IAG New Zealand submission

to the

Ministry of Business Innovation and Employment

on the discussion documents

Regulations to support the new regime for the conduct of financial institutions

and

Treatment of intermediaries under the new regime for the conduct of financial institutions

18 June 2021

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1. Introduction

1.1 This submission is a response by IAG New Zealand Ltd (IAG, we) to the Ministry of Business Innovation and Employment (MBIE) on the two discussion documents titled 'Regulations to support the new regime for the conduct of financial institutions' and 'Treatment of intermediaries under the new regime for the conduct of financial institutions', both of which were released for consultation on 21 April 2021.

1.2 IAG is New Zealand's leading general insurer. We insure more than 1.8 million New Zealanders and protect over $650 billion of commercial and domestic assets across New Zealand. We receive more than 650,000 claims a year and in the last financial year paid $1.576 billion in settling them.

1.3 IAG is a member of the Insurance Council of New Zealand (ICNZ) and has contributed to the discussions supporting the submission from the ICNZ on behalf of its members.

1.4 In section 2 of this submission we provide overarching comments on the proposals in the discussion documents. In section 3 we provide specific responses to the questions in the discussion documents on the treatment of intermediaries, and in section 4 on the discussion document on proposed regulations.

1.5 IAG's contacts for matters relating to this submission are:

Bryce Davies, Executive Manager Corporate Relations
Privacy of natural persons

Andrew Saunders, Government Relations Manager
Privacy of natural persons

2. Overarching Comments

2.1 IAG supports introducing conduct regulation for financial services in New Zealand. We do however remain concerned that the introduction of the proposed conduct regime for financial institutions on top of the conduct-type regime for financial advice will result in an overly complex regulatory framework that has both duplications and gaps.

2.2 The greatest challenges associated with the design and application of the proposed conduct regime have related to the treatment of intermediaries. Accordingly, we welcome the current consultation that responds to issues raised by insurers, and the thoughtful proposals in the discussion document to address them. We also welcome the consultation on regulations to support the new regime for the conduct of financial institutions.

2.3 Combined these two consultations represent a significant amount of material to consider and so we appreciated the two-week extension for submissions that was provided. This has given the ability to undertake more thoughtful consideration and discussion of the issues.

We support proposed changes to the treatment of intermediaries

2.4 We welcome and appreciate the consideration that has been given to issues raised by insurers in particular in previous submissions on the Bill in regard to the potential application of the provisions applying to relationships with intermediaries. We support the proposals to amend the definition of intermediary to focus on sales, and to refine the scope of who is covered as an agent.

2.5 Material changes are also required to section 446M(1) to address the issues identified previously in relation to intermediaries and of the three options proposed in the discussion document we consider a refined version of Option 4 (more significant changes to intermediaries obligations) would be appropriate. We have provided more detailed comments in response to the specific questions in the discussion document in section 3 of this submission.

Clear and non-overlapping requirements for employees, agents and intermediaries are required

2.6 In further considering the requirements in the *Financial Markets (Conduct of Institutions) Amendment Bill* ('the Bill') it has become increasingly apparent that the regime needs to provide clear and non-overlapping requirements for employees, agents and intermediaries. We note for instance that it is possible for entities such as insurance brokers to be both agents and intermediaries (i.e. they aren't exclusive groups) and so it needs to be clear what applies and when.[1] Given this we consider it may also be better to disaggregate the employee, agent and intermediary requirements rather than running them together.

2.7 We also consider that it would be better for most of the detail in current section 446M(1) to be moved into regulations (as was originally intended), keeping the provisions in the primary legislation high-level in nature. Otherwise there may be an unbalanced legislative hierarchy with similar types of provisions to be found in the primary legislation and the regulations. This change in drafting style will also allow different aspects to be refined or expanded further if required based on issues identified during initial implementation of the regime or afterwards.

The application of the proposed 'fit and proper' test needs to be further considered

2.8 While refining section 446M(1) it is also necessary in relation to employees, agents and intermediaries to rethink the proposed 'fit and proper' test as this is a concept usually applied to a narrow group of persons (e.g. company directors or senior management). This consideration needs to include both the nature of what is intended in relation to these various groups, and its scope of application.

2.9 In relation to the nature of the test, it is presumably intended to be different for an entity that is an intermediary (potentially a large business with many of its own employees) compared with an individual employee of the financial institution itself. Whether this is left to the discretion of institutions or to be expanded upon through guidance from the Financial Markets Authority (FMA) is unclear at this stage.

2.10 In relation to scope for example, the intent is presumably to ensure the suitability of persons who have direct interactions with consumers or are involved in the provision of financial products or services. However as currently drafted, based on section 446M(1)(b) it could be read as wide as applying to all employees of a financial institution regardless of their role and connection to the provision of financial products and services to consumers. This would appear to be unnecessarily broad.

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[1] They would for example fit within the definition of intermediary under the Bill and be an agent by virtue of section 10 of the Insurance Law Reform Act 1977, which provides that an insurance broker is also deemed to be agent of an insurer during the negotiation of a contract of insurance, as well as being an agent for the customer.

2.11 It is also important to consider that 'fit and proper' tests, such as those required under the Insurance (Prudential Supervision) Act 2010 (IPSA), tend to a have a high bar in terms of conduct that recognises the significant responsibilities held by directors and senior management.[2] Consideration needs to be given to whether such an approach is appropriate to be applied across the workforces of what are large institutions, many with thousands of existing employees, and recognising that there will likely be good employees that have personal histories (e.g. criminal convictions) that could be an issue under a fit and proper test, therefore potentially limiting employment opportunities for some people.

2.12 Given this we consider how expectations relating to the personal ethics of employees are appropriately calibrated under the regime needs further consideration. If something other than a fit and proper test (as for prudential supervision) is intended, then different terminology should be used or alternatively its intended application here needs to be clarified. Consideration will also need to be given in the implementation of the regime as to which employees of a financial institution are intended to be subject to this, noting there a range of non-customer facing roles in financial institutions areas such as IT or finance, and others that are involved only with commercial (non-consumer) customers.

The proposed prohibition on value or volume based targets needs to be refined to be proportionate and workable

2.13 As presently drafted and based on the definitions in the Bill the proposed prohibition is so broad as to seemingly prohibit the use of volume/value targets within a balanced scorecard, no matter how small a part of the scorecard this represented or what other customer-centric metrics were included, or such targets imposed on senior management to ensure the financial sustainability and growth of a firm.

2.14 These outcomes would go well beyond the specific issues of concern identified in designing the prohibition. It would also fail to recognise that maintaining and/or growing the volume or value of a financial services firm is fundamental to being able to continue to offer such services in New Zealand and that such targets are employed across firms in every other sector of the economy to hold senior management to account. We also note that there are other aspects of the regime that should also mitigate concerns about a sales culture being driven from the top of an organisation.

2.15 Given these issues, the prohibition should be focussed on sales incentives paid to those engaging with customers directly and their immediate manager/s as it the potential for these interactions to be unduly influenced by targets that has been identified as the issue of concern.

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[2] This is not generally a simple tick box exercise, but evidence needs to be collected, reviewed, assessed and retained across a range of topics including their competence, character, judgement, skills, experience, expertise, qualifications and knowledge that is appropriate to their position; compliance with relevant laws and professional standards; willingness to cooperate with regulators and the courts; disciplinary record and conflicts of interest etc.

Further engagement on implementation timeframes is necessary

2.16 The implementation of regulatory changes requires financial institutions including insurers to undertake significant change programmes (IT projects, new systems, training, changes to 3rd party agreements etc.) within their businesses and these involve potentially significant costs in terms of staff time and third-party costs etc. Independent of what the regulatory change is, how and when changes are implemented is very important and should be a key concern in policy development. In order to avoid imposing unnecessarily large costs and impacts on general insurers it is imperative that Government consider the system wide impacts on the insurance sector and make decisions on the implementation of specific changes while also having regard to other regulatory changes and processes occurring in parallel.

2.17 We note the regulations discussion document outlines on page 9 a timeline for next steps in the regulation making progress and implementation of the regime. We welcome this information being included but consider that further engagement is necessary on the process for implementation and the appropriate timing of it. Further engagement is required on this because:

- Implementation work cannot properly commence until the legislation and regulations are in law and the process, timing and expectations for conduct licensing by the FMA are determined, and the extent to which the FMA will issue guidance prior to commencement of the regime is clear.
- The time necessary (in isolation) to undertake the implementation of the conduct programme (e.g. development and implementation of a fair conduct programme, licencing by the FMA) cannot be estimated until the above is known as only then can the implications be properly analysed and understood.
- Insurers are currently subject to an extensive regulatory work programme, including this new conduct regime, the financial advice licensing process, reform and change of the EQC legislation and EQC cap, prudential review and reform and the review of the FENZ levy. We recognise other financial institutions are subject to a different set of significant regulatory reforms. The achievability of undertaking implementation of the new conduct regime within a particular timeframe, and whether efficient and effective implementation of it requires the timing of this and/or other reforms to be adjusted, will require careful consideration.

2.18 By the time the Bill is planned to be passed and the regulations made (Q4 2021) there will be greater certainty as to the shape of this regime and likely more knowledge of the potential timing of other regulatory reforms. We note the Bill sensibly provides for the regime to brought into effect on a date or dates by Order in Council and consultation on that date/s would be sensible in the latter part of 2021.

3. Responses to questions in the intermediaries discussion document

Option 1: Amend definition of intermediary to focus on sales and distribution	
	Do you have any comments on Option 1: 'Amend definition of intermediary to focus on sales and distribution'?
1	We support amending the definition of 'intermediary' under section 446E of the Bill to capture sales and distribution activities only, but also to ensure all sales and distribution activities are comprehensively captured. The focus should be on those intermediaries involved in sales and distribution of the relevant products/services. Individuals and entities involved in services that are preparatory to a contract being entered into, or administration and performance of a service or terms and conditions of a product/service, should not be considered intermediaries. Including them would complicate the regime unnecessarily without providing any additional protections for consumers as their role contributes to what the insurer does rather than acting independently. We are supportive of this definition being extended to ensure all sales and distribution activities are comprehensively captured regardless of whether these are financial advice or non-advice sales roles. Doing so ensures that the sale and distribution of products/services through the likes of travel agents, retailers, car dealerships and comparison websites, which may similarly give rise to conduct issues, are also appropriately covered under the regime. We also support the retention of the regulation-making power under section 446E(4) of the Bill that enables the exclusion of prescribed occupations and activities from the definition of 'involved'. This will provide flexibility to ensure the regime can in future be appropriately adjusted should issues arise when the regime is being initially implemented or subsequently.

	Do you think the scope of the proposed definition of an intermediary is comprehensive enough to capture the variety of sales and distribution methods and to avoid gaps and risks of arbitrage?
2	We consider that the scope of the proposed definition of 'intermediary' is comprehensive enough to capture the existing variety of sales and distribution methods and to avoid gaps and regulatory arbitrage. There is however another aspect of the definition of intermediary that needs to be addressed. Proposed section 446E(2) needs to be amended because this provision provides that a person is not an 'intermediary' if they are only involved as an employee of the financial institution or intermediary. Accordingly, under this provision, whether a natural person (i.e. individual) is an intermediary depends on whether they are an 'employee', a term that is not defined in the Bill. The way the provision is currently drafted means that the type of contractual relationship between an individual and the financial institution/intermediary could, depending on what is intended to be covered by 'employee', impact the analysis of whether the individual is an intermediary or not. We assume this is not the intent and suggest including a definition of 'employee' that includes natural persons whether they are permanent employees, fixed-term employees or contractors etc. would be appropriate to make this clear. Such a definition could be based on the definition in section 6 of the *Employment Relations Act 2000* for consistency.
Option 2: Refine scope of who is covered as an agent	
	Do you have any comments on Option 2?
3	We support the proposal to exclude from the definition of 'agent' those who are only involved in a very generalised way in the provision of the relevant product/service (Option 2). We agree with the comments in paragraphs 39 and 41 of the discussion document that it would be inappropriate to capture within this definition advisory or other 'preparatory' services (e.g. lawyers, accountants), or other service providers whom, while they may be acting as agents for the financial institution, are not directly or indirectly involved in providing the relevant product/service to a consumer, but rather providing an advisory service to the financial institution. We note the concept of 'agency' is also relevant in the context of intermediaries and there is an issue in the area of insurance contract law that has the potential to complicate the application of the conduct regime and undermine some of the proposed changes outlined in the discussion document. Section 10 of the Insurance Law Reform Act 1977 provides that an insurance broker is also deemed to be agent of an insurer during the negotiation of a contract of insurance by virtue of receiving a commission, as well as being an agent for the customer.

	For the purposes of the Bill, this may mean that the insurance broker is both an intermediary and the insurer's agent, which would be problematic as it could mean that despite being exempted from certain requirements as an 'intermediary', the broker is nonetheless brought back to those same requirements as an 'agent', undermining the benefits of the later proposals in the discussion document. As part of the MBIE led review of Insurance Contract Law, ICNZ on behalf of insurers has previously argued that section 10 should be amended to remove this deemed agency and it is of fundamental importance that this is addressed directly there. That is however a separate regulatory review process on a different timeline and so this issue also needs to be addressed directly within the Bill. For the purposes of the conduct regime it is necessary to: • deem that entities that are intermediaries are not agents for the purposes of the provisions in the Bill (i.e. they are one or the other but not both simultaneously); and • recraft the provisions relating to 'intermediaries' and 'agents' so they don't overlap while making it as certain as possible for financial institutions to determine the status under the Bill of the entities they deal with.
	Do you think Option 2 would adequately exclude advisory services (e.g. lawyers, accountants) and other service providers to the financial institution who are not involved, directly or indirectly, in providing any part of the financial institution's relevant service or associated products to consumers?
4	We support the policy intent behind Option 2 of carving out from the scope of financial institutions' responsibilities those persons who are only involved in a very generalised way in the provision of relevant services or associated products, rather than involved in the provision of any specific relevant services or products to individual consumers. However, based on the level of detail in the discussion document it is difficult to definitively establish whether the proposal would adequately exclude advisory services and other service providers who are not involved, directly or indirectly, in providing any part of the financial institution's relevant products/services to consumers. We support achieving the policy intent through revisions to the Bill and potentially also through including explicit exclusions for particular occupations or activities in regulations. We would welcome any further consultation on the detail of this.

	Do you think any explicit exclusions are needed for particular occupations or activities? If so, which ones, and why?
5	As discussed above, we consider explicit exclusions for particular occupations or activities would increase certainty if they do work that falls within the scope of this regime. We have identified the following as being appropriate for being excluded in relation to general insurance: • Lawyers • Accountants • Registered valuers • Engineers • Medical professionals
Objectives	
	Do you have any comments on the objectives regarding the treatment of intermediaries?
6	We support objective (a) outlined below paragraph 43. We support the general intent of objective (b), however it should be reframed along the following lines: 'minimise uncertainty and unnecessary duplication, and maximise consistency between regulatory obligations for financial institutions, intermediaries and consumers´ The purpose of these additions to objective (b) is to: • recognise the importance of considering the full regulatory regime, the various entities subject to it (e.g. financial institutions and intermediaries) and the need to ensure consistent fair conduct outcomes irrespective of whom a customer deals with, and • the need to ensure as level a playing field as possible between all relevant market participants in order to reduce distortions and the risks of regulatory arbitrage.

Option 3: Minimal changes to intermediaries obligations (remove 446M(1)(b) only)	
	Do you have any comments on Option 3: 'Minimal changes to intermediaries obligations'?
7	While acknowledging that Option 3 would represent an improvement on the status-quo, it does not however fully address the identified issues and so we do not support it. This approach would not recognise that it is unworkable and inappropriate for insurers to 'manage or supervise' intermediaries such as brokers that are both independent in nature and subject to their own conduct related requirements under the financial advice regime.
	If Option 3 were pursued, do you think any other obligations in section 446M(1)(bb), (bc), (bd) or (bf) would need clarifying or amending? Why/why not?
8	The changes required to Option 3 to make it workable would essentially turn it into something closer to Options 4 or 5. Please refer to our comments below in relation to these.
Option 4: More significant changes to intermediaries obligations	
	Do you have any comments on Option 4: 'More significant changes to intermediaries obligations'?
9	We consider Option 4 with some refinements is the most logical approach and should be the approach taken forward in the Bill. Option 4 would remove the overlapping regulation associated with the status-quo and Option 3 and recognise the reality and limits of the relationships between financial institutions and intermediaries. This approach also fits with the objectives outlined above and with the policy decision to impose a conduct regime only on financial institutions, rather than on all entities active in financial services. While similar to Option 5, Option 4 also avoids the issue of the potentially misleading bifurcation between FSLAA and non-FSLAA intermediaries associated with Option 5 given that the full provisions of FSLAA only apply to such entities when they are providing regulated financial advice. In practice, under Option 4 the focus would be on the financial institution to provide processes for the relevant matters (training and monitoring etc.) in a way that was appropriate to that intermediary and tailored to the manner in which they are distributing the institution's products and to the products themselves. Whether the intermediary is regulated under the FSLAA regime would be a relevant consideration in this regard. Adopting such a tailored approach consistent with section 446M(1A) would put the onus on financial institutions to have the appropriate processes, while enabling flexibility to accommodate both different types of intermediaries and different processes within, and approaches by, those intermediaries. It will equally be up to the FMA in undertaking its responsibilities to ensure this is the case.

	We consider the following changes to this aspect of the Bill are required to successfully implement Option 4. • We support tailoring the responsibilities of the financial institution to be more about the product performance and related outcomes for consumers, as is suggested in Option 5. • Refinements to a number of the obligations in section 446M and we reference the detail provided on this by ICNZ in its submission. • As outlined in earlier in this submission we also consider there is a need to rethink the intended application of a 'fit and proper' test to employees, agents and intermediaries (refer to further commentary above on this issue in the 'Overarching Comments' section of this submission).
10	What do you think the level of responsibility should be for financial institutions' oversight of intermediaries? For example, "managing or supervising the intermediary to ensure they support the financial institutions compliance with the fair conduct principle", or "monitoring whether the intermediary is supporting the financial institution's compliance with the fair conduct principle", or something else?
	A 'monitoring' obligation would best align with the reality of how insurance products are distributed through intermediaries and the respective roles of the insurer and intermediaries. As discussed above this should focus on the monitoring of product performance in particular.
11	What standard do you think financial institutions should have to oversee their intermediaries to?
	See our response to Question 11 above.

Option 5: Distinguish between FSLAA and non-FSLAA intermediaries	
	Do you have any comments on Option 5: 'Distinguish between FSLAA and non-FSLAA intermediaries'?
12	While there is merit in treating intermediaries that are subject to the FSLAA requirements differently from those that aren't due to the different regulation they are subject to, we consider overall that a refined version of Option 4 would be the best option. It is important to recognise that the FSLAA/non-FSLAA distinction is not binary and is complicated by the extent to which an entity provides financial advice, making applying such a distinction in binary way problematic. We also note that Option 4 does not preclude fair conduct programmes being tailored to the circumstances of an intermediary and its role and recognising regulatory aspects in this. In fact, section 446M(1A) explicitly requires a financial institution to tailor its approach in recognition of a range of relevant factors.
13	How far do you think financial institutions' oversight of FSLAA intermediaries under Option 5 should extend? For example, should it cover the general conduct of the intermediaries, or more narrowly on product performance and related consumer outcomes (or something else)?
	Please refer to our response to Question 10 above.
Obligations in relation to employees and agents	
	Do you have any comments on the proposals regarding obligations in relation to employees and agents?
14	We are generally comfortable with the proposed obligations in relation to employees and agents, given the other changes proposed in the two discussion documents. It is important however to note that as discussed elsewhere in this submission: • Consideration needs to be given to ensuring that relevant entities that are deliberately carved out of the 'intermediary' definition are not being captured as 'agents' and made subject to obligations by virtue of that, thereby undermining those changes to the definition of intermediary. • We support the drafting of the Bill being altered to more clearly spell out the obligations applying in regard to employees, agents and intermediaries separately where appropriate, rather than running them together.

	Do you think there should be a distinction drawn between employees and agents? Why/why not?
15	While employees and agents can sometimes perform similar tasks, they are different roles, with different legal obligations and rights applying in each respect. Given this, and the fact that employees are always individuals whereas agents will often be corporate entities, it would be logical that these roles are distinguished even where the tasks they perform might be the same.
	Do you think any amendments should be made to the obligations in section 446M(1) that would apply to employees and agents?
16	Please refer to the specific comments above, and those in the Overarching Comments section of this submission on how the requirements would best be located in legislation or regulation. We do not otherwise consider amendments are required to the obligations set out in section 446M(1) of the Bill that apply to employees and agents.
	Do you have any other comments or viable proposals?
17	No further comments.

4. Responses to questions in the proposed regulations discussion document

Requirements for fair conduct programmes	
	Do you have any comments on the status quo i.e. no further regulations to support the minimum requirements for fair conduct programmes in the Bill?
1	Our approach to this in principle is to avoid making regulations unless these are clearly necessary, recognising there is already a reasonable amount of detail in the Bill and that prescribing further detail in regulations may reduce flexibility without necessarily improving certainty. Please refer to our specific comments below in response to subsequent questions.
	Do you have any comments on MBIE's proposal position that no regulations are needed at this time to support section 446M(1)(a)?
2	We agree that further regulations are not needed to support the intention of section 446M(1)(a).
	Do you have any comments on the proposals regarding design and management of relevant services and products?
3	We consider proposed section 446M(1)(ab) is sufficiently clear and so regulations are not required in relation to this aspect.
	Do you have any comments on MBIE's position that no regulations are needed at this time to support section 446M(1)(ac)??
4	We agree further regulations are not needed to support section 446M(1)(ac).
	Do you have any comments on MBIE's position that no regulations are needed at this time to support section 446M(1)(bb) to (bd)?
5	At this stage we agree that further regulations are not needed to support section 446M(1)(bb) to (bd), however, we note that material changes are planned in regard to the application of these provisions to intermediaries in particular in the separate consultation document on the treatment of intermediaries. Please note we have provided extensive comments in relation to these proposals in the separate discussion document and in relation to 'fit and proper' tests above in the Overarching Comments section.

	Do you have any comments on the proposal to specify further minimum requirements regarding remediation of issues? Are there any further specific remediation principles that should be specified in regulations?
6	We are comfortable with the high-level principle-based guidance provided in section 446M(1)(ad) and do not consider the proposed additional requirements are required to inform the development of fair conduct programmes. This may be an area where guidance from the FMA would be appropriate. While maintaining that regulations are not required in this area, in relation to the specific proposals under paragraph 66 we also note that: • The use of 'all reasonable steps' in (b) is a different and seemingly higher threshold than 'reasonable steps' provided in section 446M(1)(ad) of the Bill. Whether this is intended is not clear. • The proposal that a 'remediation processes must be adequately resourced' in (d) could be read to suggest a permanent remediation capacity, which would be unusual. Whether adequate resourcing was applied to a particular case is better considered with regard to the specifics of any particular situation. • Communication with consumers (limb (f)) would normally only occur at the remediation phase rather than earlier when it is yet to be determined there is an issue requiring remediation. Also, while it is important to communicate clearly with customers at appropriate times, what is required in relation to any particular situation will vary. Some issues may require regular progress updates whereas others may be resolved by a one-off communication to the impacted customer(s) about the issue and how it was resolved. Requiring progress updates may be unnecessary. It is also necessary to recognise that complying with a communication requirement could be different when an intermediary such as an insurance broker is involved.
	Do you have any comments on MBIE's position that no regulations are needed at this time to support section 446M(1)(be)?
7	We agree that further regulations are not needed to support the intention of section 446M(1)(be). Please also note our other comments in relation to the regulation of incentives elsewhere in this submission.

	Do you have any comments on MBIE's position that no regulations are needed at this time to support section 446M(1)(bf)?
8	We agree that further regulations are not needed to support the intention of section 446M(1)(bf). The high-level requirement in the Bill is appropriate and adding further detail in regulations would risk the regime becoming overly prescriptive and limiting innovation. The only role we could see for regulations in this area would be to make clear that the communication should be appropriate to the distribution channel and reflect the nature of the institution's engagement with the customer (e.g. insurers don't directly communicate with the customers of some intermediaries because the intermediary is the agent of the customer).
	Do you have any comments on MBIE's position that no regulations are needed at this time to support section 446M(1)(d)?
9	We support not making any further regulations in relation to section 446M(1)(d). We agree the intent is that fair conduct programmes are dynamic and the provision in the Bill provides a clear onus on financial institutions to have systems and processes to ensure their programmes are fit for purpose on a continuous basis. We agree there are risks with specifying a trigger event or default period for a review as this would be arbitrary, could increase perceptions of this being a pure compliance exercise and moves away from the idea of a living document. We also note that reviewing elements of a fair conduct programme over time is likely to be a more workable proposition for a financial institution given their wide-ranging nature.
	Do you have any comments on the proposal to specify further minimum requirements regarding consumer complaints handling?
10	While the proposed minimum requirements regarding consumer complaints handling appear reasonable in isolation, to avoid additional costs or complexities, any overlap with dispute resolution scheme rules that institutions are required to be members of as a result of registration under *the Financial Service Providers (Registration and Dispute Resolution) Act 2008* is unnecessary, and any conflict between obligations needs to be avoided. ICNZ members such as IAG are also subject to detailed customer complaints handling requirements under the Fair Insurance Code. It is not apparent what the proposed regulations are intended to add to these existing legislative and other requirements and given that section 446M(1)(a) of the Bill already requires a fair conduct programme to include effective policies, processes, systems, and controls for enabling financial institutions to meet their legal obligations to consumers under various legislation, including that Act. It would be more straightforward to rely on this than to invite complexity and uncertainty by prescribing additional regulations in this area.

If a definition of 'complaint' was to be included in regulations it would need to mirror existing requirements to avoid confusion and unnecessary complexity.

Do you have any comments on the proposals to specify further minimum requirements regarding claims handling and settlement?

11

We do not believe the proposed further minimum requirements regarding claims handling and settlement are necessary or would add much to the overarching provisions in the Bill and other existing requirements (e.g. those outlined in the Fair Insurance Code).

The overarching fair conduct principle already applies to claims handling. Some other provisions already proposed also have application to it (e.g. communicating with customers, training) and so the regulations proposed do not add much to what is in the primary legislation, and would therefore be largely redundant.

Also, while we agree with claims handling being covered within the conduct regime, we dispute many of the comments below paragraph 94 of the discussion document, including suggesting that claimants sometimes have their claims significantly underpaid as this was based on limited analysis of post disaster claims. We commented further on these matters in our 2019 submission on the Options Paper that led to this Bill.

We agree that the new insurer/Earthquake Commission (EQC) agreement under which insurers will handle EQC claims on EQC's behalf gives insurers an even greater role following a major disaster and note that in the absence of this agreement the EQC handling claims directly would not be subject to any conduct regulation.

Do you have any comments on the proposed definition of 'handling and settling a claim under an insurance contract' means? If so, why?

12

We consider it may be appropriate to define what 'handling a claim under an insurance contract' means for the purposes of this legislation to provide greater certainty in the application of the new regime, recognising this is a new area of regulation. The Australian definition outlined in the discussion document has some relevant elements but is not suitable for New Zealand for a variety of reasons (see further comments below) and so we would recommend a definition appropriate to the scope and nature of this conduct regime is specifically crafted.

A definition would need to have sufficient flexibility and be comprehensively consulted on (e.g. we recommend an exposure draft consultation on the specific wording of a definition before regulations are finalised). Key elements of claims handling that need to be covered in a definition would include:

- Receiving notification of a claim from an insured and acknowledging this
- Assessing and deciding whether to accept a claim
- Making a decision about a claim and interpreting policy provisions

- Conducting negotiations in respect of settlement amounts
- Finalising and paying the claim

We note elements of the definition of 'handling and settling' being utilised in the Australian are not suitable for the New Zealand conduct legislation, specifically:

- Limb (a) – it is not clear what sorts of activity this is intended to cover.
- Limb (b) ('assist another person make an insurance claim') should be removed as this relates to agents who act for insureds in making claims ('claims advocates'). While IAG considers such entities should be subject to conduct legislation in New Zealand in order to manage the conduct risks they present to insureds, the Government has not chosen to do this and so from a drafting perspective it does not make sense to capture them within this definition. This could otherwise create issues in relation to the scope of the regime where brokers are acting on behalf of their customers.
- Limb (g), using the phase 'satisfy the liability of an insurer under an insurance claim' is problematic because it creates uncertainty as to the coverage of activities and entities that are associated with fulfilling claims (e.g. physical repair work) rather than handling the claim itself.

	Do you have any comments on the discussion regarding customer vulnerability?
13	We agree it is critical that financial institutions do the right thing for vulnerable consumers. We also agree that there is no need to include any specific regulations regarding consumer vulnerability as the Bill itself and other initiatives underway mean these issues will be included in fair conduct programmes in any case.
	Do you have comments regarding the option of including vulnerable consumers in section 446M(1A)?
14	We agree that as identified by the Council of Financial Regulators in April 2021, focusing on 'circumstances' rather than 'types' of people or customers should be the primary approach in relation to customer vulnerability. Given vulnerability is not a fixed condition it would therefore seem unnecessary for it to specified in section 446M(1A), which is a clause concerned with ensuring regard is had to the specific nature and features of the financial institution's business, the products it offers and the types of intermediaries and consumers it deals with. If vulnerable consumers were to be specified as a separate factor under section 446M(1A) this should be appropriately separate from considerations of types of consumers for the reason discussed above (i.e. vulnerability is not a fixed state).

15	Do you think any further factors should be added by regulations to the list under section 446M(1A)?
	We have not identified any further factors to be added by regulations to the list under section 446M(1A).
16	Do you think any other regulations that could be made under new section 546(1)(oa) are necessary or desirable? Please provide reasons for your comments.
	We have not identified any other regulations that should be made under new section 546(1)(oa) at this time.
Sales incentives	
17	Do you have any comments on the Status Quo (no regulations)?
	The status quo as provided in the Bill already involves an overarching obligation on the design and management of incentives in the form of proposed section 446M(1)(be). Cabinet has however already made a decision to prohibit sales targets based on value or volume. Making regulations specifying the types of incentives that are prohibited provides certainty as to what the Government is looking to prohibit, which the status-quo (no regulations) would not.
18	Do you have any comments on the option to prohibit sales incentives based on volume or value targets?
	We are supportive of providing a clear prohibition in relation to where the Government considers that the risks associated with such incentives cannot be mitigated sufficiently. The potential for incentives based on volume or value targets to significantly influence the behaviour of staff involved in customer interactions was identified by the FMA and Reserve Bank of New Zealand (RBNZ) in their conduct and culture investigations in 2018/19, specifically that remuneration tied to sales targets is particularly problematic because as the target is approached it creates an increasingly strong incentive to sell the product. We are comfortable with the proposed prohibition so long as it is appropriately targeted at the issue identified and therefore focussed on sales incentives paid to those engaging with customers directly and their immediate manager/s. See our further comments below in response to Questions 27 to 31.
19	What would the likely impacts be for financial institutions, intermediaries and/or consumers of prohibiting sales incentives based on volume or value based targets?
	IAG removed sales incentives for its customer facing staff in 2019 so prohibiting sales incentives based on volume or value-based targets would have no impacts on those staff, or on our consumers engaging with them through our direct distribution channels.

	Do you have any feedback on a more principle-based approach to prohibiting some incentives?
20	The alternative principle-based approach to prohibiting some incentives would be significantly less certain than the Government's preferred option (prohibition of incentives based on volume or value targets) and this would create a number of issues related primarily to the uncertainty in its application. The uncertainty associated with this option would carry the risk of unintended consequences due to its potentially wider and less defined application, likely leading to inconsistent outcomes across financial institutions and intermediaries, at least in the short to medium term. The lack of certainty creates risks as entities cannot be sure when putting in place an incentive arrangement whether it may be determined subsequently to be inconsistent with the prohibition, which is likely to create extra disruption and complexity in the implementation of this regime overall. Given the existence of the requirements to design and manage incentives under section 446M(1)(be) to 'mitigate or avoid the actual or potential adverse effects of incentives on the interests of consumers, so far as is reasonably practicable', a specific prohibition as in the preferred option would be a more appropriate two faceted approach and would address the types of incentives the Government has identified as being particularly problematic.
	How could a more principles-based approach to prohibiting some incentives be made workable?
21	For the reasons outlined above in response to Question 20 we do not consider that a more principles-based approach to prohibiting some incentives could be made workable, recognising that some of the issues are inherent. As well as the issues associated with a principles-based prohibition in isolation described above, having to comply with two different but likely overlapping principle-based requirements applying to the nexus between incentives and consumers interests, one an overarching management obligation (section 446M(1)(be) and the other a regulated prohibition, would appear to be particularly challenging.
	If a more principles-based option was chosen, should there be some incentives specifically excluded?
22	Should such an option be progressed, excluding some incentives specifically would be a way of providing more certainty and would enable the Government to be clear about what types of incentives it considered to be particularly problematic (i.e. by not exempting them). However, the need to specify exclusions to a principle suggests deficiencies in the principle itself and it would be more certain to simply spell out what is prohibited, as in the preferred option.

23	Do you think there are any other viable options other than what has been put forward by this discussion document? Please explain in detail.
	We have not identified any other viable options.
24	Are there sales incentives based on volume or value targets that should be excluded from the regulations (i.e. allowed to be offered/given)?
	We do consider there are types of incentives other than those discussed in the paper that should be excluded from the regulations because at present the proposal goes beyond the problem identified in a way that could unnecessarily impact the management of affected financial services firms (e.g. by limiting the inclusion of any such targets in balanced scorecards). This is discussed further in our response to Question 27 below.
25	Do you think there are any types of incentives other than those discussed in the paper that should be excluded from the regulations? Please provide reasons for your comments.
	We support the exclusion of the types of incentives proposed in paragraphs 162 to 171 of the discussion document including salary-based remuneration, performance benefits not linked to sales targets, linear/flat-line sales incentives and remuneration based on aspects other than sales. Please also note our responses to Questions 24 and 27.
26	Do you think that the scope of who can be covered by the regulations poses a risk of unintentionally capturing other intermediaries that are paid incentives but should not be covered?
	We have not identified any other inappropriately captured intermediaries at this stage should the proposals to redefine the meaning of 'intermediaries' proposed in the separate discussion document on the treatment of intermediaries be progressed.
27	Do you agree/disagree that within financial institutions and intermediaries sales incentives regulations should apply to all staff? Why/why not?
	It is necessary to focus the prohibition in the regulations on those sales incentives that 'increase the risk of mis-selling because they create an increasingly strong incentive to sell and therefore encourage the person making the sale to prioritise their own interests over that of the customer'.[3] We do consider there are types of incentives other than those discussed in the discussion document that should be excluded from the regulations because at present the proposal goes beyond the problem identified in a way that could unnecessarily impact the management of affected financial institutions.

[3] From paragraph 12 of the Cabinet Paper, Conduct of Financial Institutions: Introduction of a New Conduct Regime, 11 September 2019.

As outlined above, the proposed prohibition is so broad as to seemingly prohibit the use of volume/value targets within a balanced scorecard, no matter how small a part of the scorecard this represented or what other customer centric metrics were included, or such targets imposed on senior management to ensure the financial sustainability and growth of a firm.

These outcomes would go well beyond the specific issues of concern identified. They would also fail to recognise that maintaining and/or growing the volume or value of a financial services firm is fundamental to being able to continue to offer such services in New Zealand, and that such targets are employed across firms in every other sector of the economy to hold senior management to account. These support business growth and success and meeting obligations to boards and shareholders are an important part of the long-term sustainability businesses.

Balanced scorecards with an appropriate mix of financial and non-financial metrics have been adopted by firms to ensure a properly balanced approach is taken and incentivised. To exclude the use of sales volume or value based targets in these entirely, at least for those financial institutions subject to the conduct regime, would be disproportionate. Noting for example that one purpose of such a scorecard is that it is possible for the incentive not to be achieved even though financial metrics such as sales volume or value targets have been (e.g. because other metrics such as consumer-centric ones have not been met).

Given this, the prohibition should be focussed on sales incentives paid to those engaging with customers directly and their immediate manager/s, as it the potential for these interactions to be unduly influenced by targets that has been identified as the issue of concern. The distinction should be clear for entities to apply and for the FMA to monitor.

Do you agree/disagree that within financial institutions and intermediaries sales incentives regulations should only apply to frontline staff and their managers? Why/why not?

28 As outlined more fully in our response to Question 27 above, we agree that sales incentives regulations should only apply to frontline staff and their managers. In summary, it is only those in customer-facing/frontline roles and their direct managers that directly interact with individual customers and who could therefore be influenced in those specific engagements to mis-sell products. It is also entirely logical for a financial institution to pursue overall sales growth, and therefore for this to be a target for the entity overall and its senior management.

	Do you think that external incentives should apply to any incentive paid to an agent, contractor or intermediary? Why/why not?
29	Given the policy decision on prohibiting target-based sales incentives paid to individuals, it would be logical to apply this consistently regardless of whether they are employees, agents, or intermediaries. There would be a risk of regulatory arbitrage if the requirement was applied inconsistently to different individuals performing similar functions based on their employer or employment status. We also note that as discussed elsewhere in this submission the treatment of 'employees', 'agents', and 'intermediaries' under the regime more generally needs to be further worked through and clarified and some of these issues would apply here. We also query why the term 'contractor' is used in relation to this aspect but not otherwise in the discussion document and note our comments elsewhere in relation to the meaning and scope of 'employee'?
	Do you agree that both individual and collective incentives should be covered? Why/why not?
30	In principle we agree that the prohibition should apply to both relevant[4] individuals, and to groups of individuals (defined as 'collective' incentives in paragraph 185) where the individuals have the ability to meaningfully influence the achievement of the target. This would naturally apply to smaller teams and not for instance to an entire entity in the case of say a company-wide target. This is because one person on their own has little ability to influence the overall target for a large team (or the entire entity) and therefore there is minimal impact on each team members individual customer interactions.
	Do you have any other comments on the discussion related to incentives?
31	No further comments.

[4] . As addressed in our responses to Questions 27 and 28 - to those in customer-facing/frontline roles and their direct managers who either directly interact with customers and sell products/services.

Requirement to publish information about fair conduct programmes	
	Is more detail needed to outline what information should be published regarding financial institutions' fair conduct programmes to assist financial institutions to meet this requirement, or to assist consumers in their interactions with financial institutions?
32	We do not consider more detail is needed to outline what information should be published regarding financial institutions' fair conduct programmes. If the requirement is to exist at all, high level requirements in the Bill that allow summaries to be provided is appropriate. There is always the potential for the FMA to issue guidance in future should further detail or consistency in the presentation of information by financial institutions be considered necessary. We remain of the view that giving consumers a clear understanding of the standard of service they should expect from a financial institution and the distributors of its products, rather than information about an institution's fair conduct programme itself, is a better way to give them confidence they will be treated fairly. As such, the publication of service commitments related to how the products are provided, such as those detailed in ICNZ' Fair Insurance Code, would be more relevant to consumers than the content of Financial Institutions fair conduct programmes. We are also mindful that not all insurers will be subject to the conduct regime (creating divergent and inconsistent treatment across the sector and between insurers offering both consumer insurance and non-consumer insurance and those only offering non-consumer insurance), creating a possible risk of confusion amongst different customer types as to what a fair conduct programme strictly applies to.
	Do you have any comments on the options outlined above? What do you think the costs and benefits would be to financial institutions and consumers of the two options?
33	Of the two options presented in the discussion document, we consider Option 1 to be preferable. Option 1 would allow flexibility in how the information is presented and for this to be tailored to nature of the financial institution, its consumers and its communication channels. While Option 2 might achieve greater consistency in the way information is presented it is likely to be overly prescriptive and inflexible in allowing entities to publish information that is useful and most easily comprehensible by consumers across a range of communication methods and channels.
34	This discussion document outlines two options regarding the requirement to publish information about the fair conduct programmes. Do you have any other viable options?
	We have not identified any other viable options.

Calling in contracts of insurance as financial products under Part 2	
	Do you have any comments on the proposal to declare contracts of insurance as financial products under Part 2?
35	We note that as outlined in the discussion document 'Sections 19 and 21 of the FMC Act already provide substantive coverage of misleading conduct in relation to insurance'. We do not see a compelling case has been made for this proposed change and note the more detailed commentary provided in ICNZ's submission on this matter.
Exclusions of certain occupations or activities from the definition of intermediary	
	Do you think it would be appropriate to exclude people who are subject to professional regulation from the definition of an intermediary (e.g. lawyers, accountants, engineers)?
36	Given the changes proposed in the discussion document on the treatment of intermediaries, it is more difficult to see how lawyers, accountants, engineers etc. could be captured as 'intermediaries'. It is also not clear what the purpose would be of including them as intermediaries as they would be contributing to what the financial institution itself offered to consumers and which the financial institution should rightly be held responsible for itself. If however there was a possibility these could inadvertently be caught as intermediaries under the conduct regime, then we agree that it would be appropriate to exclude people who are subject to professional regulation as the requirements relating to intermediaries (oversight, training etc.) do not make any sense in relation to such entities (e.g. law firms) given both their nature and role.
	Do you think that any other occupations or activities should be excluded from the new proposed definition of an "intermediary"? If so, why?
37	Given the changes proposed in the discussion document on the treatment of intermediaries, we have not identified any other occupations that should be excluded from the new proposed definition of an 'intermediary'.