Conduct, Culture and Financial Inclusion

A speech delivered at The Westpac Massey Fin-Ed Centre - *Building Financially Capable Communities: Our Pathways To Success* Conference

On 29 November 2019, Auckland, New Zealand

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[1] My thanks to Rupert Barber for his contribution to these notes

"Laws control the lesser man... Right conduct controls the greater one."
Mark Twain

Tēnā koutou katoa

My thanks to the **Westpac Massey Fin-Ed Centre** for inviting me to speak with you this morning. It is a pleasure to be here.

I'm going to talk to you about a subject that's headlined often recently - the findings of our recent Conduct and Culture Review jointly undertaken with the Financial Markets Authority (FMA).

These lessons demonstrate the need for ongoing constructive change across the financial services sector, so that the public can have confidence and trust in the services they buy. Our message to the industry is simple: act now.

Why is conduct and culture important to the Reserve Bank? Our mandate is – amongst other things - to promote soundness and efficiency in the financial system.

Financial service providers – banks and insurers – hold significant advantage over their customers, due to their greater understanding of the products they sell. What is offered 'on the tin' may be difficult to understand, not exactly the product that is 'in the tin', or right for the customer throughout it's 'used by date'.

This is why trust, transparency, and understanding is important.

Misleading sales and poor service can have significant financial impact on the consumer, the financial services firm, and broader society. All up, serious soundness and efficiency costs can arise.

A financial firm's culture is the key driver of their conduct and more general risk management. Creating the right culture requires an ongoing conscious effort led from the top. Boards need to take ownership for ensuring the appropriate conduct and culture is embedded within an organisation, and they need to require sufficient information to provide effective oversight.

The FMA/RBNZ conduct and culture reviews found weaknesses

In our conduct and culture reports, the FMA and RBNZ concluded that there were weaknesses in the management of conduct risk in both the banking and life insurance industries.

Neither sector had sufficiently put customer outcomes at the heart of their business. Some did little or nothing to assess a product's ongoing suitability for customers, and sales incentive structures were prioritised over good customer outcomes.

Remediation of conduct issues was generally slow and reactive. There was also a poor and inconsistent approach to dealing with complaints and little thought given to identifying the needs of vulnerable customers.

For the Reserve Bank, the main takeout is the governance and system weaknesses, and the potential for these to undermine both system efficiency and the overall performance of firms.

A variety of isolated incidents of poor conduct were identified

Some of the instances of poor conduct identified included:

- Selling insurance products to customers who were ineligible for the cover or unable to claim.
- Knowingly sending out communications with misinformation.
- Only remediating customers who complain.
- Fees charged that materially outweigh the benefits to customers.
- Staff excluding relevant information about existing debts from credit applications.
- Staff manipulating customer records to prevent customers from receiving satisfaction surveys.

We also heard in the life insurance context that "some cover is better than no cover". While providers may have justified this as reasonable, we strongly disagree with this statement – particularly for certain poor value products where the cost of premiums outweigh the benefits received. Customer suitability must always be king – it's a core part of an efficient market.

Most of these examples show how a bank or an insurer can benefit financially from having better information or greater knowledge than their customers, whether intentional or not.

How many of these issues could have been averted by more financially literate customers?

Having customers front of mind in everything you do is not always enough. It is in their own interests – and duty – to share, educate and protect customers - particularly the most vulnerable.

Actions and recommendations for banks and insurers were wide ranging

Some of our thematic recommendations for banks and life insurers included:

- Greater board ownership and accountability
- Prioritising investment in systems and frameworks to strengthen processes and controls
- Proactive identification of issues and remediation.
- Strengthening staff reporting channels, including whistle-blower processes.
- Review and revise incentive structures so that they enforce good customer outcomes.
- Provide better training – particularly on "good" conduct, dealing with vulnerable customers and product suitability needs.

Mixed response to the conduct and culture reports' recommendations

Earlier this year, the banks and life insurers submitted plans to the FMA and RBNZ for review. These plans were expected to address our thematic recommendations and our entity specific findings.

All of the banks and most life insurers committed to remove sales incentives from frontline staff and their managers.

Some life insurers using external advisers told us that changing long-held business arrangements and distribution models is difficult and will take time to implement, this was despite our warning not to wait for legislation. The existing high up-front commissions do not give us the confidence that insurers and advisers will always act in the best interests of customers.

Overall, the Life insurance sector has failed to demonstrate the necessary urgency and prioritisation, around investment in systems, to provide effective governance and monitoring of conduct risk.

We were obviously disappointed with the life insurance industry's response which was generally underwhelming.

The real test will be the type of behaviour that is rewarded in the future and the how conduct and culture plans are executed. It is the responsibility of the boards and senior management to ensure they deliver good customer outcomes in the short and the long term.

We will continue to monitor their progress as part of our regular supervision.

There are more challenges and changes facing banks and insurers

Financial service providers face many challenges from increased public expectation and regulatory change. Financial service providers tell us that this is a key risk for them too, moving forward.

Customer expectations of 'good outcomes' from insurance and banking are evolving, and there is a heightened awareness across the financial sector as a whole of the importance of good business conduct.

Shifting attitudes from considering conduct and culture risk as a compliance exercise enforced by the regulators, to being an ongoing core part of the insurers' business.

The Reserve Bank believes that financial service providers must ensure that high quality risk management capability is in place, to support appropriate customer outcomes.

We support financial service providers using the best information understand their customers and their circumstances. We also respect that financial service providers are free to make their own commercial decisions. Getting your risk management, product suitability and pricing right is an important foundation to a sound financial sector.

However, the balance between individual customer risk-pricing and the benefit of insurance through diversification is challenging the industry, regulators, and consumers – in General Insurance as much as in Life Insurance.

Given the increased ability to identify risks to a specific cause, region, or individual through - increased data and technology - it is becoming easier to 'price' a specific risk or avoid providing coverage. We have heard firms talk of not insuring specific regions, building types, and individuals on a more regular basis.

The question becomes – what is the limit to this behaviour, when self-insurance is the only alternative? As a society, we must work together – with government, the insurance sector, regulators, and consumers – to ensure we have a broad coverage of insurance at transparent and reasonable pricing that can be understood by all.

Financial Education and Inclusion is important to a sound and efficient financial system

The public is demanding that both financial service providers and regulators play a part in providing greater confidence in the health and conduct of the financial sector, including financial education and inclusion.

So, what is the Reserve Bank doing?

The Reserve Bank is more actively playing its part in developing financial inclusion, which is an important part of our approach to promoting a sound and efficient financial system. A lack of financial inclusion can lead to:

- poor availability of accessible and safe financial products
- restricted access to banking and insurance services; and
- societal problems from the impact of high-cost short-term loans.

We are working with the finance sector and other stakeholders to develop a deeper understanding of the interaction between its policies and financial inclusion. The long-term aim is to ensure financial inclusion is firmly embedded in the Reserve Bank's normal business practices. Financial inclusion is a key priority for the Council of Financial Regulators (COFR) work plan, with the council including the RBNZ. FMA, NZ Treasury, MBIE, and the Commerce Commission.

We have also begun a number of projects that will help promote financial inclusion and transparency. In 2018 we launched the Bank's Financial Strength Dashboard ('dashboard'), an online tool for disclosing financial information on banks. The dashboard allows a side by-side comparison of banks on a range of key metrics, to help the public and investors judge the relative safety of banks before investing funds. Our experience indicates that the information has been well received and it is our intention to develop a similar dashboard for insurance firms.

We have also been considering the future of cash in New Zealand. We know that the use of cash for transactions is declining. If this leads to a reduction in the acceptance of cash, it could cause problems for the vulnerable people who are heavily reliant on cash. We are currently undertaking analysis to inform upcoming decisions on the appropriate future role of cash, and to assess what government intervention, if any, is needed. Final decisions will only be made after consultation with stakeholders – but cash will remain.

Another focus for the Bank is the South Pacific. Did you know that the average cost of sending remittances in the South Pacific is the highest in the world? Lowering these transaction costs has the potential to contribute greatly to the economic growth and development for Pacific nations.

For the Reserve Bank and our international counterparts, such as the Reserve Bank of Australia, this has become the biggest regulatory issue in the South Pacific and something that we are committed to help resolve. We see that tackling this issue is not only crucial for economic and social development, but also for improving financial inclusion both in the South Pacific and in New Zealand.

In addition, the Reserve Bank's Te Ao Māori strategy is beginning to shape a broader and dynamic view on the effects of financial stability on Māori businesses and households, and vice versa. There will be more to come from us on this and our other strategies and initiatives as they develop.

Conclusion

It's critical that the public can trust and have confidence in the financial institutions so central to New Zealand's economic and societal wellbeing.

Conduct and culture play a significant role in mitigating these risks and preventing those unfamiliar with financial products from having bad experiences.

Not only do firms need to improve their conduct and culture but understand that the information balance of power is in their favour.

Therefore, it is the responsibility of financial institutions to ensure that we narrow this information gap - financial education and financial inclusion must improve.

The Reserve Banks has begun its contribution to its journey, with several wakas afloat. Our challenge to financial institutions is - join us on this journey towards trust and confidence – a place where the financial system is inclusive and awash with well-educated customers.

Thank you for your time today.