

# SOVEREIGN

## REVIEW OF THE FINANCIAL ADVISERS ACT 2008 AND THE FINANCIAL SERVICE PROVIDERS (REGISTRATION AND DISPUTE RESOLUTION) ACT 2008

### SUBMISSION BY SOVEREIGN<sup>1</sup>

- PART 1**      Introducing Sovereign
- PART 2**      Key issues as identified by Sovereign
- PART 3**      Responses to specific questions from the Options Paper

Sovereign welcomes the opportunity to be part of the review. Sovereign does not seek confidentiality for any aspect of this submission (though, for commercial or privacy reasons, it may request confidentiality of any further supporting information that the Ministry might seek).

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<sup>1</sup> "Sovereign" is defined as Sovereign Assurance Company Limited, Sovereign Services Limited, and associated entities.

## PART 1 – Introducing Sovereign

- 1.1. Sovereign is New Zealand's largest life insurance company protecting over 741,000<sup>2</sup> New Zealanders and their families through the provision of life and health insurance using a range of distribution channels. Sovereign insures total sums insured of over \$120 billion<sup>3</sup> and last financial year paid out more than \$330<sup>3</sup> million in claims.
- 1.2. Sovereign has an A+ (superior) financial strength rating from AM Best. Our life insurance market share is 28.7%<sup>4</sup> and our health insurance market share is 7.2%<sup>4</sup>.
- 1.3. Well established within the life insurance industry, Sovereign's vision is "*Being the difference in life's moments of truth by providing certainty and giving choice*". Our vision is fuelled by our values; *integrity* to build trust, *collaborate* to win together, *drive* to make it happen, *play* to explore possibilities and *wow* to impress our customers.
- 1.4. Sovereign is a Qualifying Financial Entity (**QFE**). Sovereign has approximately<sup>5</sup> 715 employees and as at September 2014, 195-205 employee roles were permitted to provide class and/or personalised financial advice as QFE employee advisers.
- 1.5. Sovereign is a subsidiary of Commonwealth Bank of Australia and a related company of ASB Bank Limited.
- 1.6. For more information on Sovereign or life insurance products please refer to Part 1 of Sovereign's publically available submission to the Issues Paper relating to the review of the Financial Advisers Act 2008 (**FA Act**) and Financial Service Providers (Registration and Dispute Resolution) Act 2008 (**FSP Act**).

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<sup>2</sup> This includes policy owners, life assured, borrowers and workplace business

<sup>3</sup> Sovereign internal reporting as at 30 June 2015

<sup>4</sup> FSC (Financial Services Council) Market Share Report December 2015

<sup>5</sup> An approximate is given as staff turnover results in vacant roles which can fluctuate on any given day

## **PART 2 – Key issues as identified by Sovereign**

- 2.1 Sovereign recognises the positive consumer impact that the FA Act and the FSP Act have brought to the financial services advice industry through the introduction of elements such as “care, diligence and skill” requirements, education, QFEs and dispute resolution.
- 2.2 We believe there are two key issues for the financial services advice industry in relation to life insurance:
  - a. The role of advice in solving the problem of underinsurance; and
  - b. Lifting consumer trust and confidence in the industry.

### **2.3 The burden of underinsurance on individuals, families and communities**

- 2.3.1 In the last financial year Sovereign paid out more than \$330 million<sup>3</sup> in life insurance claim payments to help out customers in times of trouble. This is why we understand the positive consequences of being properly insured. Underinsurance makes New Zealand families vulnerable when their income earners die, or become permanently disabled, especially when it occurs unexpectedly. Financial burdens at a time of intense vulnerability add to personal and family stress, and have financial implications for New Zealand’s health and welfare systems.
- 2.3.2 A higher uptake of life insurance is therefore in the national interest because it provides financial security and peace of mind to individuals and their families, while reducing the potential burden on New Zealand’s health and welfare system.
- 2.3.3 Research continues to show that New Zealand has substantial underinsurance which means unnecessary suffering may occur in the case of illness, injury or death. Recent research from the New Zealand Institute of Economic Research<sup>5</sup> highlights New Zealand’s life insurance customer numbers are stagnating. This means the number of New Zealanders obtaining financial security and peace of mind is not increasing, and underinsurance remains unaddressed.
- 2.3.4 Further, life insurance in New Zealand is concentrated in medium to high income families, and Sovereign’s analysis highlights very low penetration of life insurance in provincial New Zealand, lower socio-economic and Maori and Pacific communities. So it is important to address underinsurance, for all of New Zealand.
- 2.3.5 Sovereign believes that a healthy financial advice industry (with a positive culture and strong values) is required if the underinsurance problem is to be solved. Increasing access to advice and improving the trust and confidence of consumers in the financial advice industry will help consumers and the industry alike.
- 2.3.6 Access to advice will be promoted by ensuring that:

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<sup>5</sup> “Resetting Life Insurance: Analysis of New Zealand Market Structure”, New Zealand Institute of Economic Research, November 2015

- a. Advice is affordable: The current regime promotes that objective by enabling both class and personalised advice in relation to life insurance products.
- Class advice can be delivered cost effectively and through multiple channels, thereby maximising the potential reach of advice. Many segments that are over-represented in the underinsurance statistics cannot afford or for other reasons access personalised advice. If the option of class advice is removed, those segments of the community will be excluded. The current regime should be given time to develop further following the bedding down period over the first five years, without major disruption as a result of the review.
  - For personalised advice, the current regime's approach under which different types of adviser can provide personalised advice in relation to particular products based on their complexity and risk (and, in the case of a QFE adviser, the identity of the product provider) appropriately balances the cost of delivery against consumer protection. Any changes as a result of the review that increase the costs of giving personalised advice in relation to life insurance products will be likely to increase underinsurance.
- b. Customers have multiple channel options: There must be no bias or preference to any single advice channel, as each channel has an important role to play in the industry. It is essential that any measures introduced to address perceived problems with the current regime do not inadvertently create a bias for or against any particular advice channel.

## **2.4 Trust**

2.4.1 The insurance industry is an industry built on trust. Trust in insurance companies paying out at the time a consumer most needs help<sup>6</sup> and, importantly, trust in getting the right information and advice about the type and level of cover when taking out a policy.

2.4.2 Trust takes time to build. The FA Act and FSP Act are relatively young. Sovereign therefore believes the review should recognise the "bedding down" process that has occurred. The industry has been through (and is still dealing with) fundamental change to processes, systems and consumer documentation.

2.4.3 Given that, caution should be exercised in introducing further significant change, and such change should only be pursued if justified by evidence that it is in customers' best interests.

2.4.4 Further, the FA Act and the FSP Act are part of a wider suite of financial services regulations, including product and provider regulation under the Financial Markets

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<sup>6</sup> The financial stability of insurance companies is governed by the Reserve Bank of New Zealand via the Insurance (Prudential Supervision) Act 2010

Conduct Act. Sovereign believes the review should focus on continuing to align the regulation of advice to the wider existing financial services regulation through easily-implemented incremental change to improve efficiency and enhance consumer outcomes.

2.5 We believe trust, and therefore underinsurance, will be improved through:

- Addressing inappropriate replacement business;
- Lifting transparency and quality of disclosure; and
- Future-proofing the regime.

## 2.6 **Addressing inappropriate replacement business**

2.6.1 Inappropriate replacement business<sup>7</sup> was a key concern in the Issues Paper however it is not explicitly covered in the Options Paper. Sovereign believes that switching insurance policies for the right reasons can be good for the customer, encourages product innovation and competition and supports a healthy insurance industry. However inappropriate replacement business has the potential to harm consumers, and we are aware of examples of adverse consumer outcomes, such as previously covered health conditions ceasing to be covered under a replacement policy.

2.6.2 In our opinion, there are adequate measures in the existing FA Act to address aberrant behaviour by a minority of advisers. In particular, it is beyond doubt that an adviser who encouraged a consumer to replace his or her insurance policy leading to a direct adverse consequence for the consumer (such as a partial loss of cover) would likely have breached the adviser's duty of care, diligence and skill under the FA Act. More than likely, the adviser also would have committed an offence by contravening the adviser's obligation to not engage in conduct in relation to the provision of a financial adviser service that is misleading or deceptive, or likely to mislead or deceive.

2.6.3 We therefore believe that appropriate enforcement of existing remedies within the current legislation is a more appropriate response than further, significant regulatory change.

## 2.7 **Lifting transparency and quality of disclosure**

2.7.1 Sovereign is fully in support of the options in relation to levelling the playing field on disclosure of commissions as we believe this will build consumer trust and confidence in advisers and the financial advice industry generally.

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<sup>7</sup> Defined in the Issues Paper (P36, Box 3) as "the practice of advisers persuading clients to move from one financial product to another for the purpose of receiving a high up-front commission"

2.7.2 Further, we would like to see simpler and consistent disclosure documentation from all categories of advisers, making disclosure more meaningful and easy to understand for customers and making advice more cost efficient to provide.

2.7.3 In our opinion, a simple disclosure document should include basic remuneration information together with information on soft incentives (actual or potential). This information should be on the front page of the disclosure document to ensure it is seen by the customer.

2.7.4 We believe there is an opportunity for regulators and the industry to work together to produce a simple, standardised, draft document that can then be tested with consumer groups. The final template should therefore meet the needs of consumers.

## 2.8 **Future-proofing the regime**

2.8.1 Sovereign sees an opportunity to future proof the regulatory regime to cater for potential new channel and advice options, and we do not believe this issue can be solved by distinguishing between “sales” and “advice” or removing product categories.

2.8.2 Instead, we believe it is appropriate to continue differentiating between products based on i) complexity and ii) the potential for consumer harm.

2.8.3 Further, we recommend the review clarifies that targeted advice based on known or deduced characteristics that the consumer shares with others in a cohort meets the definition of “class” advice.

### PART 3 – Responses to specific questions from the Options Paper

Question	Sovereign's Response
1, 2	<p data-bbox="331 368 1016 400">Sovereign agrees with the first and third stated barriers.</p> <p data-bbox="331 432 2029 804">In relation to the second stated barrier, that certain types of advice aren't being provided, Sovereign does not agree with the implication in the Options Paper that the legislation should ensure that all types of advice will be available to all customers. The reality is that each type of advice has a different cost of delivery. This means, for example, that personalised advice cannot be provided to certain customers where there is no financial business case for an adviser to do so. In our opinion, the Options Paper incorrectly characterises this as an uneven playing field. In fact, the reason is the cost of delivery of personalised advice. If class advice is removed, or the cost of delivery for class advice is increased, in the name of "levelling the playing field", it will have the opposite effect: certain segments of the community will be excluded from accessing advice altogether. At present, those consumers have access to low-cost class advice. Generally speaking, class advice is adequate to promote good financial outcomes for such customers.</p> <p data-bbox="331 836 2007 963">Sovereign believes there is a related barrier to consumers accessing the financial advice that they need: a lack of conviction in the value of, and a lack of understanding of the benefits of, financial advice. That barrier arises from the generally poor level of financial literacy in New Zealand.</p> <p data-bbox="331 995 1951 1075">Sovereign notes that there is no strong evidence that the fourth and fifth stated barriers are systemic or otherwise having a material adverse effect on customers' financial outcomes overall.</p> <p data-bbox="331 1107 2033 1283">In the context of financial advice in relation to life insurance, Sovereign strongly supports measures to eliminate inappropriate replacement business but notes that there is no evidence that a significant portion of replacement business leads to inappropriate outcomes for customers. Stronger enforcement of the existing remedies under the FA Act should be preferred over further regulatory change without a clear, objective fact base to support the change. Please see our comments at section 2.6 of this submission.</p>

	<p>There is no strong evidence that customers who have received financial advice do not understand the nature and scope of that advice. The fact that there are different types of advice contemplated by the FA Act and provided to customers is not, of itself, evidence that, once advice has been provided, customers do not understand the scope and limitations of that advice. In Sovereign’s experience, advisers generally pay very close attention to ensuring that customers understand the limitations of the advice – it is in advisers’ interests to do so, lest they expose themselves to liability for breach of their duties under the FA Act.</p>
6, 7, 13	<p>Consumers need to get the right information at the right time. Sovereign believes removing the distinction between class and personalised advice will not enable the consumer outcomes sought from the review, and will instead further increase the “advice gap”. If class advice is removed, or the cost of delivery for class advice is increased, certain segments of the community will be excluded from accessing advice altogether. At present, those consumers have access to low-cost class advice. Generally speaking, class advice is adequate to promote good financial outcomes for such customers.</p> <p>We also believe it is appropriate to continue distinguishing between products based on i) complexity and ii) the potential for customer harm (and, in the case of a QFE adviser, the identity of the product provider). We believe that the current multi-tier adviser model appropriately balances the cost of delivery against consumer protection. Any changes as a result of the review that increase the costs of giving personalised advice in relation to life insurance products will be likely to increase underinsurance. We acknowledge that the current names to denote registered financial advisers and authorised financial advisers might be confusing to some consumers. If that is determined to be a material problem with the current regime, we would support revised names. Importantly, however, that is a separate issue from the validity of the multi- tier adviser model and, for the reasons we have outlined, any renaming should not inadvertently or otherwise change that model. In our experience, the QFE adviser name has not created any material confusion for consumers, although an enhancement could be to explicitly provide that a QFE may brand and promote its QFE advisers as a “[abbreviated name of QFE] financial adviser”, without falling foul of the prohibitions in the FA Act against indirectly holding out that the QFE adviser is an authorised financial adviser.</p> <p>We do not support any attempt to draw a distinction between “sales” and “advice”. This is because we believe that every salesperson (whether corporate, such as in the case of a QFE, or individual) should be satisfied that the product being sold meets the consumer’s</p>



	<p>need. That need might be established by a full needs assessment or by simply asking the consumer (as in the case of a consumer who has conducted his or her own needs analysis and research). But even in the latter case the salesperson should be satisfied that the product is suitable to meet that need. That process by its very nature is a recommendation or opinion in relation to acquiring the product.</p> <p>We do support, however, the FMA providing clear guidance on the line between providing information or transmitting the financial advice of another person (particularly where that is done verbally) for the purpose of section 10(3) of the FA Act and giving financial advice. In our experience, many front office staff (such as receptionists at adviser offices and bank tellers) are reluctant to convey information to customers out of fear of over-stepping the line into giving advice. In part, this is the responsibility of the employer to provide clear instruction but because responsible employers and institutions want to ensure compliance they are taking a conservative interpretation to the giving information exception. This is contributing to sub-optimal customer outcomes, because customers cannot easily and readily access all the information that they might want to help them make good financial decisions. We would support the FMA providing clear guidance on this issue by way of example scenarios that are, or are not, within section 10(3).</p> <p>We continue to recommend a further bedding down period for the current legislation, as any major change will lead to disruption to processes, systems and documentation leading to deterioration in customer experience and, at least short-term, extra cost and complexity for the industry.</p>
9, 10, 11	<p>Research shows changing consumer behaviour will demand more online and mobile responses from the financial advice industry. The industry and government will need to work together to overcome any perceived trust issues with online and mobile delivery of financial advice.</p> <p>In order to help protect consumers and ensure advice meet customer needs, we recommend that online advice platforms should be New Zealand registered, operate under New Zealand legal jurisdiction and have a suitably-authorized individual or entity (for example, aQFE with New Zealand-resident Directors) behind the platform in order to ensure accountability.</p> <p>All substantive requirements for online and mobile financial advice should be similar to those for other delivery channels (i.e. there should</p>

	<p>be no channel arbitrage available for either traditional or new channels). In particular, there should be consistent requirements in relation to:</p> <ul style="list-style-type: none"> <li>• Quality standards;</li> <li>• Privacy and consumer protection; and</li> <li>• Disclosure.</li> </ul>
12	<p>Sovereign supports the option to extend ethical requirements to all financial advice services. Every adviser should be obligated to put the consumer’s interests before the adviser’s own interests. Further guidance on “putting the consumer first” will help all advisers meet their obligations in this regard.</p>
17	<p>Sovereign supports the entity licensing model. The licence requirements should be appropriately scaled, however, based on the risk of the adviser (having regard to size and types of products in relation to which advice is to be given). Scaling is necessary to minimise compliance costs that might otherwise force out of the industry smaller advisers who provide advice only in relation to category 2 products (such as insurance products). In essence, the preferred option is an enhancement on the current regime, whereby it retains the distinction between RFAs, AFAs and QFE advisers (noting our support for reconsidering the names for RFAs and AFAs to help remove any existing confusion by consumers) while increasing the pre-vetting of RFAs to an appropriate risk- based level to promote increased consumer trust and confidence in that type of adviser.</p> <p>The entity licensing model should ensure that all advisers have adequate capital and/or professional indemnity insurance to help minimise the risk of customer harm from the use by advisers of limited liability and special purpose vehicles and trusts.</p>
19, 20, 21	<p>Sovereign would like to see simpler and consistent disclosure documentation from advisers across the financial advice industry, making disclosure more meaningful and easy to understand for customers and making advice more cost efficient to provide.</p> <p>In our opinion, a simple disclosure document should include basic remuneration information together with information on soft incentives</p>

	<p>(actual or potential) and an explanation of whether an adviser is independent or aligned with a single provider. This information should be on the front page of the disclosure document to ensure it is seen by the customer.</p> <p>The best way to achieve consistent disclosure is to mandate the form of disclosure. We believe there is an opportunity for regulators and the industry to work together to produce a simple, standardised, draft document that can then be tested with consumer groups.</p>
22, 23	<p>We have seen no evidence that multiple disputes resolution schemes lead to poor outcomes for consumers. From Sovereign's perspective, the benefits of having sector-specific schemes with strong sector knowledge (i.e banking, investments and insurance) outweigh any potential drawbacks.</p> <p>However, we do see a need for greater consistency between the schemes, particularly in relation to the review processes used by each scheme. Additionally, we recommend the Financial Services Providers Register (<b>FSPR</b>) require all advisers to list the name of the dispute resolution scheme to which they belong.</p>
25, 26	<p>As stated in our response to Part 3 of the Options Paper, we believe the best way to get information to consumers is online through an enhanced FSPR that provides timely and reliable information.</p>
32-35	<p>In our opinion, fundamental change to the current regime is unnecessary. There is no demonstrable systemic harm or market failure from the current regime, which is only five years old and has not yet had the opportunity to be properly embedded. Some enhancements are justified, as supported in this submission. Incremental change will best promote the objectives of the review. Sovereign therefore supports enhancements based on Package One but subject to the adjustments indicated in this submission.</p>