Conflicted remuneration (soft commissions) in the life and health insurance industry

May 2018

Findings from an FMA review of soft commissions in the life and health insurance industry

FMA
FINANCIAL MARKETS AUTHORITY
TE MANA TATAI HOKOHOKO - NEW ZEALAND

Contents

Executive summary

Purpose of this report

The main form of remuneration for financial advisers who sell life and health insurance in New Zealand is commission. The commissions paid by insurers to advisers include monetary and non-monetary benefits. This report outlines the findings of our review into non-monetary commissions, also known as soft commissions.

Soft commissions are incentives or benefits such as gifts, prizes, trips, professional development such as training or software, events including conferences, sponsorships, payment of membership fees and loans to advisers.

We are interested in soft commissions because they present a real conflict of interest for advisers, as remuneration or incentives provided by insurers could influence an adviser in giving advice to a customer.

A report that we published earlier this year[1] showed that some financial advisers, in particular Registered Financial Advisers (RFAs), were unaware they need to manage conflicts of interest. Where advisers sell insurance products in order to obtain the soft commission and do not manage the conflict of interest, this may lead to poor outcomes for their customers.

We undertook this review to better understand the soft commission structures in place for life and health insurance products and how advisers respond to these incentives.

What we found

Our review covered data relating to a two-year period. Our main findings were as follows:

- **Insurers provided 242 different instances of soft commissions to advisers.** Each instance represents one offering from the insurer. For example, a conference is one instance but it may apply to hundreds of advisers. In this report, we refer to each of these instances as a soft commission.
- **Insurers spent $34 million** on soft commissions - 9% of the sales revenue insurers received in the same period for policy sales by advisers.
- **Nearly half of the soft commissions required the adviser to meet a target** - to sell a particular dollar value or number of the insurer's products. Advisers are incentivised to sell the insurer's product, and they need to balance this against achieving the best outcome for the customer, which is potentially conflicted conduct.
- Soft commissions fell into six different types. **More than 50% of the total spend on soft commissions was on trips** ($18 million out of $34 million), though the number of the trips was low (29 out of 242 instances).

Our analysis supports an earlier finding[2] by the FMA that overseas trips appear to be effective sales incentives for advisers. We found that the behaviour of advisers in responding to trips offered by insurers, and the number of trips offered by insurers, was in line with what we observed in our 2016 review.

Overall, we found that the financial benefit to insurers from providing soft commissions is small. This suggests that there are other non-financial reasons for insurers to continue offering soft commissions to advisers. One potential reason is that it results in increased loyalty from advisers. This is particularly the case where insurers require advisers to place a certain percentage of their business with the insurer to receive the soft commissions. Another potential reason is that insurers pay soft commissions to maintain their market share and competitive position against other insurers.

During the period of our review, some insurers made changes to their commission structures by ceasing to offer some types of soft commissions. One insurer told us that they stopped offering overseas trips as a soft commission to advisers as they did not feel this type of incentive is in their customers' best interests.

1: Update on the FMA's ongoing review of insurance replacement business and conflicted conduct – FMA report, March 2018
2: Replacing life insurance – who benefits? – FMA review of the life insurance industry, 2016

Our expectations

This review is part of a broad range of regulatory activities to monitor conduct, sales and advice practices and commission structures in the life and health insurance sector. Where these practices can lead to harm for consumers we want providers to focus their resources on improving outcomes for consumers.

We are concerned that insurers are designing incentives that potentially set advisers up to fail in complying with their obligations. Advisers have an obligation to exercise care, diligence and skill[3] and this, in our view, requires adequate management of conflicts of interest. Authorised Financial Advisers (AFAs) also have a code of conduct that they must comply with. Insurers must, for their part, take responsibility for conflicted conduct that results from these incentives[4].

Customers dealing with advisers may not be aware of the rewards an adviser is receiving for selling the products. Disclosure can help mitigate the risks of conflicted conduct. In the case of soft commissions, it is less clear that disclosure (in the context of individual consumers and transactions) is an effective way to manage the conflict.

Our report in March 2018 showed that among the sample of advisers we reviewed, some failed to recognise that these incentives would cause a conflict of interest in providing advice to their customers. Half of the advisers we reviewed were not aware of, or were in breach of their obligation to exercise care, diligence and skill when providing financial advice. The risk that customers dealing with advisers do not receive complete information about the benefits of a policy are increased when they are not aware of the rewards an adviser is receiving for selling the product.

We strongly encourage all insurers to consider the nature and value of the soft commissions they provide to advisers to ensure that this method of remuneration supports a focus on good customer outcomes. We have been raising this issue for several years but have seen little response from insurers. This will be a focus of our future interactions and discussions with insurers.

Next steps

We will show the findings of this review to the Ministry of Business, Innovation and Employment (MBIE) to assist in its review of insurance contracts and conduct.

We will be meeting with the insurance providers to ensure they recognise our expectations that they have obligations to manage the conflicts of interest that their incentives are creating.

We will also be publishing the results of two more reviews that examine practices in the insurance and banking industry in New Zealand. One review concerns Qualifying Financial Entity (QFE) insurance providers' replacement business, and the other relates to our review of the structure of bank incentives in the sale of financial products. This work is aligned with our Strategic Risk Outlook and our priorities to focus on the risks and harms associated with conflicted conduct across all financial services.

3: Financial Advisers Act 2008, section 33
4: See the glossary for the difference between AFA and RFA.

Why we conducted this review

Background

We consider that conflicted remuneration poses a material risk to our intended regulatory outcome of capable, confident and well-informed investors. Our concerns about conflicted remuneration, and the effects that it may have, align with two of the seven strategic priorities in our Annual Corporate Plan 2017-2018, namely:

- conflicted conduct
- sales and advice.

The reports published by the FMA in this area are clear that both advisers and insurers must take responsibility for conflicted conduct that results from sales incentives. Financial advisers have obligations to act with care, diligence and skill. There are, however, different obligations for Authorised Financial Advisers and Registered Financial Advisers. The Financial Services Legislation Amendment Bill (FSLAB) contains proposals to 'level the playing field'. The proposed changes that are currently before Parliament would discard the RFA model and require all advisers to meet minimum standards of conduct and competence. All insurers need to play their part to help advisers meet their duties.

At the heart of our concerns is the established distribution model for the sale of insurance policies, which includes commissions (monetary and non-monetary). Commissions that focus exclusively on sales volumes and targets rather than customer outcomes are the drivers of the poor conduct we have discovered through our regulatory activities in the insurance sector. Our view is that it is the responsibility of insurers to measure and manage the impact of incentives on advisers' behaviour and consumer outcomes.

Additionally, this review is one of the actions we are taking to respond to a recommendation made by the International Monetary Fund (IMF) in their Financial Sector Stability Assessment in 2017. The IMF recommended refinement of FMA's supervision by enhancing insurance intermediary and insurance conduct regulation and supervision.

Our review of the life insurance industry in 2016 showed that overseas trips appear to be effective sales incentives for advisers. Insurance policies were more likely to be replaced with another policy, if the insurer provided an overseas trip to the adviser as a sales incentive. Our report in March 2018 showed that over half of the advisers we reviewed were not meeting their obligation to exercise care, diligence and skill when providing financial advice.

Scope of the report

This report is a data-based review of the structure, design and volume of soft commissions. We asked nine life and health insurers about the soft commissions they provide to financial advisers. We examined the information they provided to explore the following themes:

- What soft commission structures are in place to incentivise financial advisers to provide advice on, and sell those products?
- Is there a correlation between soft commissions and sales performance by advisers selling life and health insurance products?
- Is there a correlation between sales performance and the independent ratings assigned to life and health products, and how does this relationship intersect with the soft commissions provided on those products?

Our overall focus was on the incentive practices in the life and health insurance industry. We analysed the types of soft commissions provided by insurers and how much was spent on each to understand how they impact adviser behaviour. We have considered if there have been any changes in the behaviour of advisers or insurers since our 2016 review.

There are limitations in our remit over the conduct of insurers, which meant we were unable to measure the full impact of the soft commissions on consumer outcomes. Insurers are prudentially licensed by the Reserve Bank of New Zealand. The FMA's role in the regulation of insurers relates specifically to provision of advice on insurance products. We also enforce fair dealing laws as they apply to insurers.

The FSLAB is currently in select committee process. When finalised, this Bill will introduce consistent standards for conduct, competence and disclosure for all financial advisers.

MBIE recently announced the terms of reference for a review of insurance contracts law. This will include a review of the gaps in the regulation of insurance providers' conduct.

Risks to consumers

All advisers need to balance making a sale that may lead to them receiving a soft commission from an insurer, with their obligation to exercise care, diligence and skill when providing financial advice. Authorised Financial Advisers (AFAs) also have an obligation[5] to place the interests of their customers first. Some of the potential risks of advisers not exercising care, diligence and skill, and failing to place the interests of their customers first are:

- recommending a product or value of insurance cover that is not suited to customer needs
- failing to properly analyse customer needs and instead focus on selecting products that provide a soft commission
- failing to exercise due care when dealing with vulnerable customers
- recommending that a customer replaces their policy with another policy so that the chance of the adviser receiving a soft commission increases.

When insurers encourage advisers to sell their products it must not be to the detriment of the customer. Even though we do not license insurers, we expect them to demonstrate conduct that puts customers' interests first. This is important to help customers get insurance cover that meets their needs. It can also help increase customer confidence in the insurance industry and supports fair, efficient and transparent financial markets.

Potential harms from conflicted advice:

- A customer may be over-insured or under-insured.
- A customer may have a policy with less favourable terms such as exclusions or increased premiums (where a policy is being replaced), or with features that do not meet their needs. This may affect the customer's ability to claim on the policy at a later date.
- Consumers overall may pay higher premiums due to insurers paying soft commissions to advisers.

5: Code of Professional Conduct for Authorised Financial Advisers, Code Standard 1

What we reviewed

Insurers

The focus of this review is the life and health insurance industries in New Zealand. In October 2017 we obtained data from nine major insurers who provide life and/or health insurance. We excluded life and health insurers who do not distribute their products through advisers, such as those who only sell directly to consumers through their own branches, phone service or website. We also excluded small insurers and those who only provide insurance to people in particular occupations.

The data was obtained under section 25 of the Financial Markets Authority Act 2011, which means that insurers are legally obliged to provide the information to the FMA. The data obtained covered the period April 2015 to March 2017.

Company	Life insurer	Health insurer
AIA	✓	✓
Asteron Life	✓	
AMP	✓	
Fidelity Life	✓	
nib nz		✓
OnePath	✓	✓[6]
Partners Life	✓	✓
Southern Cross		✓
Sovereign	✓	✓

6: OnePath sold its health insurance book of policies to nib nz on 1 December 2015. Therefore, OnePath was a life insurer for all months of the 24 month review period and was a health insurer for only the first eight months of the review period.

Commissions

Insurers usually pay a monetary commission to advisers, when consumers buy life or health insurance through an adviser. Different insurers calculate the monetary commission paid to advisers in different ways. Each insurer may set different criteria that advisers need to meet in order to receive the commission.

Some monetary commissions are paid when the initial sale is made (known as "upfront" commission). Others are paid each year a policy remains in force (known as "trail" commission). These commissions are the main way that advisers are remunerated for selling insurance policies. The data collected for this review did not relate to the monetary commissions paid to advisers.

Soft commissions are additional benefits provided to advisers to encourage them to sell the insurer's product. Examples of these commissions are gifts, prizes, trips, professional development (such as training or software), events (including conferences), sponsorships, payment of membership fees and adviser loans. These commissions are the subject of this review. Three instances of soft commission provided by different insurers are summarised below to illustrate how these operate.

Example	What the soft commission involved	Qualifying criteria that the adviser was required to meet
Example 1 – conference	An educational and industry development forum for 30 advisers.	Attendance was by invitation only. Invites were issued to advisers who had a strong relationship with the insurer, or where the insurer wanted to build a stronger relationship. Advisers were not required to sell a particular value or number of products to receive an invitation.
Example 2 – prize	Competition where advisers could enter a draw to win a new BMW car.	Advisers who met certain criteria were invited to enter the competition. Advisers received multiple entries into the draw based on the value of policies they sold during the promotional period.
Example 3 – sponsorship	An adviser requested sponsorship from the insurer for a golf tournament being run by the adviser, in return for promoting the insurer's business at the tournament.	The adviser was asked to submit an application for sponsorship, describing the expected benefits to the insurer and to the adviser.

Products

We asked the insurers to provide information about their life and health insurance products, such as the types of products sold, and the sales income received for the products. We also asked if the products were independently rated.

Different insurers use different terms to refer to the cover they provide, such as policies, benefits or cover. We refer to these collectively as 'products'.

Some common examples of life and health insurance products are:

- **Life** – life insurance, death cover
- **Income protection** – disability income, mortgage repayment insurance
- **Trauma** – critical illness, crisis cover, serious condition cover, serious trauma
- **TPD** – total and permanent disability, total and permanent disablement
- **Health** – medical cover, surgical cover.

Advisers

There are different types of financial advisers in New Zealand, such as authorised financial advisers (AFAs), registered financial advisers (RFAs) and QFE advisers. We asked the insurers to provide us with data about the soft commissions they provided to advisers who are not their employees. Incentives provided by insurers to their employees are outside the scope of this review.

In some cases, insurers provide the soft commissions directly to adviser businesses and groups, who in turn employ a number of individual advisers. We included these soft commissions to businesses and groups in our review, collectively referring to them as advisers.

What we found

Overview

In this section, we outline what we learned about the soft commission structures in place for life and health insurance products to incentivise financial advisers to provide advice on, and sell these products.

We analysed 242 instances of soft commissions provided to advisers by the nine insurers in our review, over the period April 2015 to March 2017. We asked the insurers to provide data on six different types of soft commission[7]. A description of the 242 instances of soft commissions, split into six types, and the number and spend on each type is below.

Trips

- Domestic and international trips for advisers
- Some trips contained an educational component
- 29 trips (5 domestic and 24 international) provided by nine insurers

$18m

Professional development

- Included training, software subsidies, and a range of other business support provided to advisers
- 39 professional development soft commissions provided by seven insurers

$5.5m

Events

- Included workshops, dinners, conferences and corporate entertaining
- 41 events provided by seven insurers

$3.8m

7: Some insurers included soft commissions in a different way than we were expecting. For example, some insurers included professional development soft commissions in the “other” soft commission type. We did not move these soft commissions between types because:
• some of the soft commissions were part of a package or programme of soft commissions that could not easily be separated into the types we specified; or
• the soft commissions could be considered to be in either type.

Other soft commissions

- Included payment of advisers' professional association membership fees, contributions to advisers' superannuation plans, subsidised or discounted insurance and business loans
- 21 other soft commissions provided by four insurers

$3.5m

Sponsorship

- Included marketing and business development grants provided to advisers, for example for adviser events such as golf tournaments and conferences
- 72 sponsorships provided by seven insurers

$1.7m

Gifts, rewards and prizes

- Included gift vouchers, Christmas gifts, prizes for sales-based competitions and other small gifts
- 40 gifts, rewards and prizes campaigns by eight insurers

$1.6m

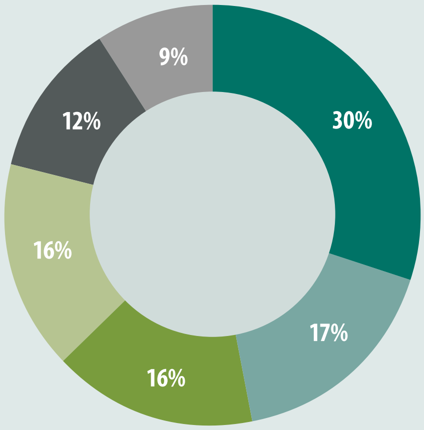
Total spend on soft commissions **$34m**

Insurers' revenue from new product sales[8] **$377m**

8: Insurers earned $377 million in revenue for new product sales, meaning that 9% of the revenue was shared with advisers in the form of soft commissions. This is in addition to the monetary commissions paid to advisers by the insurers.

Types of soft commissions

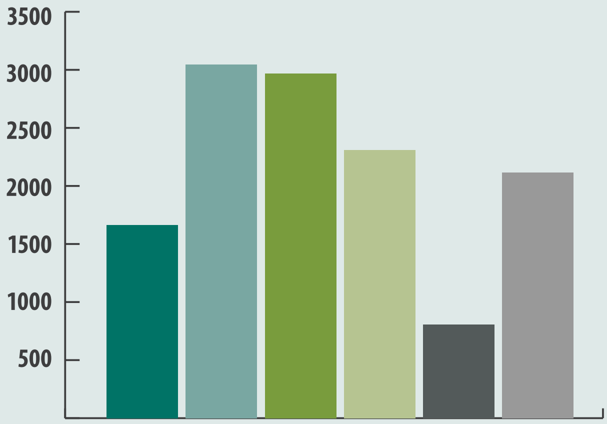
Percentage of the number of each type of soft commission



During the review period:

- Trips comprised 12% of all soft commissions provided, and were the only type of soft commission provided by all nine insurers.
- 42% of soft commissions required the adviser to sell a particular number or value of the insurer's products.
- Sponsorship (30%) was the most frequently provided soft commission.
- Three of the insurers provided all six types of soft commissions to advisers. Other insurers provided a smaller range of soft commissions. One insurer provided only two types: trips, and gifts, rewards and prizes.

Number of advisers receiving each type of soft commission



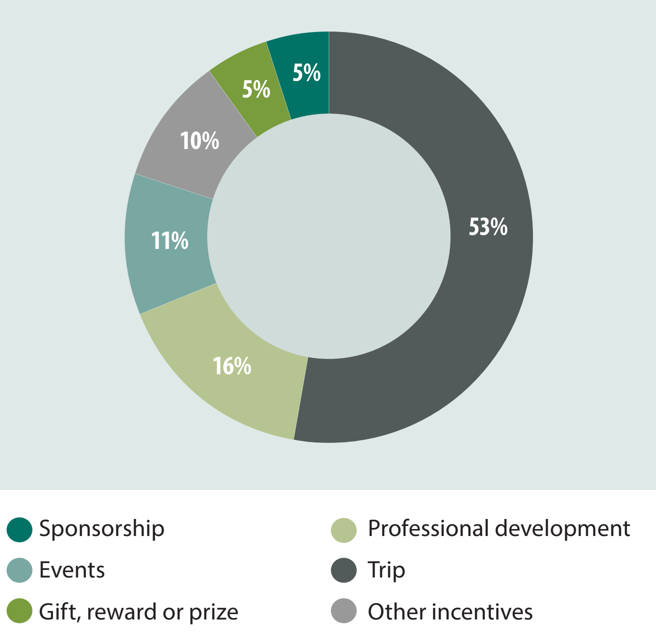
We looked at how many advisers received each type of soft commission. Advisers may receive numerous different soft commissions from one or more insurers during the year, and may be eligible to receive more than one trip in a year. This chart shows how many individual advisers received each type of soft commission directly from insurers[9]. Findings of note are:

- Around 3,000 advisers received events and a similar number received gifts, rewards and prizes from insurers.
- Only 800 advisers received trips as a soft commission, despite trips comprising over 50% of the total spending by insurers on soft commissions.

9: Where the soft commissions were provided to adviser businesses and groups, rather than individual advisers, we did not receive data on how many individual advisers benefited. For example, one insurer provided a software subsidy to adviser business groups, but we do not know how many advisers in those groups benefited.

Cost of soft commissions

Percentage of cost by type of soft commission



During the review period:

- The total cost of soft commissions was $34 million.
- Insurers' spend on soft commissions varied greatly. One insurer spent $209,000 whilst another spent $12 million on soft commissions (over one third of the total spend for all insurers).
- Over 50% of the total cost of commissions related to trips, despite trips accounting for only 12% of the number of soft commissions.
- The second highest spend on soft commissions was on professional development, accounting for $5.5 million (16%) of the total spend.
- Although sponsorship was the most frequently provided soft commission, it only comprised 5% of the overall cost.
- Insurers earned $377 million in revenue for new product sales, meaning that 9% of the revenue was shared with advisers in the form of soft commissions. This is in addition to the monetary commissions paid to advisers by the insurers.

In-depth reviews

We have taken an in-depth look at the two types of soft commissions that have the highest spend by insurers: trips and professional development.

Trips

During the review period:

- Insurers' spend on trips varied greatly. One insurer spent $6 million on three trips (over one third of the total spend on trips for insurers), while another spent $79,000 on two trips.
- The average value of each trip provided was $623,000, or $22,000 per adviser.
- The qualifying criteria are typically set to ensure that the trip is a reward for the insurer's most successful advisers, as measured by sales.

Despite only 29 out of the 242 instances of soft commissions relating to trips (12%), they accounted for more than half of the total spend over our review period.

The number of advisers attending each trip is small – usually less than 50. In most cases, the adviser's partner is invited to attend. Our understanding is that members of the insurer's management team also attend to host the trip.

The insurers provided a mix of domestic and international trips. Destinations offered during the review period included Taupo, Bay of Islands, Queenstown, Tahiti, China, Britain, Argentina, Japan, United States of America, Singapore, Australia and Fiji.

Some examples of the trips provided are shown below:

Destination	Details of the trip	Cost to the insurer[10]
Queenstown, New Zealand	Four-day trip to Queenstown for 12 advisers. Included all flights, accommodation, meals and activities (heli-skiing, wine tour, motorsport driving experience).	Total cost of the trip was $103,000, or $8,600 per adviser.
Sunshine Coast, Australia	Trip to the Sunshine Coast for 29 advisers. Included all flights, accommodation, meals and sightseeing activities. Also included an educational component with business seminars and networking sessions.	Total cost of the trip was $478,000, or $16,500 per adviser.
London, United Kingdom	Trip to London for 20 advisers. Included all flights, accommodation, meals and sightseeing activities. Also included an educational component with professional development activities.	Total cost of the trip was $1.9 million, or $95,000 per adviser.

10: Includes all costs associated with the trip including costs of the insurer's management attending, and any fringe benefit tax paid.

In all instances, advisers were required to meet qualifying criteria set by the insurer to be able to attend the trip. This criteria included:

- selling a particular number or value of the insurer's products over a set time period (usually 6 or 12 months)
- minimising the number of existing customers' policies that are cancelled or replaced with other insurers' policies during the trip qualification period[11]
- meeting other criteria set by the insurer, such as not having any customer complaints or being in dispute with the insurer during the qualification period.

The trips are intended to both incentivise advisers to sell the insurers' products and to reward advisers for their success. This focus on sales volumes and targets rather than good customer outcomes increases the potential for conflicted conduct.

Comparison of findings with FMA's 2016 review

The data we collected supports our 2016 review, which found overseas trips appear to be effective sales incentives for advisers. We also compared the data to see if insurers made changes to the soft commissions they provide over time. The data showed that the number of trips offered by insurers was in line with the 2016 review. However, two insurers told us they are no longer providing some of the types of soft commission that they provided during the review period.

For example:

One insurer ceased offering overseas trips that required advisers to sell a particular number or value of the insurer's products to qualify for the trip. As a result, their sales dropped by about one-third in the year after they stopped offering overseas trips to advisers. However, they will not return to offering overseas trips as they feel that this type of soft commission is no longer aligned with their goals of protecting, and acting in, their customers' best interests. This suggests that soft commissions definitely have an impact on adviser behaviour, and that in some instances advisers are acting in their own interests, rather than their customer's interests.

Overall concerns

We remain concerned about the potential conflict of interest posed by soft commissions (in particular, overseas trips), and the potential impact on customer outcomes if these conflicts are not appropriately managed or eliminated. We encourage insurers to consider the number and nature of soft commissions that they provide to advisers, to ensure that where they provide these incentives, risks to customers from conflicted conduct are minimised.

11: Typically insurers allow no more than 15% of existing policies sold by the adviser to be cancelled or replaced during the qualification period. Insurance policies may be cancelled replaced for a variety of reasons, such as customers' needs changing or more suitable products becoming available. This condition (known as "persistency") is in place to deter advisers from cancelling or replacing policies for reasons other than customer needs.

Professional development

During the review period we found:

- Soft commissions relating to professional development accounted for 16% of the number and value of the total.
- The value of spend on professional development varied from $24,000 to $4.6 million.
- Each insurer who provided professional development commissions spent between 2% and 38% of their total soft commission spend on professional development.
- The majority (71%) of professional development commissions relate to training and workshops. These are often provided using internal resources, such as insurers' staff, so the direct cost to insurers is relatively low.
- $3.9m or 70% of total spending in this area was on software, though there were only five instances of this type of soft commission.

What constitutes professional development?

Insurers classified professional development in different ways; training (including product training), software support and subsidies, conferences, workshops, phone line rental, telemarketing expertise, business support, technology support, HR support, insurance discounts or subsidies, business loans and independent audits.

In our view, not all of these soft commissions contribute to an adviser's professional development (for example, phone line rental or insurance discounts and subsidies). These soft commissions may reduce the advisers' costs of running their business but we do not consider them professional development, which relates to the acquisition of knowledge and skills.

Business support

Some insurers told us that they provide benefits, outlined above, to ensure that advisers have adequate business support and to benefit the wider insurance industry and customers. For example, some insurers provide loans to advisers who may have difficulty obtaining a bank loan when they are establishing a new adviser business and are reliant on income from commissions that take time to earn. Some insurers provide a subsidy to advisers for specialist software used to record customer interactions. This may help advisers to meet their record keeping obligations.

Some of the soft commissions relating to professional development may lead to improved outcomes for customers through the advisers having increased knowledge and support. For example, one insurer told us they will pay for an independent audit of an adviser's business where the adviser may benefit from additional guidance to support compliance with the law and improvement to their business practices.

Potential conflict

Some insurers require advisers to place a certain amount of their new insurance sales with the insurer to receive these benefits. For example, one insurer required advisers to agree to place at least 85% of their new sales with the insurer in order to receive a package of professional development soft commissions.

We are concerned at the conflict that this presents for advisers. When advisers receive this type of support from a single insurer, they are likely to be incentivised to place a large portion of their business with that insurer, instead of focusing on their customers' needs. This is particularly the case if the adviser has not made it clear to their customers that they are incentivised in this way.

We expect insurers to consider how they design this type of soft commission. If insurers wish to assist advisers with professional development, they need to ensure that the adviser receives the right incentives to also focus on achieving good outcomes for their customers.

How advisers respond to soft commissions

Soft commissions and sales

We collected data from the insurers about their sales of new products during the review period. We then analysed the data to determine if advisers sell more of a particular insurer's products during a period when soft commissions were on offer.

During the review period we found:

- A higher value of soft commissions is related to higher sales income for insurers.
- Increased spending by insurers on soft commissions appears to correspond with increased sales, but only by a small amount.
- The qualification date for trips appears to correspond with a peak in sales.

Our analysis showed a relationship between the value of sales and the value of soft commissions. In looking at this relationship, we only considered the soft commissions that required advisers to sell a certain value or number of products in order to receive the soft commission.

We looked at the value of new product sales each month compared to the spending on soft commissions by insurers. The insurer's spending on soft commissions typically occurs at the time the soft commission is provided, rather than being spread across months. For example, an adviser's sales in each month for a whole year may contribute towards their qualification for a trip, but the cost of the trip to the insurer is incurred in a single month.

Our statistical analysis showed that, in general, a higher value of soft commissions corresponds to higher sales income. However, sales income also depends on the insurer and the month of the year, which is to be expected given the large differences in sales volumes between insurers and at different times of the year.

We saw some deviations from this relationship in our statistical analysis. For example, one insurer had 17% higher sales income in the period than another insurer, despite spending 50% less on soft commissions that required a certain value or number of sales.

Where insurers spent money on soft commissions, they could expect the value of sales to increase by between 1% and 8% of the value of the soft commission spend[12]. This means that the expenditure by insurers on soft commissions is not having a large impact on sales. For example, if an insurer spent $100 on a soft commission, in general, sales would increase by an amount between $1 and $8.

Other reasons for soft commissions

Soft commissions do not appear to provide a substantial financial benefit to insurers, which suggests that there are other, non-financial reasons why insurers provide soft commissions to advisers. A study of these potential reasons for offering soft commissions to advisers is outside the scope of this review. However, the information we collected suggests insurers wishing to generate loyalty among advisors may be a reason. Advisers may be incentivised to place all, or a majority, of their new policies with a particular insurer – not due to a particular soft commission being offered at a point in time, but because of the wide range of benefits that can be obtained over the long term.

Based on the information we analysed, advisers seem to be the main beneficiaries of the soft commissions provided by insurers. It is difficult to discern any direct benefit to consumers (although some insurers have cited indirect benefits from professional development or other forms of support). This confirms the conflict of interest risk that we set out to examine because advisers receive personal benefits by selling particular insurance products to their customers.

Another reason that insurers may continue to provide soft commissions, despite their small impact on sales, is that failing to provide soft commissions may adversely impact sales and market share. In other words, while the soft commissions don't materially increase sales, not providing soft commissions may materially decrease sales.

For example:

One insurer told us that when providing trips as a soft commission, they have "little option but to compete with the market offerings." By failing to provide trips as a soft commission, this insurer believed they would be providing advisers with a reason not to do business with them, and would lose out to their competitors.

12: With 95% confidence and with all other variables held constant.

We are concerned that a heavy focus by insurers on market share and adviser relationships may come at the expense of good customer outcomes.

Sales trends and timing of trips

We also analysed how adviser sales respond when the end of the qualification period for a trip is imminent. The data showed that the end of the qualifying period appears to correspond with a peak in sales.

This is consistent with the finding in our 2016 review of life insurance, which showed that overseas trips appear to be an effective sales incentive for advisers. An example of this finding is in the graph below, which shows that sales peak in March when the qualification period for the trip ends.

Exercising care, diligence and skill

All advisers are required, under the relevant legislation, to exercise care, diligence and skill when providing financial advice. AFAs are also required[13] to provide disclosure to their customers regarding remuneration, which includes telling customers about any soft commissions that they may receive from insurers. However, the majority of life and health insurance products are not sold by AFAs. Other adviser types are not expressly required under current legislation to provide disclosure to their customers regarding any soft commissions that they may receive from insurers.

When consumers are receiving financial advice about insurance, we encourage them to ask their adviser how the adviser is being remunerated by the insurer. This may include asking the adviser about what soft, or non-monetary, commissions, the adviser will receive if the consumer acts on the adviser's recommendations.

We also expect insurers to take responsibility for their part in adding to the conflicts of interest faced by advisers. This includes being able to explain why they believe their approach to soft commissions is aligned to good customer outcomes.

Example of sales trends and timing of qualification for trip

13: Financial Advisers (Disclosure) Regulations 2010, Schedule 1, and Code of Professional Conduct for Authorised Financial Advisers, Code Standard 7

Soft commissions, product ratings and sales

We also collected data from the insurers about the independent ratings of their products during the review period. Some financial advisers use independent research companies to help them understand insurance policies and rate their features[14].

We analysed the data to determine if:

- advisers sell more of high or low rated products; and
- soft commissions have any impact on sales of high or low rated products.

During the review period we found:

- 42% of products had an independent product rating.
- 81% of sales related to products that had an independent rating.
- Where products had a rating, sales of products with a higher rating were greater than sales of products with a lower rating.
- There was no evidence that soft commissions affect the sales of higher- or lower-rated products.

Insurers provided us with data about any independent ratings assigned to their products during the review period. Three different rating companies provided these ratings. Each company uses a different rating scale, such as a score out of five, a ranking, a percentage or a grade. In order to compare the products of different insurers, we grouped the ratings into three categories (high, medium and low).

We found that of the 125 rated products, 43% were rated high, 40% medium, and 17% low. Sales of highly rated products made up 75% of sales of rated products during the period.

We did not form a view on the accuracy of the product ratings or whether it is beneficial for insurers to have a rating for their products. However, we see that there were more sales of highly rated products than products with a low rating.

It appears that advisers are taking these ratings into account when making product recommendations to their customers. However, the product recommended to a customer must still be suitable for their individual needs. We expect advisers to analyse customer needs and consider a range of factors – which may include product ratings – when providing advice about products to their customers.

Impact of soft commissions on sales of rated products

We also looked at the impact of soft commissions on sales of rated products. We were interested to understand if advisers would recommend a product to a customer, regardless of its rating, in order to receive a soft commission. We did not find any evidence that soft commissions affect the sales of rated products.

This suggests that advisers are recommending products with a low rating to their customers less frequently than more highly rated products, even if they could receive a soft commission from doing so. However, the fact that advisers are recommending highly rated products more frequently does not mean that the potential conflict of interest associated with soft commissions has been sufficiently minimised. We remain concerned about the potential harm to consumers from the incentives provided by soft commissions, especially where those commissions have not been disclosed to consumers.

14: Not all products sold by insurers are rated. Some of the reasons why a product may not be rated are that it is an unusual type of product or it has been created with special features to meet the needs of a particular group of customers, meaning that it is not easy to compare to other products. The scope of this review does not include providing a view on whether products should be rated, or on the quality of products that are not rated.

Future focus

We will show the findings of this review to the Ministry of Business, Innovation and Employment (MBIE) to assist in its review of insurance contracts and conduct.

We will be meeting with the insurance providers to ensure they recognise our expectations that they have obligations to manage the conflicts of interest that their incentives are creating.

We will also be publishing the results of two more reviews that examine practices in the insurance and banking industry in New Zealand. One review concerns Qualifying Financial Entity (QFE) insurance providers' replacement business, and the other relates to our review of the structure of bank incentives in the sale of financial products. This work is aligned with our Strategic Risk Outlook and our priorities to focus on the risks and harms associated with conflicted conduct across all financial services.

Glossary

Adviser	Provides financial advice to consumers. Includes AFAs, RFAs and QFE Advisers.
AFA	Authorised Financial Adviser – an individual financial adviser authorised by the FMA to provide personalised advice on most types of financial products, including insurance. Can also be authorised to provide investment planning services. They are required to abide by a code of conduct that includes a requirement to place client interests first and act with integrity.
FMA	Financial Markets Authority
FMA Act	Financial Markets Authority Act 2011
IMF	International Monetary Fund - an international organisation which works to secure financial stability, facilitate international trade and promote high employment and sustainable economic growth.
Product rating	Assessment of an insurance product by an independent research provider.
QFE	Qualifying Financial Entity – a business that takes responsibility for the financial advice provided by its employees and representatives, without those people having to register as advisers individually. QFE Advisers sell the QFE's own products and sometimes the products of other providers. They can give personalised advice on insurance. QFE advisers may or may not be employees of the QFE.
RFA	Registered Financial Adviser - an individual financial adviser who is registered on the Financial Service Providers Register but who is not authorised by the FMA and not subject to a code of conduct. Can give personalised advice on most insurance products including life and health insurance. They are not permitted to give advice on more complex products such as KiwiSaver, bonds, shares, managed funds and derivatives.
Soft commissions	Incentives or benefits provided by insurers to advisers such as gifts, prizes, trips, professional development such as training or software, events including conferences, sponsorships, payment of membership fees and adviser loans.

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