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Corporate Law
Labour and Commercial Environment Group
Ministry of Business, Innovation & Employment
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20 July 2015

Dear Sir / Madam,

Review of the Financial Advisers Act 2008 and the Financial Service Providers (Registration and Dispute Resolution) Act 2008

Introduction
Thank you for the opportunity to respond to the MBIE's Issue Paper – "Review of the Financial Advisers Act 2008 (**FA Act**) and the Financial Service Providers (Registration and Dispute Resolution) Act 2008 (**FSP Act**)".

This submission is made by the Southern Cross Medical Care Society (**Southern Cross**). Southern Cross is the largest private health insurer in the New Zealand market with over 800,000 New Zealanders and a market share in excess of 60%. Southern Cross is licensed under the FA Act as a Qualifying Financial Entity (**QFE**) and provides advice on 'category two' insurance products. Complementing our internal QFE adviser force, Southern Cross has agency relationships with approximately 250 Authorised Financial Advisers (**AFA's**), 580 Registered Financial Advisers (**RFA's**) and a further 350 external QFE advisers. Internal and external advisers play an important role in advising on and distributing our category two products to the general public.

In general:

- Southern Cross welcomes MBIE's review of the FA Act and FSP Act. The FA Act is broadly meeting its purpose of promoting the sound and efficient delivery of financial adviser services, and of encouraging public confidence in the professionalism and integrity of financial advisers;
- Southern Cross experience as a QFE has been largely positive; and
- Southern Cross is satisfied with the operation of the FSP Act.

Structural v specific changes
The implementation of the FA Act required financial advisers and providers to make significant changes to their businesses - the regulatory implementation costs for Southern Cross were substantial. In our view:

- weaknesses in the original structural design (e.g. to categories and types of advice and advisor etc) do exist in the FA Act. However, the weaknesses are not particularly substantive and the inefficiencies they generated at the time have already been largely accommodated by participants;

- potential changes to the structural design of the original FAA scheme, while likely to deliver minor regulatory benefits, will carry significant compliance costs for the entire sector (because such changes are structural all businesses will be forced to adapt again). In our view 'categorising' and 'type' changes should be avoided if at all possible.

- Further structural changes without demonstrable material evidence of consumer and participant benefits could lead to disillusionment generally.

However, there are specific issues which if addressed may enhance the operation of the FA Act.

Registered Financial Advisers
Southern Cross is supportive of the current licensing regime in place for AFA's. In our opinion personalised advice in relation to more complex products requires a higher level of skill and competence, and it remains appropriate those providing such advice have the necessary qualifications and experience. Southern Cross also supports continuing professional development obligations for AFA's.

However, we have some concerns in respect of the existing RFA framework:

- the entry licensing requirements for RFAs may have been set too low – for example there are no material qualitative differences between RFA entry requirements and those providing financial adviser services 'incidental' to their business;

- It is unclear whether the general public understand the differences between RFA's and AFA's. This may not matter if the types of services RFAs can perform remain restricted, but there may well be a perception from consumers that there is qualification attached to RFA status; and

- We have not seen any evidence that the market works to encourage RFA's to extend their qualifications and up-skill to become AFA's or to compete with them for similar business.

Southern Cross therefore supports a review of the entry/registration requirements for RFA's. It may be that an appropriate level of competency, knowledge, skills, ongoing professional development and compliance with a simplified code of practice in the existing RFA 'registration' framework is required.

However, we are not convinced that the two adviser classes should be merged as this would cause upheaval and force costs on the entire sector (and probably weaken overall existing AFA standards/requirements).

Commissions / Churn
Like many Southern Cross has concerns that some financial product providers may incentivise advisers to recommend a product for a higher commission as opposed to a product which may be more appropriate after taking the individual needs of the customer into consideration ('churn').

While the levels of commission paid are not as unsustainable as the life insurance market, as a long term contract the consequences of churn in health insurance is detrimental to consumers, and in this respect has parallels to life insurance. This is because in general health insurers also do not accept risk for consumer pre-existing medical conditions (i.e. medical conditions present prior to purchase). However, it is relatively common place for advisers to offer small discounts to move consumers to new products. While these discounts may only exist in the short-term, the medical history of these consumers is usually fully re-underwritten by their new health insurer. The effect is that these consumers lose cover for health issues they have had or developed during the time with their previous health insurer.

In many cases, it is also uncertain whether the loss of cover is properly explained and understood by consumers, i.e. they may need to pay significant amounts for treatment of these conditions as they are not covered by their new health insurance policy.

In order to address such downside effects of churn we believe that there needs to be a more thorough review of remuneration arrangements financial advisers have in place with product providers and their effect on consumers. This review should capture 'traditional' commissions as well as other "soft" sales incentives. However, it would not be appropriate to shoe-horn a review of churn and any outcomes in to this FA Act review if it would delay the review generally.

We also note churn and the payment and disclosure of commissions is a significant issue in other jurisdictions around the world (for example, the recently released *Frydenberg* 14-point life insurance framework in Australia and the FCA's Retail Distribution Review relating to certain financial products in the UK). This experience may provide MBIE with an opportunity to capitalise when working through solutions and suitable models.

Product rating tools

A significant recent development in the insurance market has been the influence of 'product rating tools'. Product rating tools take a number of different forms and may be used directly, e.g. online by consumers, or on an intermediary basis by advisers.

Southern Cross considers that product rating tools should be a useful source of information for consumers trying to easily compare certain financial products. However, the success of these tools in meeting this objective is dependent on the research and logic that drives the tools. We have three concerns in this area:

1. while the tool developers / owners are not themselves regulated by the financial services legislation, the methodologies used in rating various insurers are sometimes inconsistent or poorly thought through. Notwithstanding, the reliance placed on these tools by advisers and consumer appears to be significant and appears to be growing. This appears to be a material weakness in consumer protection;

2. advisers may be using tools to support recommendations to their clients to move to other insurers and appear to be incentivised to do so. In other words the tools are linked to commissions and churn generally; and

3. there is no transparency (for consumers) of which financial service product providers make payments to rating tool companies and whether they have beneficial interests in those companies.

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These information asymmetries are, in our view, undermining the ability of consumers to seek independent / objective advice on financial products. (We would be happy to provide examples of issues should MBIE wish to consider this aspect further).

Further guidance

Industry participants have had difficulty applying aspects of the FA Act to their businesses. To a degree this is inevitable following the implementation of significant regulatory change. However, while the FMA have been helpful in their interactions with industry, we believe they could provide more generic detailed guidance to the market on key/common areas of concern.

In our view, 'guidance notes' or 'practice statements' from the FMA would reduce uncertainty (which is another driver of cost). The current uncertainty around regulatory interpretation by the conduct enforcement agency may also be stifling innovation and appropriate risk taking.

Non-exhaustive examples of areas in which more detailed guidance would be helpful include:

- determining whether a customer interaction is a 'no advice', 'class advice' or 'personalised advice' situation;
- examples and expectations of financial advisers in terms of the main conduct provisions of the FAA (in particular sections 32-35); and
- determining whether a 'material breach' has occurred in terms of the Reporting and Notifications Standard Conditions for QFE's.

We note that the Australian Securities and Investment Commission (**ASIC**) and FCA in the UK have made available 'regulatory guides' to regulated entities. We acknowledge that the FMA has not been in existence as long as ASIC, but believe that the FMA could begin to more usefully set out its' expectations to market participants in the medium term.

Yours sincerely,

Peter Tynan
Chief Executive Officer

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