Southern Cross
Travel Insurance

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31 May 2019

Financial Markets Policy
Building, Resources and Markets
Ministry of Business, Innovation & Employment
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Options Paper: Conduct of Financial Institutions

Introduction

Southern Cross Benefits Limited has traded as Southern Cross Travel Insurance since 1982 and now has over 37 years' experience as a specialist travel insurer. The company is part of the Southern Cross Group and is 100% New Zealand owned, but operates as a separate legal entity to the Southern Cross Medical Care Society with its own dedicated Board of Directors.

Southern Cross Benefits Limited is New Zealand's largest travel insurer by market share. Each year we sell more than 300,000 insurance policies to customers in New Zealand and Australia. Annually we receive more than 40,000 claims.

Thank you for providing an opportunity to submit on the options paper "Conduct of Financial Institutions". Southern Cross Benefits Limited is pleased to participate in the wider discussion on conduct and culture in the financial sector. The health of the financial services and markets depends on the level of trust and confidence in which they are held by New Zealanders. Good conduct and a customer-centric culture are crucial to achieving this outcome, and should be the cornerstone of conducting business in the financial sector.

We have concerns with the detail provided on the proposed options and their inter-relationship with existing and pending laws and regulations (in particular the Financial Markets Conduct Act 2013 ("FCMA") and the new Financial Services Legislation Amendment Act ("FSLLA").

We also have concerns around moving too quickly and incomplete consideration/identification of intended consequences. To address this question, we would suggest that some thought and consultation goes into presenting the strategic, systemic framework that we may be required to move to, and not just the additional regulation options potentially on offer. We would welcome the opportunity to engage further with the Ministry as to how this might be achieved.

We have provided feedback on the specific questions below.

1. Which overarching duties should and should not be included in the regime? Are there other duties that should be considered? Do you agree with the pros and cons of each duty? Do you have any

estimates of the size of the costs and benefits of these options? Are there other impacts that are not identified?

We support a principles-based approach to regulation as long as it comes with sufficient detail and guidance.

The duties are a combination of over-arching and subordinate duties which are not consistent in terms of their scope and as a result overlap. For example, duties 5 and 6 fit within option 1.

Our preferred option is not to have over-arching duties. Instead, we advocate further specific duties for disputes handling and customer communications to add to the proposed specific duties in relation to product distribution, product design, and claims. By taking a specific approach, there would be greater clarity.

Should MBIE's preference remain to have over-arching duties, we would propose a re-worded option 1, option 2, and a new duty to act with honesty and integrity. These duties would be truly overarching so that the other duties would be unnecessary.

Further, we note that options 5 and 6 appear likely to duplicate existing laws. There may be potential conflict between the proposed options and the 9 duties recently released in the Code of Conduct for Advisers (which is conduct focused). The result may be a network of rules that overlap and are difficult to administer.

MBIE's approach is principles-based, which has the advantage of simplicity, but necessarily results in vagueness and uncertainty without some guidance as to how it would be applied. We seek detail as to the standards that the sector must meet. This might take the form of a code, guide or handbook. For example, words like "transparent", "timely" and "fairly" are vague and would require some further guidance as to how they might be applied. Without such clarity, there might be a long period of uncertainty for the industry and the regulator while awaiting judicial interpretation. Such guidance would be necessary to underpin whatever framework of duties MBIE ultimately pursues, whether over-arching or specific (as we would prefer).

All the duties, whether over-arching or specific, should be subject to tests of reasonableness. This would allow demonstration of having taken reasonable steps. As noted, it would be important to have detailed guidance as to how the duties apply, and such guidance should set out what is reasonable steps by the financial services provider.

The duties would result in significant change which would involve a substantial increase in the costs of compliance for financial services companies. We anticipate having to conduct at least a detailed review of our systems and business processes across the business. However, without detail and guidance, it is not possible to ascertain the cost accurately at this stage.

<u>Option 1: A duty to consider and prioritise the customer's interest, to the extent reasonably practicable</u>

We do not support over-arching duties. However, if MBIE wishes to proceed with over-arching duties then we would support this duty if re-worded.

Unless in a specific context, words like 'prioritise' conflict with existing company laws, director duties and prudential regulation. We suggest this duty should use better understood, more settled legal concepts like: 'take in to account' or 'have regard to'.

As we have noted, there is vagueness to the principle-based approach. For example, there is no clarity around what is required to assess what is in a customer's best interests. Customers have a variety of needs, it is a one size fits all product, invariably it will not please all customers.

The UK model has a framework of six guiding principles but is specific on the areas of focus through the customer lifecycle. MBIE's current draft may benefit from a close consideration of the UK model.

Option 2: A duty to act with due care, skill and diligence

We do not support over-arching duties. However, if MBIE wishes to proceed with over-arching duties then we would support this duty, particularly in its application to advisors and brokers.

Option 3: A duty to pay due regard to the information needs of customers and to communicate in a way which is clear and timely

We support a requirement that communications with customers are clear, and therefore we support this duty, but standalone and not part of a framework of over-arching duties - in the same way as the duties in relation to claims handling, product design and distribution networks.

Some guidance on timeframes is required to provide clarity for the industry and the regulator.

The Options Paper refers to insurers reaching out to customers following an event that may lead to claims. While the intention is to deal with widespread natural disasters, some further work is required to define the type and scope of other events to which this would apply.

Option 4 – a requirement to have systems and controls in place that support good conduct and address poor conduct.

While we support a duty that encourages or requires 'design' and 'systems' to support good conduct, we do not consider that duty 4 is necessary.

As drafted this duty is too specific to be an over-arching principle.

The duty would require some form of guidance as to how it would be applied. For example, the Australian prudential standards provide explicit requirements on frameworks governing risk.

Option 5 - A duty to manage conflicts of interest fairly and transparently

We believe that commission in the adviser market should be absolutely capped and disclosed. The lack of obligation/regulation here is at the heart of many conduct issues regarding product suitability and churn. However, the specific duty in relation to product distribution should address the problems in this area, and therefore we do not support duty 5.

Option 6 - A duty to ensure complaints handling is fair, timely and transparent

We support this duty, but standalone and not part of a framework of over-arching duties, in the same way as the duties in relation to claims handling, product design and distribution networks.

There would need to be some detailed guidance as to how it would be interpreted, such as a standard definition of a "complaint".

2. Do you think the overarching duty for managing conflicts of interest should be general (as it is currently worded) or focus on conflicts of interest that arise through remuneration? What are some examples of conflicts of interest that arise outside of conflicted remuneration and incentives?

Duties 1 and 2 would appear to overlap a conflict duty, which could result in multiple duties for similar issues, which would be costly and inefficient to comply with and to enforce.

Any conflict duty should be limited to conflicted incentives in the advised sales arena, accompanied by clear and detailed guidance formulated and consulted on with industry participants on identifying conflicts, materiality and process.

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

The duties cannot function effectively in practice without underlying detailed guidance. Some kind of guidance documents are necessary, which could take the form of a code of practice.

4. Which options for improving product design do you prefer and why? Do you agree with the pros and cons of the options? Are there other impacts that are not identified? Are there other options that should be considered? Do you have any estimates of the size of the costs and benefits of the options?

Option 1: The regulator will have the ability to ban/stop the distribution of specific products if they have particularly poor customer outcomes

We support the banning powers outlined in options 1 and 2, as long as the criteria to be met is clearly articulated. However there needs to be some detail as to how the regulator would gain visibility of products and assess the products. For example, clear articulation is required as what is a "poor customer outcome" so that the industry can understand how product performance is measured.

Any changes in this area that impact on currently sold products and legacy products would mean that insurers would need sufficient time to implement the new regime and accommodate the necessary compliance changes.

Option 2: ban certain products.

See comments above.

Option 3: Requirement that insurers identify the intended audience of a product and have regard for the intended audience when placing the product

We support option 3, but more detail and clarity is necessary to understand how this would be interpreted in practice.

For example, in travel insurance, where an insurer has a single product designed to meet the a broad range of customer needs, this may not be ideal for all customers, so some clarity is required as to who is the consumer that the insurer must have in mind. Further, travel insurers reasonably may not wish to provide extra cover for the pre-existing medical conditions because of the extra risk based on statistical data. It would be necessary to have some clarity as to how this situation would interface with the option 3 requirements.

We disagree with the first 'con' stating that the requirement will place an obligation in time and cost for a company in identifying characteristic of an audience for a product. If a company does not already meet this requirement at the very least, then it is not doing its job.

5. If a design and distribution requirement like option 3 were chosen, are there particular products for which this is more necessary than others? If so, please explain what and why.

Option 3 is particularly relevant for long-term products such as life insurance. As the status of a person's health changes over the life of the product, at the time of sale consideration should be given as to the suitability of the product and its long-term benefits for its intended audience.

6. Which options to improve product distribution do you prefer and why? Do you agree with the pros and cons of the options? Are there other impacts that are not identified – such as unintended consequences or impacts on particular business models? Are there other options that should be considered? Do you have any estimates of the size of the costs and benefits of the options?

We support any of options 1, 2 or 3 to set standards and general principles to design products that link to good customer outcomes and drive the right behaviour that can then be measured and enforced.

Option 1: Duty to design remuneration and incentives in a manner which is likely to promote good customer outcomes.

We agree that there is a need to manage the conflicts that arise at the point of sale between the institution and customer.

Option 1 would have a very significant impact on conduct, in particular in relation to networks of advisers in the life insurance field.

It would be necessary to support this option with clarity and guidance as to what compliant remuneration and incentives would look like: for example, whether performance structures be based around customer satisfaction and reduced complaints.

Were the option to apply beyond sales staff to management's key performance indicators, there is a risk that it would encourage and reward conservatism and mediocrity of performance within an organisation.

Option 2: ban target-based remuneration and incentives, including soft commissions.

We support this option because it would help to create a level playing field for insurers and in the adviser market, and would shift the focus on to skills around service as opposed to sales.

Option 3: prohibit all in-house remuneration and incentive structures linked to sales measures

We support this option, but only if the same restrictions are placed on advisors. Otherwise there might be a shift in balance in the industry away from the more efficient direct distribution model in favour of intermediated sales which push up the price of products.

Option 4: impose parameters around the structure of commissions.

We support this option. It is a good halfway house between complete prohibition and what is currently in the market.

Option 5: a duty on manufacturers to take reasonable steps to ensure that sale of products are likely to lead to good customer outcomes.

Many of the current issues with distribution lie in the field of advised sales, particularly through advisors in the life insurance space. We support this option if it were to apply to advised sales and did not apply to non-advised sales.

7. To assist us in comparing the pros and cons of various options, please provide information about remuneration and commission structures currently in use (i.e. what are common structures, average amounts of remuneration/commissions, qualifying criteria etc.?)

While we predominantly transact with customers directly, a small part of our business involves paying agents a commission of between 15% and 30% to sell our products.

8. What is your feedback on imposing a duty to ensure claims handling is fair, timely and transparent? Do you agree with the pros and cons? Are there other impacts that are not identified? Are there other options that should be considered? Do you have any estimates of the size of the costs and benefits of this option?

Option 1: Duty to ensure claims handling is fair, timely and transparent.

We broadly support this duty. However, there is a need for clarity around in what time frame an insurer is required to deal with a claim. For example, a customer may make an insurance claim but not provide sufficient details to enable an insurer to deal with the claim, causing delay. There is also a need for clarity around what is "fair": the claims outcome may be both legally correct and within the spirit of the proposed reforms but may not be considered fair by the consumer.

9. If this option were to be adopted, should an attempt be made to clarify what fair, timely and transparent mean? Why? What are the benefits and costs of doing so?

Please see our submission above.

10. What is your feedback on requiring the settlement of claims within a set time? Are there other impacts that are not identified? How do you think that exceptions should be designed? Should there be different time requirements for different types of insurance? Do you have any estimates of the size of the costs and benefits of this option?

Option 2: requirement to settle claims within a set time, with exceptions for certain circumstances.

We support the concept that claims should be settled without undue delay. If a time limit on the settlement of claims were set, clarity on the definition of what is a "claim" and what constitutes "settlement" of such claim would be necessary. For example, historic claims that have been declined, part settled or not pursued are frequently raised or re-litigated by customers outside of two years.

11. Do you agree with this option to empower and resource the FMA to monitor and enforce compliance? Do you agree with the pros and cons? Are there other impacts that are not identified? Are there other options that should be considered? Do you have any estimates of the size of the costs and benefits of the options?

Option 1: Empower and resource FMA to monitor and enforce compliance.

We support the FMA being appropriately resourced and empowered to monitor and enforce compliance with any conduct regime. The FMA would be the most appropriate regulator to supervise a conduct regime, especially if a principles-based approach is adopted.

12. What is your feedback on the option to require banks and insurers to obtain a conduct licence? Do you agree with the pros and cons? Are there other impacts that are not identified? Are there other options that should be considered? Do you have any estimates of the size of the costs and benefits of the options?

We do not support multiple conduct licensing with the same conduct regulator. Banks and insurers are already subject to Reserve Bank registration and licensing regimes, and two licences is sufficient.

13. What is your feedback on this broad range of regulatory tools? Do you agree with the pros and cons? Are there other impacts that are not identified? Are there other options that should be considered? Do you have any estimates of the size of the costs and the benefits of the options?

We agree in principle with the FMA having a broad range of regulatory tools at its disposal for enforcement action.

Any penalties for breach of conduct requirements ought to be matters enforced by the FMA alone. Given their jurisdiction and continuing oversight role in this area we consider this appropriate and fair, and more likely to lead to a consistent approach to enforcement, improved outcomes, consumer protection and uplifts in standards.

14. Do you think that the maximum penalties available for breaches of any conduct duties should be the same as the existing FMC Act penalties? Is there a case for making the penalties higher?

The current level of penalties under the FMCA are appropriate.

15. What is your feedback on the option of executive accountability?

While we agree with the need to life conduct in the industry generally, and support practical steps to achieve this, we do not support an executive accountability regime as part of this reform. An executive accountability regime is a complex exercise and not something to be added to a general regulatory change. Even on the limited detail provided as part of the options paper, there are significant questions as to how the scheme would operate, which require detailed input from the industry and other stakeholders. Such consultation should take place after the reform proposed in the Options Paper is put

in place. This would also provide time to address issues of how the regime would interface with other existing director liability regimes.

An executive accountability regime requires an approach based on lessons from regimes overseas. The Banking Executive Accountability Regime (BEAR) in Australia and the Senior Managers Regime in the UK (the SMR) came about after extensive consultation with the industries, and were introduced after general regulatory schemes were established. They have also required considerable regulator and industry resources to establish and maintain.

16. What is your feedback on the whistleblowing option? Do you agree with the pros and cons? Are there other impacts that are not identified? Are there other options that should be considered? Do you have any estimates of the size of the costs and benefits of the options?

We support a requirement for financial institutions (including insurers) to put in place whistleblowing procedures. However, such whistleblowing requirements could be covered under general legislation, the Protected Disclosures Act 2000.

17. What is your feedback on the option of regular reporting on the industry? Do you agree with the pros and cons? Are there other impacts that are not identified? Are there other options that should be considered? Do you have any estimates of the size of the costs and benefits of the options?

We support additional reporting.

18. What is your feedback on the role of industry bodies? Do you agree with the pros and cons? Are there other impacts that are not identified? Are there other options that should be considered? Do you have any estimates of the size of the costs and benefits of the options?

While industry bodies have an important role to play, there is no justification for a greater role than they currently have in this area.

19. What is your feedback on the options regarding who the conduct regime should apply to? In particular: Do you agree with the pros and cons of the options? Are there other impacts that are not identified e.g. do the proposed overarching duties conflict with existing regulation that applies to other financial institutions? Are there other options that should be considered? Do you have any estimates of the size of the costs and benefits of these options? Which options do you prefer and why?

Broadly we agree with the pros and cons of the options.

In respect of to whom the regulation would apply, we prefer option 2: that the package of options should apply to all those financial service providers that offer similar services to banks and insurers.

In terms of overlap with existing regulation, there is a need for further clarity and detail on how conduct changes would interact with existing legislation (the FMCA, FSLAA, the Code and the Insurance Prudential (Supervision) Act 2010).

Of the options proposed to address overlap with existing regulation, we prefer option 1. Option 2 would create complexity at both an entity and product level, and be very difficult to understand and navigate for both consumer, regulator and entity. However, the best approach would be to develop the proposed framework to a more advanced state.

Southern Cross Benefits Limited