

## **SPEECH NOTES | PREPARED FOR THE LBA CONFERENCE | 26 MAY 2011**

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Good morning, it is a pleasure to be able to attend and present at the Life Broker Association's annual conference.

Firstly, I would like to thank your President, Ron Flood, for inviting me to speak to you today.

It's also a bit of a homecoming for me to be here at the Brentwood Hotel, in the middle of the Miramar electorate that I thoroughly enjoyed serving as a Member of Parliament for 9 years.

As you know, I only joined the ISI at the beginning of this month so I'm still coming up to speed with the industry, the Association, and the issues and challenges we face.

My past involvement with the industry was as an Associate Minister of Finance to Roger Douglas and then David Caygill. I had day to day responsibility for monetary policy and the regulation of financial institutions, including insurance. They were dramatic days and I learnt a lot about the industry from having oversight of the sale of State Insurance and the corporatisation of Government Life, that later evolved into TOWER.

After finishing in Parliament I worked in corporate finance for several years before becoming an international consultant in Government sector reform.

In the few weeks since taking up the role of chief executive of the ISI, I have spent much of my time visiting members to get a current view of the issues we face and to discover their aspirations for the ISI.

Many things have changed for the better since the 1990s. Customers now have access to plain language descriptions of what they are buying.

Of course no one will understand even a plain language document unless they take time to read it. It is clear from the finance company collapses that many New Zealanders still do not understand:

- That a company paying higher interest rates is usually less secure and not a better company;
- That putting money aside in a well managed fund/investment with appropriate fees can provide returns in excess of what can be achieved in a bank account; and,
- That outside of Auckland, it is likely that an investment in equities or bonds will out-perform an investment in housing over the next few years.

Most New Zealanders would benefit from using a competent adviser but all too often we are reluctant to pay for competent advice.

As a wise person once said, good advice can be expensive but not as much as bad advice.

Like me, you were probably appalled at the number of people who invested in finance companies because of the recommendation of someone they had met once at the bowling club:

- Or people who thought they had truly diversified their risk because they split their savings between four different finance companies, that each had the same issues;
- Or the people who bought into a finance company because they didn't know the difference between investing in a secured mortgage, and funding residential construction with no customers secured for the finished homes;

- Or even who put their life savings into a finance company because they liked the personality of the owner or the celebrity fronting their advertisements.

These all point to the need for greater financial literacy which probably can help the next generation of consumers but won't do much for those of us over 50.

We need to use competent advisers and it is noteworthy the number of people who are now seeking accreditation including many of your members.

The members of ISI are discussing how the ISI might play a bigger role in rebuilding New Zealanders' confidence in the finance sector. The life insurance companies in New Zealand, like the banks, weathered the Global Financial Crisis well but unfortunately many members of the public do not differentiate between a finance company and a managed fund or life insurance business, despite being entirely different entities.

We need higher levels of competence in advising on financial services because:

- The range of products available is becoming more diverse, which means the potential for mis-selling increases;
- The customer base is becoming more diverse;
- The growing potential of the Maori, Pacific and Asian population for financial services is not matched by a similar diversity of advisers;
- The New Zealand tradition of high up front rather than trailing commissions can incentivise churn that does not benefit the customer.

For today, Ron has suggested four key discussions points for me to focus on and I hope to provide you with a clear picture of where ISI stands on these topics.

My aim is to cover each topic at a high level, and to then open up the floor for your thoughts and questions.

## SETTING THE SCENE

I want to begin by giving you an overview of the role ISI has looked to assume over the last few years.

ISI has four core objectives, namely:

- **Stakeholder Engagement:** establishing and building productive relationships with key groups and organisations to better represent the industry;
- **Consumer Perception:** increasing public confidence in the industry;
- **Retirement Income and Savings:** participate in the development of public policy that will increase the level of private engagement in long term savings; and,
- **Insurance Gap:** understand the extent of the problem and identify solutions to bridge this gap.

Over the coming weeks we will be revisiting these objectives and looking to confirm the future direction and focus of the ISI. It is likely that the core objectives will remain, but our focus may change slightly with respect to how we look to contribute to many of the debates and issues our industry faces.

For today, I'd like to focus on a couple of key items that Ron has raised with me that directly affect the way you operate your businesses.

## **TOPIC 1: “BANNING” COMMISSIONS**

The possibility of New Zealand “banning” commissions on financial services products has been debated over the last year following the announcement that the Australian industry intends to do just this.

However, the Australian industry does operate differently to New Zealand. The majority of life insurance products sold in Australia are attached to a person’s superannuation. The Australian market also has a much lower commission structure for life insurance products.

ISI doesn’t necessarily subscribe to the idea that commissions are bad per se. What we do believe is that there should be greater clarity about the various charges and fees that are contained within financial products, and that the public are entitled to know (and agree to) what these fees and charges are.

At the end of the day it is about transparency and disclosing to clients anything that could potentially be a conflict of interest.

In fact, I think the bigger issues will be in the areas of high upfront rather than trailing commission and the related issue of “soft commissions”, and that will be an interesting debate at some future point.

We would like to see the industry move towards a structure where a client is presented with a proposal that clearly separates out the product costs from the distribution or advisory costs.

In this situation an Adviser would still be able to charge a commission – but this fee would be fully disclosed to, and agreed with, the client at the point of sale.

How the client elects to pay this fee would then be negotiable between the client and the adviser – they may choose to pay an up-front fee for service or advice, or to build this fee into the product and have it deducted as a percentage of the total annual premium. The difference would be that they would fully understand what the charges are and determine whether they feel they are getting good value for money.

Last year we formed a working group to consider this issue at a high level but it obvious that there are a lot of issues to consider before any progress can be made in this area.

Any changes in this area are likely to begin with savings and investment products as the commissions are much easier to separate out and disclose to clients.

Rather than commission bans, I would suggest that the recent devastating loss of life from natural disasters around the Asia Pacific region will have greater implications for commissions in this country.

The impact of these events may well see reinsurance rates rise dramatically and these costs will need to be passed through to the consumer, which could very well place pressure on the cost of advice as consumers look to minimise their costs and look at areas where savings can be made.

This could create additional pressure from direct sellers who could look to exploit the high cost of premiums from traditional insurance companies by discounting their rates to reflect lower acquisition costs.

## **TOPIC 2: REPLACEMENT POLICY ADVICE**

The Replacement Policy Advice (or “RPA”) has attracted some negative publicity since it was launched in July last year.

Some of the criticism has been fair, but the intention of the RPA has always been to ensure consumers are fully informed about the potential risks and benefits of replacing an existing policy with a new one.

Due to a number of factors, policy churn within our industry is high. Many policies that are replaced are done so for reasons other than client interest.

ISI accepts that people have legitimate reasons to replace policies, but we want to ensure they do so for the right reasons, and make the decision armed with all the relevant facts. That was what the ISI wanted to achieve with the new RPA process.

Following the initial launch, we went through a significant consultation process with a number of advisory organisations, including the LBA, to identify how we could improve the process and make it work better for everyone.

This was a hugely positive and co-operative exercise and we appreciated the goodwill that was shown by all parties to find a workable solution.

Unfortunately the ISI membership is extremely broad and our members adopt a number of distribution models. When the new process was circulated to our members for ratifying, we found a number of our members objected to it.

The ISI Board has asked me to review the RPA policy including how the intention could be achieved given the different distribution models currently being employed in the industry.

The fact is that our industry is now subject to new rules of engagement when it comes to offering financial advice, and the underlying principle is that we must all place the interests of the client above all else.

Obviously the new regime places significant obligations on AFAs to provide comprehensive advice and disclosure. As such, we have previously indicated that AFAs can either use their Statement of Advice or the RPA documentation to demonstrate they have put the needs of the client first.

And while not everyone who sells life insurance is required to become an AFA, the FMA has indicated that the AFA model is likely to be used as a reasonableness test for RFAs if a complaint is lodged with respect to the inappropriate sale of a life insurance product.

In this regard the RPA process should be a valuable tool for sellers of life insurance products who are not AFAs, as it would provide a paper trail that can show the right level of advice was provided to the client and that any possible conflicts of interest were made known to them.

At the moment the process is “on hold” pending my review. I have been asked to review the RPA as it currently stands and consider how we can find a solution that will deliver the right outcome for the customer, while satisfying the requirements of the various business models employed by our members.

My aim is to begin this review shortly.

### **TOPIC 3: INDUSTRY RATIONALISATION**

Industry rationalisation isn't a new phenomenon. It happens in almost any industry, especially where competition and profit margins are strong. It is the sign of an attractive, thriving industry.

In any free market industry organisations are continually being acquired in an attempt to either establish an industry position, or increase market share, or remove a key competitor, or rationalise products and services to enjoy cost efficiencies and greater margins. Or perhaps a combination of a number of those things.

In the life insurance industry alone we have seen many names disappear from the local landscape over the years: names like MLC, Provident, Colonial, Prudential, Government Life, National Insurance, Guardian, Oceanic, Pacific, NZI Life, FAI Metropolitan Life, National Mutual, Royal Sun Alliance, Norwich and more recently ING and AXA.

The demutualisation process in the 1990s meant that industry rationalisation was always likely to increase as companies became listed vehicles and more open to takeover bids.

However it is interesting to note that, twenty years ago, ISI had 16 members actively involved in selling life insurance products – today we have 15 members (14 now that AMP and AXA have merged).

So the number of companies operating in the New Zealand market hasn't changed that much, although many of the names have.

Using ISI market share data, twenty years ago the top five life insurance companies (in terms of in-force premiums) were:

1. AMP (26%);
2. National Mutual (19%);
3. Tower (13%);
4. NZI Life (12%); and,
5. Colonial (9%).

Today, the top five are:

1. Sovereign (30%);
2. AMP/AXA (19%);
3. Asteron (9%);
4. OnePath (8%); and,
5. AIA (6%).

Twenty years ago the top five companies accounted for 79% of total in-force premiums. Today, the top five only account for 72% - and prior to the AMP/AXA merger, the top five only accounted for 66% of total in-force premiums.

So it seems that competition has actually increased over the last twenty years, with total in-force premiums spread more evenly across a similar number of companies.

Over the same time, the range of products offered by the industry has expanded into new and exciting areas. Twenty years ago the ISI reported on 7 personal and group product lines – today, we report on 13.

In 1991 the industry was dominated by conventional and unbundled life products. Term life and income protection were only newly emerging products (in fact, income protection was reported within a combined, and very small, “permanent health and disability” category). Trauma insurance didn’t even exist.

Today, term life, income protection and trauma products account for 74% of total in-force premiums.

And over the last twenty years total in-force premiums have almost doubled from \$971m to \$1.8b.

In such a thriving industry, new players always emerge, attracted by the profile and profit potential.

These new players may not adopt conventional business models. They may choose to use technology to sell their products, or distribute their products in ways other than the traditional advisory channels. They may choose to compete in niche product areas.

So rather than rationalising, I believe the industry is in good heart and providing consumers broader choices both in terms of the products they can have and the way they choose to buy them.

And given the level of under-insurance that is believed to currently exist in this country, that has to be a good thing for the public, the industry, and the economy as a whole.

#### **TOPIC 4: ISI DIRECTION**

I believe the ISI has an important role to play in shaping the future direction of our industry. It is the reason why I accepted the role of CEO.

Far from being a simple mouthpiece for our members, our focus needs to be on driving changes that will benefit New Zealand and our members in the longer term. At the heart of this needs to be a strong consumer focus.

We need to create an industry that delivers real value to the public, and that sets high standards so that the public can have confidence that we will be there for them in their time of need.

ISI needs to lead the industry – to create and lead meaningful discussion and debate around the issues we face not only as an industry, but as a nation.

For example, a critical piece of work being undertaken this year is a research study into the level of insurance held by New Zealanders and the reasons why many people have inadequate (or no) levels of cover. This research will help us to determine how much insurance New Zealanders have, and how much cover they should have.

The data from this research will be used to identify solutions that will encourage more people to protect themselves, their families and their businesses.

But this will only happen if the public has confidence in our industry and the way in which we operate.

My role will be to work with ISI members and the wider industry to identify ways to do this.

Over the next few weeks the ISI will be discussing how it will operate in the future. I am encouraged that overwhelmingly our members want to be proactive rather than reactive and help identify win-win opportunities for New Zealand and the industry.

To be effective in an MMP environment business organisations like the ISI need to:

- Identify solutions and not just highlight problems;
- Collaborate to create wide stakeholder support for returns; and,
- Manage the inevitable internal members' tensions about when to co-operate for New Zealand and the industry's benefit, and when to compete with other members for market share and profitability.

Most of our members believe we have the right strategic objectives, the challenge is to have our delivery and behaviour matching our own aspirations.