



26 February 2016

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

Dear Sir,

Review of the Financial Advisers Act 2008 – Options Paper

We welcome the opportunity to make a submission on the “Options Paper” referenced above. Our submission is primarily concerned with the life insurance sector but much of what applies in that sector applies equally elsewhere. The submission comprises three parts:

- Commenting on the matters considered in the Options Paper; and
- Building on the recommendations in the MJW report entitled “Review of Retail Insurance Advice – An opportunity for a new beginning” which MJW completed in November 2015 and which was funded by the Financial Services Council. That report is available here:
http://mjw.co.nz/wp-content/uploads/2015/11/MJW-Independent-Report-Final-November-2015_pwd.pdf
- An Appendix with answers to three specific questions and comments on the 3 proposed packages.

Options Paper

In our view much of what is proposed is an important improvement on what we have currently. The MBIE staff working on this should be commended for their work to date in what is a complex area with many vocal vested interests.

In arriving at proposed changes the focus must be on improving outcomes for the consumer. The consumer has to have confidence in financial advisers. This includes confidence in where to go for any redress and certainty if financial recompense is the right response. The regime has to be structured such that the authorities can effectively and efficiently oversee the market such that problems that arise can be effectively addressed.

While to date the idea of building a regime around individuals, who are subject to regulation, is attractive the practicalities of this need to be recognised. The licensing of entities has the attraction of having a smaller number of entities to manage and the benefit of peer review (pressure) to ensure individuals within an entity adhere to licensing conditions. An appropriate level of professional indemnity insurance should be mandatory for all licensed operators, individual or entity.

We see four key points a new regime needs to address:

1. The key road block to achieving “public confidence in the professionalism of advisers” is the conflict of interest that arises when a product provider remunerates an adviser for placing a customer into one of their products if the structure of that remuneration works against an alignment of interests. That is the situation we have at present in the life insurance sector.

If that issue is not satisfactorily resolved all other changes will be negated and therefore ineffectual. We remain unconvinced disclosure can adequately deal with this issue.

2. The conflict of interest does not matter when the customer expects to be sold a product. We consider that a clear distinction must be made and can be made between a person selling a product and one who is providing independent advice. Consumers do not necessarily have to have a choice of product, what they do need to know is that the person they are dealing with is trying to sell them something. We prefer to refer to these people as product representatives.

3. Remuneration disclosure, both of the adviser and the entity they work for, from the product provider is essential. We believe an effective form of disclosure will be to show a person the cost of a product if no commission was payable (a true nil commission premium). This will highlight the cost of the transaction to the consumer and encourage them to consider their available choices on how to proceed with their purchase of life insurance.
4. Competency and ethics. An adviser must be competent to give advice and act in the customers interests.

What makes financial services (life insurance) so special that we advocate regulating commission? The person that sells you a TV from the appliance store doesn't have to disclose commission or have it capped so why should we do this for financial services or life insurance in particular?

The answer is multi-faceted. Life insurance (and financial services in general) is socially desirable. Our civil society wishes to offer a hand-up to those that need it when required. We desire to have that occur as efficiently as possible. To ensure those that need it get what they should we regulate it. We require Directors of institutions that provide it to be "fit and proper" and if the insurance sector does not function effectively the costs fall back onto the government.

Buying life insurance is a contract to purchase over time unlike a TV purchase which is transactional and short term in nature. People it would seem are less effective when making long term purchases as opposed to short term purchases. Furthermore the effect of getting the purchase of a TV "wrong" is nowhere as significant as getting the purchase of life insurance wrong. Interestingly the TV (or car) is regulated and must meet safety standards. Insurance products are not regulated (for safety). For all these reasons and more, we see life insurance as special which warrants special attention. We note the commission issue cannot be addressed from within the industry by the industry itself and so regulatory intervention is called for.

MJW report

The Issues Paper and Options Paper both provided time and space to the issue of commission and the conflicts of interest that arise because of it. How to deliver a fair basis to remunerate organisations and individuals when selling a life insurance product is an important and complex question. It is clear that the life insurance industry is unable to bring about a solution to the conflict of interest issue on its own. The events after the publication of the MJW Report demonstrated this.

Why does reforming the industry matter? Because life insurance is clearly socially desirable and consumers deserve better outcomes than they are currently receiving.

Why is the reform necessary as part of the FAA review? Because the root cause of industry problems is the conflict of interest arising for "commissioned advisers". This sits firmly within the ambit of the FAA review. The activities of some advisers in the industry, brings the whole adviser industry into disrepute. To move forward and for the reforms to be successful the industry must be changed so as to build respect from the public.

Major reforms to the initial commission paid on life policies are critical. We have a poorly functioning market because of the perverse financial incentives in place for advisers. Unless these are tackled head on the ability of a new FAA regime to bring about real change is negated. We do not doubt that the changes which will eventuate from the reforms will on their own, lead to a better industry and better outcomes for the consumer but they will be hamstrung if adviser commission is not tackled.

What changes do we advocate? These are set out in the MJW report but we highlight two, the second of which is a way to implement one of the report's recommendations:

- Major reductions in the level of the initial commission and a move to a servicing commission model
- Life insurance could be included in the definition of "Financial Product" in the FMC Act. This change will give the FMA wide powers to encourage the life industry to make major changes to how it operates. For example it badly needs a code of conduct covering replacement policies.

We note that Australia has seen the need to make major changes to remuneration and introduced legislation which has been welcomed by the industry to effect the changes.

We would be pleased to expand further on this submission and talk further in person.

Yours sincerely,

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Appendix

Responses to specific questions from the Options Paper:

Q14 *“If there was a ban or restriction on conflicted remuneration who and what should it cover?”*

A Life insurance commission should be restricted as per the MJW report.

Q17 *“What are the benefits and costs of shifting to an entity licensing model whereby the business is accountable for meeting obligations (Option 1)? If some individual advisers are also licensed (Option 2), what specific obligations should these advisers be accountable for?”*

A Entity licencing is less onerous for the regulator and has the important benefit that individuals within an entity have an incentive to police each other to protect the entity brand value. An appropriate level of professional indemnity insurance should be mandatory irrespective of licencing of individuals or entities.

Q21 *“How could remuneration details be disclosed in a way that would be meaningful to consumers yet relatively simple for advisers to produce?”*

A In life insurance a true nil commission premium should be required to be disclosed. This is easily obtained as many insurers currently offer this and others could easily calculate it. A true nil commission premium can be up to 35% less than the premium with commission.

Specific comments on the 3 proposed “packages”

Package 1 – Requires a disclosure statement setting out remuneration and a replacement policy process, if relevant. We support both of those and the ethical obligation.

Package 2 – We don't support stopping complex advice in QFE's, or that product representatives must be employed directly by the product provider. Requiring product representatives (advisers or salespeople) to be employed directly by the product provider will curtail legitimate and useful activity that currently occurs. For example this would prevent banks from selling either life insurance (usually from an associated entity but the bank is not the product provider) or general insurance (house, contents motor vehicle) which in all circumstances in the New Zealand market, the bank is not the product provider (general insurer). We believe banks selling these products is a good outcome for consumers. We like entity licencing in this package.

Package 3 – As noted above in our package 2 comments, we don't like the requiring of “tied agents”. We believe there should be permitted product representatives who are not employed by the product manufacturer. We like the idea of a warning provided to consumers that the product representative is not an independent adviser but a product representative. That makes the distinction very clear. We believe an ethical obligation can still be placed on product representatives to act in the consumers' interest (product applicability) and the product representative ought to be competent to do that.