on achieving good customer outcomes.

We perceive option 5 as it is presented as fitting well with the proposed product distribution obligation. However, it is important that it does not unduly add to compliance costs (which will ultimately be passed to consumers) or that it impedes the process of customer onboarding.

Care must be taken in considering bans or limits around commission-based remuneration structures. Their removal, or scaling back, will likely see a transferral of costs onto consumers (i.e. more fee for advice models) in order to recover income that otherwise would have been earned via commission. This will have the unintended consequence of creating a barrier, or disincentive for consumers to seek professional financial advice.

What is your feedback on the options relating specifically to insurance claims? Which option do you prefer and why?

MAS is supportive in principle of there being a duty on insurers to ensure claims handling is fair, timely and transparent (option 1). However, we would like to understand further how such an obligation would be operationalised. As presented in the options paper, there does appear to be some overlap in the responsibilities of the regulator and of external disputes resolution schemes (for example the examination of "any attempts to settle claims for less than the insurer is obliged to settle for" (paragraph 180). Care should be taken that this proposal doesn't undermine consumer confidence in existing legislation such as the Financial Service Providers (Registration and Dispute Resolution) Act.

Option 2 is not supported as the principles-based approach proposed under option 1 is preferable, and more workable than a prescriptive time-bound model for the settling of claims. This is problematic as each claim comes with a unique set of circumstances. The need for insurers to reserve capital against unresolved claims incentivises them already to settle in a timely manner. Those claims that aren't already settled within a reasonable timeframe are likely to be the exceptional circumstances that any regime needs to recognise and allow for.

What is your feedback on the options for tools to ensure compliance? Which option do you prefer and why?

In principle MAS supports greater empowerment through legislation for the FMA (and the RBNZ) to monitor and enforce good conduct within the financial services industry. However, the cost of this approach needs to be carefully considered. Any additional cost (or at least a significant portion of it) would presumably be levied on industry and therefore ultimately flow on to consumers.

The options paper notes as a 'pro' to empowering the FMA as conduct regulator "a clear divide between conduct and prudential regulation" (paragraph 190). We take a differing view in that the principles of good conduct should be a fundamental component within any prudential regulation framework. Conduct risks are inherent in respect to the prudential matters of governance, capital and liquidity management, disclosure and conflicts of interest.

The role of the RBNZ as a conduct regulator complementary to its prudential oversight role should not be overlooked. It already has a mandate to consider the conduct of banks, insurers and non-bank deposit takers through its prudential supervision of these sectors and the existing tools in place (e.g. licensing, risk management programmes). Greater empowerment of the RBNZ, alongside greater empowerment of the FMA, within existing legislation should provide the most cost-effective and least complex compliance outcome.

MAS does not support separate conduct licensing for financial institutions. Banks, insurers, managed investment schemes, discretionary investment management services and non-bank deposit takers are already subject to licensing regimes (often multiple regimes where they are also QFE licensees, or in the future will be licensed Financial Advice Providers). A further distinct licensing regime only adds cost, complexity and potential overlaps with existing licensing tools. It is preferred that existing licensing tools are better leveraged to achieve the same desired outcomes.

Option 5 explores executive accountability as a mechanism to "establish conduct expectations and incentivise compliance by creating the possibility of penalties for individuals". MAS agrees that the

introduction of an accountability regime would be a positive step in that it would create a strong incentive for directors and senior managers to ensure compliance with conduct obligations. However it should be considered with careful analysis of the additional value and consumer protection it would provide alongside other conduct regulation and compliance tools.

We would agree that reporting on sector statistics improves transparency and enables public scrutiny. However considerable sector information is already published (e.g. KiwiSaver statistics RBNZ banking key statistics, ICNZ general insurance market data).

Option 7 however seems very focussed on insurance metrics. Some of which will be very problematic to develop consistent and meaningful data. For example, claims declinature rates must be based on very clear and precise definitions of what constitutes a declined versus a withdrawn claim. It is concerning that reporting is proposed at specific company levels (paragraph 209). This may help to achieve the desired outcome of helping to inform customer decisions but at the same time presents the risk of unfounded prejudice against companies where consumers don't have the context and understanding of the information they are presented with. Any reporting requirement should therefore be supported with a regulator led consumer education and awareness campaign. A cost-benefit analysis should be performed to ascertain the level of understanding and value that consumers would receive from reporting made available to them.

What is your feedback on who the conduct regulations should apply to? Which option do you prefer and why?

MAS supports option 2: application of the preferred package of options to all those financial services providers that offer similar services to banks and insurers.

All consumers of financial products are at risk of harm resulting from poor conduct.

Where a desired outcome is to "ensure that conduct and culture in the financial sector is delivering good outcomes for all customers" (paragraph 17) it would be inconsistent with this objective to limit the scope of conduct regulation to just banks and insurers. The customers of other financial institutions (e.g. managed investment schemes, non-bank deposit takers, etc) are exposed to conduct risks – e.g. information asymmetry, conflicts of interest, product complexity, long-term risks of poor financial outcomes.

An entity-based approach is good in principle that it forces financial institutions to duly consider their customers at all levels but if limited to banks and insurers it may create an unequal playing field that could be confusing and potentially may result in adverse consequences for consumers. Many banks and insurers also manufacture and/or distribute the same products that may not be covered by the proposed conduct regime.

We also note that the options paper appears to use a very limited definition of general insurance (footnote, page 9). Only house, contents and motor vehicle appear to be within scope however the range of general insurance products is far broader than this.

If the intent is to address the issues identified through the Australian Royal Commission, and to a lesser extent, the FMA/RBNZ joint conduct and culture reviews of the New Zealand banking and life insurance sectors, then the scope of who conduct regulation applies to should be broadened to also include intermediaries of financial products and services.

It is also critical that any new regime be integrated effectively with existing conduct related legislation. Any overlaps need to be clearly applied and the most pragmatic approach may be to carve out direct overlaps to avoid duplication and uncertainty as to the applicable obligations. In particular, is conduct in the provision of financial advice which is addressed through the recently passed Financial Services Legislation Amendment Act. This important, and wide reaching in terms

of conduct related to the distribution of financial products and the entities covered, doesn't appear to have been considered at all within the context of the options paper, with the one small exception of looking to it for a potential definition of retail client.

What is your feedback on the initial preferred package of options?

MAS supports a regime that utilises a principles-based set of duties. This should be supported with clear guidance to assist entities to understand their obligations.

MAS does not support limiting of the package to banks and insurers. All consumers are exposed to the harms of poor conduct. For the regime to be credible in building consumer confidence in the financial services sectors, and to avoid an uneven playing field where many of the regulated entities (banks and insurers) also offer unregulated products (e.g. managed funds) it is important that providers of all common consumer financial products be subject to the same standards of conduct. These same standards of conduct should be extended to intermediaries involved in the sale/distribution of financial products to consumers.

MAS is supportive of the six overarching duties to govern conduct. Care should be taken though to be consistent with terminology and to avoid overlap with existing legislation to avoid confusion over the application of obligations.

MAS may be supportive of an accountability regime for directors and senior managers in respect to the overarching duties. This is conditional on appropriate cost-benefit analysis on the value and consumer protection it would provide alongside other conduct regulation and compliance tools

MAS supports the measures proposed to address conflicted remuneration provided clarification is made that the "ban on target-based remuneration and incentives" applies only to sales (volume and/or value) targets.

MAS is in principle supportive of a duty to ensure claims handling is fair, timely and transparent. However greater clarity is required as to how this duty would be operationalised and applied, and how overlaps between the role of the regulator and of external disputes resolution schemes will be avoided.

MAS is supportive of the product design and distribution obligations proposed. The duty on manufacturers to ensure oversight of intermediaries shouldn't just fall on manufacturers. It is critical that intermediaries of financial products are also subject to the same standards of conduct and duty of care to consumers.

MAS does not support the differentiation of conduct and prudential regulators. We view good conduct as being a fundamental component of a prudential regulation framework. Therefore we view both the FMA and RBNZ as jointly having important, continuing roles to play as conduct regulators.

MAS does support there being a broad range of tools available to monitor and enforce the conduct regime. These tools should be backed with strong pecuniary penalties consistent with other financial services legislation. We do not support going so far as to have separate conduct licensing given the extent to which financial institutions are already licensed.

MAS is not convinced that the publishing of regular reporting will be effective in informing consumers as desired unless it is supported by a regulator led educational and awareness campaign to provide context and understanding of the information presented to them.

Do you have any other general feedback?

No.

Your name

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Your email address

Privacy of natural persons

Your organisation

Medical Assurance Society New Zealand Limited (MAS)

In what capacity are you making this submission?

business

Other capacity

Privacy act/release

Can we include your name or other personal information in any information about submissions that we may publish?

yes

We intend to upload submissions to our website. Can we include your submission on the website?

yes

You may ask us to keep your submission, or parts of your submission, confidential. If so, you'll need to attach reasons and grounds under the Official Information Act 1982 for consideration.

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