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

22 July 2015

Introduction

1. IAG welcomes the opportunity to comment on the issues affecting the provision of financial advice to New Zealanders.
2. The issues paper (the Paper) raises many questions in relation to the Financial Advisers Act (FAA) and the Financial Service Providers Act (FSPA). We have not responded to all of these questions in this submission. Instead we have provided our general thinking on the two Acts and the changes that need to be made.
3. We focus most of our attention on changing the definition of financial adviser and consequential changes to the associated obligations. Our aim is to create the conditions that will increase the supply of financial advice and improve decision making by consumers in relation to financial products and services. The FAA gets in the way of achieving this and should be amended.
4. We would welcome the opportunity to discuss our submission with you.
5. IAG's contact in relation to this submission is:

Bryce Davies, *Senior Manager Government and Stakeholder Relations*

T: 09 969 6901

M: O21 245 6313

E: bryce.davies@iag.co.nz

About IAG New Zealand

IAG New Zealand is made up of IAG New Zealand Limited trading under the NZI and State brands, Lumley General Insurance (NZ) Limited and AMI Insurance limited. IAG New Zealand Limited also underwrites general insurance for ASB, BNZ and The Cooperative Bank and Lumley General Insurance (NZ) Limited underwrites general insurance for Westpac. IAG New Zealand Limited, Lumley General Insurance (NZ) Limited and AMI Insurance limited have a combined 47% share of the on-shore general insurance market, managing 3.8 million policies of 1.5 million New Zealanders. IAG New Zealand Limited, Lumley General Insurance (NZ) Limited and AMI Insurance limited are wholly owned subsidiaries of Insurance Australia Group (IAG), Australasia's largest general insurer.

IAG New Zealand Limited, Private Bag 92 130, Auckland

Overview

6. IAG believes that the core issue in relation to the Acts under review is ensuring that they create the conditions that will lead to greater supply and consumption of financial advice.
7. To do this the financial adviser regime needs to be simplified. A clearer distinction is needed between advice and sales.
8. Financial advisers should be regulated by an amended FAA to ensure minimum, yet high levels of independence, conduct, competency and accountability.
9. Sales people and their employers should be removed from the FAA and be subject to the current care, conduct, redress, and censure obligations in the Financial Markets Conduct Act (FMCA), Fair Trading Act (FTA), Consumer Guarantees Act (CGA) and Financial Service Providers Act.
10. The outcome of our recommendations would be that an organisation like IAG would not be captured by the FAA. We would be responsible for the sales activity of our staff and tied agents under existing laws and obligations.
11. That would remove the compliance and operational burden of the FAA and positively impact the decisions we can make, along with other insurers and financial product and service providers to support our customers' decision making through the increased provision and consumption of advice.

Our thinking on the Financial Advisers Act

A need for more advice

12. The Financial Advisers Act seeks to "promote the sound and efficient delivery of financial adviser and broking services, and to encourage public confidence in the professionalism and integrity of financial advisers and brokers".
13. The Paper unpacks this purpose into three goals for the regulation of financial advice, that: a) consumers have the information they need to find and choose a financial adviser; b) financial advice is accessible for consumers; and c) public confidence in the professionalism of financial advisers is promoted.
14. In our view the second of these goals appears to be the most pressing for New Zealand, given the limited consumption of financial advice now and the expected growth in the need for financial advice as New Zealand's capital, superannuation and annuity markets mature.
15. However the availability of financial advice is something that occupational regulation (in the form of the FAA) can only ever influence at the margins. It can change consumers' confidence in advisers (the third goal, above)

and increase uptake, but only for those consumers for whom a perceived lack of quality was the barrier to use.

16. We suspect that the availability of advice has not materially changed with the implementation of the FAA. It started with a low base and, if anything, may have reduced as large institutions sought to limit the operational and compliance risk the regime created. Added to this possible reduction in financial advice is an increase in the cost and complexity of operating sales and service channels.

17. In our experience there are more fundamental forces impacting the demand and supply of financial advice than the FAA. On the demand side is consumers' understanding of the importance and value of financial advice; a matter of literacy and experience. On the supply side, operational capability, cost to serve and liability risk are inhibiting factors.

18. The net result is that in some circumstances it is simply uneconomic to provide advice. In the general insurance market this is typically where the complexity of the need outstrips the value of the underlying sale. This is most likely to be the case for small businesses – where they still have much of the complexity and needs of bigger businesses, but the size of their premium means that the cost of providing advice can easily outstrip the margin available from transacting the business.

19. We believe that it is unrealistic to expect that occupational regulation will materially change the business case that governs decisions about the demand and supply of financial advice. Therefore, the FAA's main impacts will be in relation to the first and third goals listed above.

20. Nevertheless, reducing the burden of regulation will positively impact the supply decisions by insurers and other providers. This is an outcome well worth pursing and can be achieved by recalibrating the current regime to ensure it better defines the occupation it seeks to regulate.

The central issue with the FAA is definition

21. The central issue with the FAA is (and always has been) defining who is and is not a financial adviser.

22. The current definition catches too many people within the definition of financial adviser and as a result does not accord with what average consumers experience of financial advice or what they expect in terms of who is and is not a financial adviser.

23. The idea that a person who gives financial advice is a financial adviser is, on the face of it, simple and straight forward. However in practice it establishes a regulated occupation on the basis of phraseology; on how a person chooses to communicate with their customer.

24. Providing an opinion on a product or recommending to someone that they purchase it, while rightly considered giving advice, should not automatically imply that the individual providing it is part of a professional occupation called *financial advisers*.

25. For example, a Customer Service Officer in a call centre saying "I think you should consider taking the comprehensive car insurance" is not the same

as an investment adviser talking though options for diversifying a retirement savings plan.

26. The FAA does acknowledge that there is a difference between these two people; that there is a spectrum of complexity and risk to consumers on which financial advisers sit. It reflects this by including a range of exemptions and rules to ensure it accurately targets and calibrates its obligations. We contend that this is evidence that the definitions need to be refined; that despite the seemingly simple definition, only a subset of those caught were truly meant to be regulated as financial advisers.

27. To accommodate the lower end of the scale (the majority of people caught), the obligations imposed are calibrated such that they merely replicate those they were subject to under the FTA and CGA and are now subject to under the FMCA. In effect, the FAA carves out from its obligations the majority of the people it captures.

28. Similarly the FAA has provisions which allow employers to be accountable for the actions of their staff when advising consumers – another example of an expectation and accountability that already existed in the FTA and CGA, and was strengthened by the FMCA.

29. The net effect is more compliance and more costs, without any meaningful or additional benefit for consumers. We contend that this runs counter to the principle of proportionality set out in the principles of good regulation at the beginning of the Paper.

30. What is needed is a clearer definition of who is a financial adviser and who should therefore be subject to regulations aimed at maintaining the professionalism of that occupation. This definition should minimise the number of exemptions and rules needed to target the FAA's obligations.

Distinguish between sales and advice

31. We agree with the analysis by MBIE on the distinction between pure sales and pure advice and contend that a far clearer distinction is needed between the two. For IAG this sits at the heart of the changes that are needed.

32. We agree that the basis for distinguishing between advice and sales should rest on the notion of for whom the individual is acting and not how one frames their sentences.

33. If one is acting for the product or service provider then one is selling. One is not a financial adviser and should therefore fall outside the remit of the FAA. If one is acting for the consumer, then one is providing advice, is a financial adviser and should meet the obligations of that profession set out in the FAA.

34. This would see much of the complexity that arises from a definition based on phraseology swept away and replaced with a simple test based on agency to determine when one is a financial adviser.

35. This would make *independence* an important and determining factor. It would mean that, even though a person may provide an opinion or recommendation (financial advice), that would only make them a financial

adviser and subject to the obligations of the FAA if that advice was independent, because they were acting for the consumer and not the product or service provider.

36. Overall we think this distinction would accord with consumers' basic expectations of who is and is not a financial adviser. It would also ensure that any regulation is targeted to those who should be within the profession.

37. We support the ICNZ's assertion that this distinction is easily made in the General Insurance market. People either act on behalf of the insurer (think branch and call centre staff) or on behalf of the consumer (think insurance brokers).

38. We should note that some brokers can be tied to an insurer for all of their business, making them a sales person. Brokers can also be tied to an insurer in relation to specific insurance schemes. What that means is that one individual can at different times be a sales person and adviser. It is important that the broker's customers understand for whom the broker is acting at any given time.

39. This simple agency test would provide the clarity we see with the other regulated occupations, where professional licensing provides a bright line for those who are in and those who are out. We recognise that it may not remove all of the exemptions currently in the FAA.

40. This should allow sales people to recommend, provide opinions and advise consumers in relation to their products and services, without this immediately making them a financial adviser and shifting their duty of care from their employer to the consumer.

41. This may require a consequential amendment to the FSPA to ensure sales people are not considered financial service providers.

A positive obligation to alert consumers

42. The question that then arises is 'can we rely on consumers to understand this distinction or is something additional needed for this bright line test to work and for consumers to understand for whom the person they are talking to is acting?' The most immediate option available is some form of disclosure.

43. Calibrating this type of obligation will be critical to achieving the benefits from a clearer distinction between advice and sales and a tighter definition of who is and is not a financial adviser. Too onerous a disclosure obligation will exacerbate the current cost-to-serve issue and act against the sought for change in the 'business case' for giving advice.

44. We contend that an agency-based definition of financial advise will allow a lighter form of disclosure to be implemented. There is less need to explain that which accords with consumer expectations and experiences of receiving independent financial advice or simple being sold a financial product or service.

45. We also contend that disclosure would need to reflect the changing use of distribution channels and their different nature, e.g. face-to-face versus on-line transaction only.

46. Lastly, we would need to think carefully about the aim of any disclosure. It is neither sensible nor possible for disclosure to fully educate consumers about the different obligations due to them by their sales person or adviser.

47. Any disclosure must have a simple aim, be achieved quickly and easily, and leave the consumer in no doubt as to what they have been told and what it means.

48. Overall we think a simple statement alerting the consumer to fact they have not received independent financial advice and may wish to do so is sufficient to put them on notice and take action if necessary.

Rely on existing obligations for those involved in selling

49. It is right and proper that there is a minimum standard of conduct and accountability when selling financial products and services. Consumers should receive products and services that are appropriate for their needs, that accord with what they thought they we getting, and that come with easy means of redress if things go wrong.

50. We agree with the ICNZ analysis that there are sufficient obligations within existing consumer and financial markets law to ensure appropriate standards of conduct in selling, to provide redress to consumers, to deter poor practices, and to censure providers (and their directors) when they fail to meet these obligations.

51. The Financial Markets Conduct Act 2013 includes *Part 2 Fair Dealing*, which deals with the conduct of those who deal with financial products and services. Specifically:

- s.19 Misleading or deceptive conduct generally
- s.20 Misleading conduct in relation to financial products
- s.21 Misleading conduct in relation to financial services
- s.22 False or misleading representations
- s.23 Unsubstantiated representations

52. The Fair Trading Act 1986 has similar provisions in *Part 1 Unfair Conduct* that apply more generally. Specifically:

- s.9 Misleading or deceptive conduct generally
- s.10 Misleading conduct in relation to goods
- s.11 Misleading conduct in relation to services
- s.12a Unsubstantiated representations
- s.13 False or misleading representations

53. The Consumer Guarantees Act 1993 (CGA) includes *Part 3 Supply of Services* which deals with the suitability of the service and means of redress. Specifically:

- s.28 Guarantee as to reasonable care and skill
- s.29 Guarantee as to fitness for a particular purpose
- s.32 Options of consumers where services do not comply with guarantees

54. Finally, the Financial Service Providers Act 2008 includes *Part 1 Registration* which provides the approval and redress mechanisms for consumers. Specifically:

- s.11 No being in business of providing financial service unless registered and member of approved dispute resolution scheme
- s.12 No holding out that in business of providing financial service unless registered and member of approved dispute resolution scheme

55. We contend the conduct obligations within the FAA simply replicate a subset of those in the FMCA, FTA and CGA. The removal of sales people from the remit of the FAA would not alter the conduct obligations that they are subject to or reduce the deterrence, redress and censure mechanisms they and their employer work under.

56. We believe that these existing obligations can be relied on to maintain the quality and accountability of the sales processes established by product providers and used by their sales people.

57. We would contend that the disclosure obligation for sales people should fall away. The pertinent information is either already available to the consumer (e.g. contact details) or is already a requirement of membership of an Approved Dispute Resolution Service (ADRS) (e.g. operation of an Internal Complaints Handling Services (ICHS) and informing customer of that ICHS and ADRS).

Retain institutional accountability for sales staff

58. Our position has always been that large institutions should be responsible for the conduct of their staff. This reflects the natural and correct expectation of consumers that the provider is accountable for the action of its staff when they sell.

59. The FAA recognises this through the Qualifying Financial Entity (QFE) mechanism. This allows the Financial Markets Authority (FMA) to rely on the governance and practices of the organisation and hold it and its directors to account when things go wrong. However the existing obligations in the FMCA, FAA, CGA and FSPA, already sheet home this accountability to the company and its directors.

60. These Acts also enable the provider to be investigated and censured. For example the FMA has the power under the FMCA to apply or initiate a range of interventions to correct poor conduct including: direction orders; pecuniary penalty orders; compensatory orders and banning orders. The

FMA also has the power to remove a financial service provider off the register under s.18B and 18C of the FSPA.

61. Relying on these existing provisions retains the status quo regarding reliance and accountability, while removing the tests and obligation associated with becoming a QFE (and the associated compliance burden). They do not reduce or limit the power of the FMA or Commerce Commission to take action against a provider.

Focus the FAA on those providing independent financial advice

62. We contend that those individuals who act on behalf of the consumer – who are independent financial advisers, should be held to a common set of obligations aimed at maintaining the professionalism of financial advisers.

63. These obligations should focus on maintaining the professional standards of financial advisers and achieve minimum, but high levels of quality in the advice they give to consumers.

64. We contend that the consumer is entitled to the same level of care, independence, professionalism and quality – irrespective of the nature of the product(s) or service(s) on which advice is being given.

65. We believe the obligations should exist relation to:

- Ethical behaviour: Financial advisers must act in the interests of the consumer and with due skill and care.
- Independence: financial advisers should be independent, or at the very least should manage and make the consumer aware of the biases and conflicts of interest that they have, whether these arise through how they are remunerated and or through the relationships they hold.
- Competency: a minimum level of product, advisory and customer care capability is necessary and that this must be maintained through continued professional development.
- Redress: financial advisers should provide consumer appropriate avenue for redress through dispute resolution and professional indemnity insurance.
- Disclosure: consumers should be given the opportunity to understand some basic facts about their financial adviser so that they may determine whether to accept their advice or not. This should include information on for whom they act, their conflicts of interest, and the avenues of redress available.

66. At present both RFAs and AFAs would fit within the agency-based definition of financial adviser. However these two categories of financial adviser are subject to different obligations. This naturally suggests a need to mature the obligations applying to all financial advisers and to achieve an appropriate level of consistency.

67. We acknowledge that the stringency of occupation regulation can impact supply (albeit at the margins, as noted above). If the standards are too

high it can make it harder for new entrants to come into the market and lead existing participants to exit.

68. However we reiterate our point above; that if the regime is to focus on those who are truly financial advisers, then there must be a standard that applies to all who are part of the profession.

Retain efficiency for companies of financial advisers

69. The FAA allows financial advisers to be covered by a QFE, so that a degree of administrative efficiency can be achieved, particularity in respect of registration and dispute scheme memberships. IAG believes that it is appropriate that this continue.

Our thinking on the Financial Service Providers Act

No concerns about registration or dispute schemes

70. The issue paper raises a number of questions in relation to the FSPA. The most substantial of which relate to registration and existence of multiple dispute resolution schemes.

71. IAG is not concerned by the requirement to register as a financial service provider. This is a necessary measure to ensure compliance with other obligations.

72. Similarly we do not see any need (at this time) to consider consolidation of the dispute resolution schemes. The current arrangements are working well and there does not appear to be an issue for which consolidation would be a natural conclusion.

Dispute scheme Caps

73. The Paper asks if the $200,000 jurisdictional limit for disputes should be raised. This has also been consulted on in relation to insurance claims arising from the Canterbury Earthquakes.

74. IAG believes that the critical element in this is ensuring that disputes are heard by the right authority. We are not convinced that there is an access to justice issue.

75. ADRS for the most part ensure that insurers have correctly interpreted and applied the wordings of its policy and followed relevant codes and practices – an important and valuable role. For example the Insurance and Savings Ombudsman "has the power to consider Complaints made by a Complainant about Participants relating to:

- a) breaches of contract by the Participant;
- b) breaches of statutory obligations by the Participant;

- c) breaches of industry codes by the Participant; and
- d) non-compliance with relevant industry practice.”

76. Occasionally there are disputes that are complex, turn on points of law that require interpretation, or require scrutinising the merits and ultimately finding favour with conflicting technical information. These types of disputes are best dealt with in the courts, as they have the necessary skills, procedures and experience to do so.

77. While value is not a perfect identifier for these types of disputes, it can often be the case that larger value disputes have these features. We would be wary of raising the cap if that meant disputes are being heard in the ‘wrong’ forum.

78. At present insurers are able to waive the cap to allow disputes of greater than $200k be heard by their ADRS. It must also be accepted by the ADRS. We do not unnecessarily withhold access to our ADRS when the amount under dispute exceeds the jurisdictional limit.

79. We note the point that the cost to replace a home is increasing, but for most homes this will only be a problem when the entire claim is in dispute and not just a difference in settlement values.