MINISTRY OF BUSINESS,
INNOVATION & EMPLOYMENT
HIKINA WHAKATUTUKI

Discussion document

Regulations to support the new regime for the conduct of financial institutions

April 2021

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Submissions process

The Ministry of Business, Innovation and Employment (MBIE) seeks written submissions on the issues raised in this document by 5pm on Friday 4 June 2021.

Your submission may respond to any or all of these issues. Where possible, please include evidence to support your views, for example references to independent research, facts and figures, or relevant examples.

Please use the submission template provided at: ***http://www.mbie.govt.nz/have-your-say/conduct-of-financial-institutions-regulations/***. This will help us to collate submissions and ensure that your views are fully considered. Please also include your name and (if applicable) the name of your organisation in your submission.

Please include your contact details in the cover letter or e-mail accompanying your submission.

You can make your submission by:

- sending your submission as a Microsoft Word document to ***financialconduct@mbie.govt.nz***.
- mailing your submission to:

  Financial Markets Policy
  Commerce, Consumers and Communications
  Ministry of Business, Innovation & Employment
  PO Box 1473
  Wellington 6140
  New Zealand

Please direct any questions that you have in relation to the submissions process to ***financialconduct@mbie.govt.nz***.

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List of Abbreviations

CCCFA	Credit Contracts and Consumer Finance Act 2003
EQC	Earthquake Commission
FEC	Finance and Expenditure Committee
FMA	Financial Markets Authority
FMC Act	Financial Markets Conduct Act 2013
FSLAA	Financial Services Legislation Amendment Act 2019
FSP Act	Financial Service Providers (Registration and Dispute Resolution Act) 2008
MBIE	Ministry of Business, Innovation and Employment
NBDT	Non-Bank Deposit Taker
RBNZ	Reserve Bank of New Zealand

1 Introduction

Purpose of this discussion document and context

1. The purpose of this discussion document is to seek feedback on possible regulations to support the new regime for the conduct of financial institutions being developed under the Financial Markets (Conduct of Institutions) Amendment Bill.

2. The Ministry of Business, Innovation and Employment (MBIE) is specifically seeking feedback on a number of proposed areas of regulations, particularly relating to:

   a. requirements relating to the content of fair conduct programmes as required under sections 446G and 446M of the Bill

   b. the regulation of incentives to support the duties in sections 446N and 446O of the Bill

   c. the requirement to publish information about fair conduct programmes under section 446HA of the Bill

   d. exclusions of certain occupations from the definition of “intermediary” under section 446E of the Bill

   e. calling in contracts of insurance as financial products under Part 2 of the FMC Act.

Context and scope

3. In late 2018 and early 2019, the Financial Markets Authority (FMA) and the Reserve Bank of New Zealand (RBNZ) published two joint reviews on the conduct and culture of banks and life insurers in New Zealand. These reviews identified a number of issues with bank and life insurer conduct and gaps in how we regulate them.

4. In light of these reports, and the findings of the Australian Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, the Government consulted on potential options to improve the conduct of financial institutions in New Zealand, to ensure good outcomes for customers.

The Financial Markets (Conduct of Institutions) Amendment Bill

5. Following public consultation on options and discussion with industry bodies to inform drafting, the Government introduced new legislation regulating the conduct of financial institutions on 11 December 2019.

6. The Financial Markets (Conduct of Institutions) Amendment Bill[1] (the Bill) amends the Financial Markets Conduct Act 2013 (FMC Act) and will, amongst other things:

- require banks, insurers and non-bank deposit takers (together, financial institutions) to be licensed by the FMA in respect of their general conduct towards consumers
- require financial institutions to establish, implement, maintain, and comply with effective fair conduct programmes that are designed to ensure the institutions meet an overarching principle to treat consumers fairly
- require financial institutions and intermediaries to comply with regulations that regulate incentives.

7. The Bill contains a number of regulation-making powers to support its operation, including in relation to the content and publication of fair conduct programmes, incentives and other discrete issues.

What does this discussion document do?

8. The purpose of this document is to seek feedback on a number of areas of potential regulations to support the operation of the Bill. This feedback will inform officials' advice to the Minister of Commerce and Consumer Affairs to enable policy decisions on regulations.

9. This discussion paper contains high-level analysis of possible regulations and seeks feedback in each area. The document does not contain quantified cost-benefit analysis.

10. The document is structured in six main sections, as outlined below. We welcome your feedback in response to the specific questions or any other relevant information that you wish to provide.

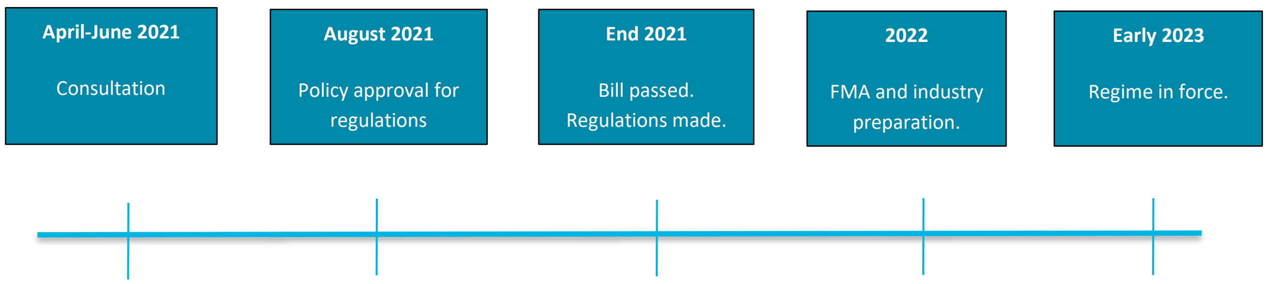
Part 1: Introduction
Part 2: Requirements for fair conduct programme
Part 3: Sales incentives
Part 4: Requirement to publish summary of fair conduct programmes
Part 5: Calling in contracts of insurance as financial products under Part 2
Part 6: Exclusions of certain occupations or activities from the definition of "intermediary"

[1] Financial Markets (Conduct of Institutions) Amendment Bill
https://legislation.govt.nz/bill/government/2019/0203/latest/LMS262880.html

Process and timeline

11. Submissions on this paper close at 5pm on 4 June 2021. Following that, officials will review the feedback and make recommendations to the Minister of Commerce and Consumer Affairs, with the view to finalising regulations before the end of 2021 or early 2022.

12. Below is a timeline for next steps in regulation-making progress and implementation of the regime. Timing is indicative online and may be subject to change.



2 Fair conduct programme requirements

Background

13. The Bill sets out an overarching fair conduct principle (section 446B) which is that a financial institution must treat consumers fairly. The requirement to treat consumers fairly includes, but is not limited to:

    a. paying due regard to consumers' interests

    b. acting ethically, transparently, and in good faith

    c. assisting consumers to make informed decisions

    d. ensuring that the relevant services and associated products that the financial institution provides are likely to meet the requirements and objectives of likely consumers

    e. not subjecting consumers to unfair pressure or tactics or undue influence.

14. Section 446C of the Bill sets out that the fair conduct principle applies when a financial institution:

    a. is designing any relevant service or any associated product

    b. offers to provide any relevant service or any associated product to a consumer

    c. provides any relevant service or any associated product to a consumer

    d. has any dealings or interactions with a consumer in connection with any relevant service or any associated product (for example, responding to a complaint or handling a claim under an insurance contract).

15. The fair conduct principle outlined in section 446B of the Bill is not an enforceable duty itself, but rather informs other fundamental duties of the regime outlined in sections 446G to 446M. Of particular relevance to this section of the discussion document are sections 446G and 446M. Section 446G provides a duty for financial institutions to establish, implement and maintain an fair conduct programme comprising effective policies, processes, systems and controls that are designed to ensure they comply with the fair conduct principle. Section 446M provides a non-exhaustive list of minimum requirements that must be included in fair conduct programmes.

16. The requirement to have a fair conduct programme is a way for financial institutions to operationalise the fair conduct principle through policies, processes, systems and controls

throughout every relevant part of their business, from the governance level to day-to-day interactions with consumers, whether those interactions are made directly or indirectly through intermediaries.

Changes to conduct programme requirements since Finance and Expenditure Committee consideration

17. The Bill as introduced into the House of Representatives on 11 December 2019 set the content of fair conduct programmes at a high level. The intention behind this approach was that the majority of the requirements for conduct programmes, including technical content and details of implementation, would be established by regulations. This approach was attractive as regulations could be altered over time as the Government, industry, and the regulator's understanding of "good conduct" developed and changed, reflecting societal values.

18. The Finance and Expenditure Committee (**FEC**), which considered the Bill, thought that the content of the fair conduct programmes would be a key component of the regime and therefore concluded the nature of these programmes should be set out in primary legislation.

19. The Bill was reported back with additional detail of what fair conduct programmes must include. For example, specific requirements have been inserted into section 446M relating to:

    a. Designing and managing the provision of products and services (including regularly reviewing and making improvements to those products and services)

    b. Identifying, monitoring, and managing conduct risks

    c. Remediating conduct issues

    d. Managing or supervising employees, agents and intermediaries.

20. The requirements inserted at select committee are consistent with the matters that were previously only listed in the regulation-making power (see clause 16(2), section 546(1)(oa) of the Bill). The requirements inserted also reflect findings of the FMA-RBNZ conduct and culture reviews in the banking and life insurance sectors.

Purpose of this section

21. We consider the amendments to section 446M in the Bill provide further certainty to financial institutions of what, at a minimum, conduct programmes must include. At the same time, flexibility has been maintained through the regulation-making power of section 546(1)(oa).

22. The regulation-making power in clause 16(2), section 546(1)(oa) allows regulations to be made that prescribe additional, or more detailed requirements for fair conduct programmes.

23. It may be necessary or desirable to have regulations to support the requirements in amended section 446M. Therefore, the purpose of this part of the discussion document is to seek feedback on whether regulations are necessary to add additional requirements, or provide further detail to support the current requirements in section 446M.

Objectives and criteria

24. The overall objective of the Bill is to improve the conduct of certain financial institutions in respect of services and products provided to consumers, and to ensure the fair treatment of consumers.

25. To achieve the high level objectives above, the following criteria apply in considering whether regulations should be made as they relate to minimum conduct programme requirements:

- Regulations are **consistent with the fair conduct principle.**
- Regulations provide further **certainty** about the nature of the obligations for financial institutions in developing their fair programme conduct programmes.
- Regulations are **necessary** to support the objectives of sections 446G and 446M.

26. We note that the new regulatory regime governing the conduct of financial institutions is principles-based and not a rules-based regime which focuses on prescribing how outcomes must be achieved.

27. The intention of the Bill is to drive positive industry behaviour change with respect to the treatment of consumers. The new conduct regime needs to be flexible to achieve the desired outcomes (i.e. consumers are treated fairly) since the regime will encompass a broad range of regulated entities and the diverse range of products and services offered by those entities.

28. A rules-based regime generally does not encourage innovation in the industry, due to the prescription of rules, or provide flexibility to the regulator in its regulatory responses. It can prevent innovation and the development of industry-led best practice.

29. However, principles-based regulation can also provide a lack of certainty for regulated entities. Certainty means that there is a shared understanding between those applying the rule as to its meaning and application in particular instances. If there is uncertainty of what the rules mean, or how they apply, there may also be a lack of predictability of what the regulatory response may be for regulated entities i.e. that the regulator will respond in similar ways, in similar situations. It may also allow for a reduced level of customer protections if firms narrowly interpret their obligations.

30. It is our intention to find the right balance between a principles-based and rules-based conduct regime, so the objectives of the regime can be achieved — that there is positive culture shift within financial institutions that improves conduct for the benefit of consumers. In general, this means that we will use prescription where certainty is required to achieve the desired outcome, but a broader principles-based approach, with supporting regulatory guidance, where flexibility is required. This is why in some areas we think regulations are necessary, and in others they are not.

Counterfactual (no regulations)

31. The status quo would involve not making any further regulations under section 546(1)(oa) to support the minimum fair conduct programme requirements outlined in sections 446M(1)(a) to (e).

32. We expect that passing the Bill (without any further regulations for fair conduct programmes) would have a material positive impact on improving the conduct of financial institutions in respect of services and products provided to consumers and therefore ensuring the fair treatment of consumers. The Bill fills a regulatory gap that was identified in the FMA-RBNZ conduct and culture reviews in that there is currently no explicit legislative mandate for the regulation of the general conduct of financial institutions.

33. As discussed above, the changes to section 446M at select committee include further high-level categories of requirements which we consider added further clarity and certainty of what an effective conduct programme would look like.

34. Financial institutions would develop fair conduct programmes consistent with section 446M. As section 446M outlines a non-exhaustive list of minimum requirements, financial institutions would also have to consider what other policies, processes, systems and controls not included in section 446M would be necessary for the financial institution to meet the fair conduct principle.

35. Financial institutions, in developing their fair conduct programmes, would also need to take into account the list of factors in section 446M(1A). This section requires financial institutions to take into account the individual circumstances of their own services, products and operations when considering what an "effective" conduct programme is in the context of their business. This may mean, for example, that less complex financial institutions (e.g. those with fewer lines of products or services and smaller target consumer markets) would develop less complex fair conduct programmes, and vice versa for larger, more complex institutions.

36. However, we note there are areas where minimum requirements of section 446M may still be uncertain. This may result in difficulty in operationalising the requirements across financial institutions with respect to policies, processes, systems, and controls necessary to comply with the fair conduct principle.

37. For example, the Bill introduces a requirement in section 446M(1)(ab) that fair conduct programmes must include effective policies, processes, systems and control for designing and managing the provision of a financial institutions products and services. However, the rest of the Bill does not provide any further detail on how financial institutions apply the fair conduct principle when designing and managing the provision a financial product or service. This may result in large variabilities between financial institutions on how their conduct programmes cover this requirement.

38. However, this would not necessarily be a problem as conduct programmes should be 'right-sized' to fit the financial institution's size, product and customer mix, culture and strategy, reflecting the conduct risks that may arise. It may be problematic if financial institutions take a compliance approach to their conduct and culture or narrowly interpret their obligations,

which may result in lower levels of consumer protection and continued poor consumer outcomes.

39. The conduct of financial institutions will be a new and complex regulatory regime for both the financial services sector and the FMA. The FMA will likely develop guidance over time to communicate expectations and highlight best practice in relation to the outcomes relating to specific provisions of the Bill and that there would be frequent dialogue between regulated parties and the FMA as the regime beds in.

1	Do you have any comments on the status quo i.e. no further regulations to support the minimum requirements for fair conduct programmes in the Bill?

Fair conduct programme requirements – discussion and options

Overlap with existing regulations

40. The Bill creates overlaps with a number of existing pieces of consumer protection legislation. This reflects the requirement contained in section 446M(1)(a) which provides:

> *The fair conduct programme must be in writing and include effective policies, processes, systems, and controls for— enabling the financial institution to meet all of its legal obligations to consumers, including under this Act, the Fair Trading Act 1986, the Credit Contracts and Consumer Finance Act 2003, the Consumer Guarantees Act 1993, and the Financial Service Providers (Registration and Dispute Resolution) Act 2008;*

41. This provision addresses the fact that there are overlapping regulatory regimes. It also reflects the intention of the new conduct regime to 'overlay' other existing consumer protection legislation with new "systems and controls" obligations. It therefore contemplates a financial institution's existing policies and procedures for meeting their obligations under other regimes such as the CCCFA, which would sit within their fair conduct programmes (and therefore be consistent with the fair conduct principle). For instance, financial institutions could draw on compliance work in relation to financial advice or consumer credit contracts in order to meet some of the new requirements. In this way, overlap could be managed.

42. The FEC has also inserted a statutory review clause in the bill. This could be used to address any unforeseen issues that might arise from interactions with other regimes.

43. We do not consider that further regulations are needed to support the intention of this clause of the Bill at this stage.

2	Do you have any comments on MBIE's position that no regulations are needed at this time to support section 446M(1)(a)?

Design and management of relevant services and products

44. Section 446M(1)(ab) sets out minimum requirements in fair conduct programmes for financial institutions to consider when designing and managing the initial distribution and ongoing servicing of financial services and products to consumers. The obligation, specifically is:

> *the fair conduct programme must be in writing and include effective policies, processes, systems and controls for - …..designing, and managing the provision of, the financial institution's relevant services and associated products, including regularly reviewing—*
>
> *i. the relevant services or associated products that are provided to consumers on an ongoing basis to determine whether they are likely to continue to meet the requirements and objectives of those consumers (when viewed as a group); and*
>
> *ii. whether enhancements or improvements in the financial institution's relevant services or associated products should be made available to those consumers (when viewed as a group);*

45. This provision reflects the findings of the FMA-RBNZ conduct and culture reviews that there was variability in the processes of how financial institutions design and manage the distribution of financial products and services. The FMA-RBNZ conduct and culture life insurance sector review found that insurers were not adequately assessing product suitability throughout the product lifecycle, and for insurance products sold without advice, there were inadequate systems and controls to prevent or limit sales to customers who the product may not have been suitable for.

46. While some financial institutions were found to design products with customers' needs in mind, others were primarily focused on how the product benefits the bank or insurer, rather than customers. Poor design of financial products have led to poor value products or products that are not fit-for-purpose, and the complexity of some products can limit consumer understanding of what they are buying, resulting in increased conduct risk.

47. Section 446B(1)(d) states that the requirement to treat consumers fairly includes ensuring that the relevant services and associated products that the financial institution provides are likely to meet the requirements and objectives of likely consumers. This particular part of the fair conduct principle, when read in conjunction with s446M(1)(ab), makes it clear that customer interests must be considered in product design and management.

48. Section 446M(1)(ab) also makes clear that the obligation to have policies, processes, systems and controls to comply with the fair conduct principle with respect to designing and managing the provision of relevant products and services applies on an ongoing basis (including regular reviewing), rather than just at the initial product design and sale stage.

Option – Further obligations regarding distribution of products and services

49. We consider that the existing principle-based obligations in the Bill in section 446M(1)(ab) are relatively clear regarding the design of products in line with the fair conduct principle, including ongoing review of products.

50. However, we consider that the obligations regarding the “management” of the provision of products is less clear. In particular, it is less clear what is required or expected in relation to initial distribution, which is a critical interaction point for consumers where they assume risk or liability in relation to financial products or services.

51. We are therefore seeking feedback on the implications of further specifying what financial institutions must include in their fair conduct programmes when they manage the provision of financial products and services.

52. In particular, we are seeking feedback on potential requirements that financial institutions must include in their fair conduct programmes policies, processes, systems and controls for:

    a. identifying the likely consumers, and their likely requirements and objectives, for each relevant service and associated product

    b. ensuring there are processes, policies, systems and controls for management of provision of the relevant service or associated product (regardless of channel or method by which it provides those services or products) that are consistent with the identified group of likely consumers, and their likely requirements and objectives.

53. Financial institutions and their intermediaries would need to consider whether their existing distribution methods and processes (for example, agency agreements) are consistent with ensuring financial products and services are likely to be distributed to an identified group of likely consumers. This could include factors such as how the product is marketed to consumers and the sales practices that are adopted. We anticipate that a financial institution, before a product is distributed, will have some form of distribution strategy in place, which would include setting out situations in which a review may be required.

54. We note these obligations would apply to all financial institutions and all relevant services and associated products.

Pros	**Cons**
• Customers’ interests and needs would be taken into account when designing and distributing products. • Provides further clarity on what financial institutions have to do to with respect to designing and managing the provision of relevant products and services • Could reduce the problem of mis-selling leading to poor consumer outcomes. • Could help financial institutions in their training of employees, agents and	• Would possibly create additional costs for financial institutions (depending on whether they are already doing this) as they would need to dedicate resource into identifying the characteristics of the group of likely consumers, and monitoring whether products and services have reached these consumers. Costs would be higher for financial institutions with a wider

intermediaries to ensure good consumer outcomes.	range, and more complex, financial products and services. • It may not be necessary given the current requirements in the Bill are reasonably clear and specifying further requirements in regulations may reduce flexibility of the regime. • There may be consumers who fall outside the identified group of likely consumers the product is designed for but for whom the product is still suitable. Those consumers may be discouraged or prevented from buying the product. • A product or service sold to a consumer that falls within the identified group of likely consumers is not automatically an appropriate sale, and therefore is not automatically in line with the fair conduct principle. Specifying these further steps with respect to design and provision of products and services may not increase certainty.

3	Do you have any comments on the proposals regarding distribution of relevant services and associated products? We are particularly interested in how these proposals may be implemented.

Risk management

55. Section 446M(1)(ac) of the Bill is intended to be an overarching requirement to identify and manage conduct risks across a financial institution which reads:

(ac) identifying, monitoring, and managing risks associated with conduct that fails to comply with the fair conduct principle, including—

i. having clearly defined roles, responsibilities, and accountability arrangements in relation to identifying, monitoring, and managing those risks; and

ii. requiring records to be maintained that are sufficient to allow an assessment to be made of the financial institution's performance in complying with the fair conduct principle; and

iii. *requiring regular and comprehensive reporting about those risks, and about failures to comply with the fair conduct principle, to the board or other governing body of the financial institution;*

56. This requirement is principles-based in nature and therefore has been framed at a high-level. This requirement is in response to FMA-RBNZ conduct and culture findings of variability in the level of maturity in risk management, including conduct risk, within banks and life insurers.

57. At this stage we do not consider that further regulations are needed to support this requirement.

4	Do you have any comments on MBIE's position that no regulations are needed at this time to support section 446M(1)(ac)??

Management and supervision of employees, agents and intermediaries

58. As previously noted, the FEC inserted into the Bill detailed requirements regarding managing or supervising employees, agents and intermediaries. Sections 446M(1)(bb) to (bd) of the Bill set out a number of requirements that conduct programmes must include in relation to employees, agents and intermediaries, including:

    a. requiring employees, agents and intermediaries to follow procedures and processes that are necessary or desirable to support the financial institution's compliance with the fair conduct principle

    b. managing or supervising each of those employees, agents and intermediaries to ensure that they are supporting the financial institution's compliance with the fair conduct principle, and monitoring whether those persons are giving that support.

59. The latter requirement sets out certain specific requirements for fair conduct programmes in relation to all employees, agents and intermediaries including:

    a. obtaining reasonable assurance that each employee, agent or intermediary is competent and otherwise a fit and proper person

    b. setting conduct expectations

    c. establishing procedures or processes for dealing with misconduct

    d. monitoring whether those intermediaries are treating consumers consistently with the fair conduct principle.

60. We consider the level of detail inserted by FEC provides sufficient clarification regarding expectations for financial institutions managing and supervising employees, agents and intermediaries compliance with the fair conduct principle. For example, the detail contained in new s446M(1)(bd)(i) to (iv) sets out the matters we originally considered could be covered in regulations.

61. We do not consider there is a need for regulations regarding the management and supervision of employees, agents and intermediaries at this stage.

62. We note that a separate consultation document is currently also seeking feedback on potential amendments to the Bill (via supplementary order paper) regarding the treatment of intermediaries. The consultation paper titled *Treatment of intermediaries under the new regime for conduct of financial institutions* generally focuses on the scope of obligations that will apply to intermediaries as well as the definition of who an intermediary is – issues that are more suited to be considered in primary legislation. We acknowledge that it may not be possible to give considered feedback on possible regulations that relate to intermediaries until it is clear what the final form of the Bill will be. We therefore invite any relevant feedback on regulations relating to intermediaries, either through this consultation document, or through the other.

5	Do you have any comments on MBIE's position that no regulations are needed at this time to support section 446M(1)(bb) to (bd)?

Remediation of issues

63. Through the FMA-RBNZ reviews of banks and life insurers, the regulators identified instances of weaknesses in systems and processes resulting in impacts such as customers being charged incorrect fees or interest. Where issues were identified, they were usually a result of customer complaints (i.e. lag indicators), rather than proactive, internal monitoring processes (i.e. lead indicators). Furthermore, in some instances, banks and life insurers had not approached remediation with a sense of urgency.

64. Section 446M(1)(ad) responds to the issues identified in the conduct and culture reports which requires that financial institutions, in their conduct programmes, must have policies and processes for:

> *Identifying conduct that fails to comply with the fair conduct principle and taking reasonable steps to mitigate any actual or potential adverse effects of the failure*

65. This clause is intended to cover issue identification and subsequent remediation of conduct issues. We consider there would be benefit to inserting further certain minimum standards with respect to systems and processes regarding remediation. This may also assist in clarifying expectations of what 'reasonable steps' are in section 446M(1)(ad).

66. We are therefore seeking feedback on the option of specifying in regulations that the following must form part of conduct programmes with respect to this 'remediation requirement':

    a. Review and remediation processes must be comprehensive, efficient, timely and transparent

    b. Review and remediation must be fair, equitable and transparent taking into account consumers' interests and needs, and financial institutions must take all reasonable steps to remediate all affected consumers

c. Once conduct that fails to comply with the fair conduct principle has been identified, financial institutions should act take all reasonable steps to ensure that the misconduct ceases and that consumers are not continuing to be adversely affected

d. Review and remediation processes must be adequately resourced

e. Adequate records must be kept of review and remediation processes

f. Financial institutions must communicate with consumers about the progress and outcome of review and remediation processes in a clear, concise, timely and effective manner.

g. Financial institutions must review their remediation processes to ensure conduct risks and issues are being adequately managed.

Pros	**Cons**
• Provides further certainty to financial institutions in developing their conduct programmes on what 'reasonable steps' are with respect to remediating conduct that fails to comply with the fair conduct principle.	• It may not always be possible that compensation can be fair, equitable and transparent. For example, when customers are no longer contactable but they take all reasonable steps to do so. • May not be necessary to specify through regulations these minimum requirements for remediation because fair conduct programmes will likely cover these requirements anyway.

6	Do you have any comments on the proposal to specify further minimum requirements regarding remediation of issues? Are there any further specific remediation principles that should be specified in regulations?

Design and management of incentives

67. Section 446M(1)(be) of the Bill requires that fair conduct programmes must include effective policies, processes, systems and controls for "designing and managing incentives to mitigate or avoid the actual or potential adverse effects of incentives on interests of consumers, so far as reasonably practicable".

68. Sales incentives, particularly those that can create conflicts of interests have been a focus of the FMA-RBNZ conduct and culture reviews and the FMA's thematic review of incentive structures and soft commissions. The reviews found that some sale incentives were behind instances of poor conduct in financial institutions. The FMA-RBNZ reports found that often sales are seen as more important than good customer outcomes. The bank conduct and culture report concluded that the sales performance measures for front line staff and their

managers meant "that the risk of inappropriate sales practices occurring is high. It is therefore unsurprising that we were told by some salespeople of inappropriate sales practices taking place."

69. We note that later in this discussion document we discuss the prohibition of certain types of incentives as provided under regulation-making power section 546(2)(of). The intention for those regulations, consistent with Cabinet decisions, is to address incentives based on volume or value-based targets where we consider conflicts of interest that arise from the incentive are so problematic and cannot be managed, and therefore should be prohibited.

70. The requirement in s446M(1)(be) is a broader, overarching obligation with respect to how incentives are designed and managed generally, and apply to incentives that have not been prohibited. It requires financial institutions to carefully consider, across all levels of their organisation, whether incentives they offer comply with the fair conduct principle, and whether incentives need to managed in an appropriate way to avoid any actual or potential adverse effects on the interests of their consumers. This would apply to all incentives (as defined in section 446P), including, for example, general linear commissions and high up-front commissions.

71. We note that incentive structures within financial institutions have already began to change ahead of the Bill being enacted. For example, all banks have committed to remove sales measures for frontline staff and their managers.

72. We expect incentive structures within financial institutions to transform in light of expectations from regulators, the proposed prohibitions discussed in Part 3 of this paper, and the requirements in the Bill. The s446M(1)(be) obligation provides a legislative basis for the FMA to test financial institutions on their incentive structures, particularly those that the FMA consider problematic.

73. We do not consider there is a need for regulations regarding the design and management of incentives at this stage. As noted above, Part 3 of the discussion document discusses prohibiting specific types of incentives.

7	Do you have any comments on MBIE's position that no regulations are needed at this time to support section 446M(1)(be)?

Communication with consumers

74. Section 446M(1)(bf) of the Bill requires that fair conduct programmes must include effective policies, processes, systems and control for "*communicating with consumers about the financial institution's relevant services and associated products, including to ensure that the institution communicates with consumers in a clear, concise and effective manner*".

75. The FMA-RBNZ conduct and culture reviews identified instances of weaknesses in how financial institutions communicated with their consumers, particularly in the life insurance sector. We expect in response to this requirement that financial institutions would ensure their customer engagement strategies provide a framework for engaging with consumers to ensure the suitability of products and services, including on an ongoing-basis. We would

expect different engagement strategies for different products and services, for example where products are renewed annually (such as general insurance) compared with where products are rolled over year to year (such as life insurance).

76. We intend that this is a high-level principles-based requirement that cuts across all of a financial institution's dealings with consumers (including when product distribution is intermediated), and should be read in connection to other conduct programme requirements.

77. For example, this communications requirement when read together with section 446M(1)(ab) (design and management of provision of relevant services and associated products), introduces the concept of ongoing management of products through post-sales support and service. This is important as post-sale customer interactions that are more focused on additional sales rather than ensuring consumer satisfaction or ongoing product suitability can lead to poor consumer outcomes. In managing the provision of relevant financial products and services, financial institutions should have systems and controls that are designed for good customer outcomes, including checking in with consumers on ongoing product suitability (particular where customer circumstances have changed), informative updates about changes to products and services, and encouraging consumers to consider ongoing suitability of the product or service. The communications requirements would also apply when a financial institution is handling or settling a claim on an insurance product, or handling a complaint (reflected in section 446C(1)(d)).

78. Given the high-level intent of this requirement, we do not consider any regulations are necessary at this stage.

8	Do you have any comments on MBIE's position that no regulations are needed at this time to support section 446M(1)(bf)?

Review and maintenance of conduct programmes

79. Section 446M(1)(d) – "ensuring that there are in place methods for regularly reviewing, and systematically identifying deficiencies in, the effectiveness of the programme" – is a requirement so that there is a mechanism in place for financial institutions to review their conduct programmes and ensure that they are continuously fit for purpose.

80. This clause does not specify how regularly such a review should be done. There is a risk with specifying a trigger event for a review in that it may be seen as a compliance exercise and that the timeframe could be seen as arbitrary.

81. Fair conduct programmes are meant to be 'living documents', with a focus on effectiveness. Fair conduct programmes should change if the conduct risk profile of a financial institution changes.

82. At this stage we do not consider any further regulations regarding s446M(1)(d) are necessary. Fair conduct programmes are intended to be dynamic and the status quo puts the onus on financial institutions to have systems and processes to ensure their conduct programmes are fit for purpose on a continuous basis.

9	Do you have any comments on MBIE's position that no regulations are needed at this time to support section 446M(1)(d)?

Further possible regulations

83. In addition to the minimum requirements for fair conduct programmes outlined in section 446M of the Bill, section 546(1)(oa) provides a regulation-making power to further prescribe additional, or more detailed, requirements for fair conduct programmes relating to 1 or more of the following in connection with a relevant service or an associated product, including:

    a. governance and management of conduct and risks associated with that conduct

    b. monitoring outcomes for consumers, including whether consumers' interests are being had regard to

    c. how services and products are designed and managed

    d. dealing with consumer complaints

    e. dealing with insurance claims

    f. communicating with consumers, including particular disclosure requirements and requirements for warnings

    g. appropriate control or supervision over the involvement of intermediaries in the provision of the services and products

    h. the design and management of incentives.

84. As discussed previously, FEC inserted new minimum conduct programme requirements in section 446M that largely follow the possible areas where regulations can prescribe requirements for conduct programmes, as set out directly.

85. However, we consider there are further areas where regulations may be warranted. We discuss each of these areas in further detail below.

Consumer complaints handling

86. The FMA-RBNZ conduct and culture reviews into the life insurance and banking sectors found that processes and systems for consumer complaints were sometimes found lacking, with systems suffering from a lack of investment, or being poorly understood internally.

87. Complaints are a channel for identifying issues and risks. For example, if one particular product or service was receiving a raft of complaints this may indicate deficiencies in the product or that the products are being sold to the wrong customers. This relies on a financial institution having sound systems and processes for recording and responding to complaints, systems to identify trends in complaints, as well as internal escalation and reporting processes.

88. In section 446C(1)(d) (when the fair conduct principle applies) of the Bill, responding to a complaint is provided as an example of when the fair conduct principle applies, and hence should form part of the fair conduct programmes. However, the rest of the Bill does not any provide further detail or guidance on expectations on complaints handling.

Option – further obligations regarding handling of consumer complaints

89. Under this option, we would specify in regulations further minimum requirements with respect to policies and processes for dealing with complaints that must be included in fair conduct programmes. Financial institutions would be required to have appropriate systems and controls in place for recording and remedying complaints, and make it easy for customers to raise concerns. This means making the complaints process visible and easy to access and understand. All staff should be aware of the complaints process and be able to either deal with complaints or refer the complaint to the right person or team.

90. Specifically, this option would introduce obligations for financial institutions so that:

- Complaints must be dealt with in a fair, timely and transparent manner.
- Records must be kept of all complaints and any action taken in relation to them, including the dates on which:
    - each complaint that was received; and
    - any action that was taken in relation to that complaint.
- The progress and outcomes of complaints must be communicated with consumers in a clear, concise, timely and effective manner.
- Systems and procedures are in place to identify trends in complaints.

91. We note that in this option, the requirements to deal with complaints in a fair, timely and transparent manner and the record keeping requirements are based on the standard conditions for full financial advice provider licences.

92. We also note that all financial institutions will be a member of an approved dispute resolution scheme, as required under the Financial Service Providers (Registration and Dispute Resolution) Act 2008. Each dispute resolution scheme requires participating members to have internal complaints handling services and to publicise the availability of that service. In addition, s446HA(2)(a)(iii) of the Bill requires financial institutions to make publicly available a summary of their fair conduct programme and the summary must include sufficient detail to assist consumers to understand how to make a complaint.

93. A suitable definition of what constitutes a consumer complaint may also be necessary. A definition of a "complaint" can be found in the standard conditions for full financial advice provider licences which provides a starting point.

Pros	Cons
• Requiring a more systematic approach can result in a better understanding of the underlying causes of complaints, and for financial institutions to respond by changing systems or products/services themselves, to be more customer-focussed. • Provides further certainty to financial institutions on expectations with respect to how they handle consumer complaints. • Encourages investment in systems and processes for recording and handling complaints. This may lead to the better design and distribution of products, or better issues identification and therefore, better and more timely remediation.	• Could result in some additional costs beyond the status quo, particularly those related to IT system investments, to financial institutions that may need to adjust their complaints processes and systems to ensure compliance with these obligations. • The concepts of 'fair' and 'timely' are subjective and will often depend on individual circumstances. • May duplicate requirements under dispute resolution scheme rules as required by registration under FSP Act.

10	Do you have any comments on the proposal to specify further minimum requirements regarding consumer complaints handling?

Claims handling and settlement (insurance focus)

94. The handling and settlement of insurance claims may be the most important and meaningful interaction for consumers with their insurer. When the claims process breaks down both parties can suffer with low customer satisfaction and insurer costs going up. Submissions to the MBIE Insurance Contract Law Issues Paper highlighted the following issues that consumers have faced when pursuing an insurance claim:

    a. Claimants can experience long delays.

    b. Claimants sometimes have their claims significantly underpaid.

    c. Inadequate communication between insurers and customers.

95. There are industry-led interventions on insurance claim handling standards. The Insurance Council of New Zealand (**ICNZ**) has developed a Fair Insurance Code that sets minimum standards for ICNZ's members including with respect to claims handling. Commitments of ICNZ members under the Code include managing claims quickly, fairly and transparently and making decisions on claims within 10 business days.[2] ICNZ represents the fire and general insurance

[2] Insurance Council of New Zealand, *Fair Insurance Code 2020* (2020)

industry only, and whilst membership is voluntary, ICNZ's current members represent more than 95 percent of all fire and general insurance policies written in New Zealand. However, other types of insurance products are not covered by the Code, including life insurance and health insurance.

96. We also note that from Q2 2021, there is a new process for handling Earthquake Commission (EQC) claims under which private insurers will manage the total claim, including the EQC portion up to the statutory capped level of damage, and then any claim under their private insurance to cover additional losses up to the sum insured. This makes it especially important that private insurers are handling and settling claims in a way that meets consumers' reasonable expectations.

97. In section 446C(1)(d) (when the fair conduct principle applies) of the Bill, handling a claim under an insurance contract (claims handling) is provided as an example of when the fair conduct principle applies, and hence should form part of a financial institution's fair conduct programme. However, the rest of the Bill does not any provide further detail or guidance on expectations on claims handling or settlement. This is similar to the situation described above for handling a complaint.

Option – further obligations regarding claims handling and settlement

98. Under this option, we would specify in regulations further minimum requirements with respect to policies and processes for insurers handling and settling claims that must be included in fair conduct programmes. For consumers, the value of an insurance product lies in the ability to make a successful claim when an insured event occurs. Insurers and their representatives are expected to handle and settle an insurance claim fairly, transparently and without delay. Therefore we consider that is it important to clarify requirements on financial institutions, any employees or agents handling a claim.

99. Specifically, this option would be further specify that fair conduct programmes, with respect to claims handling, must include effective policies, processes, systems and controls for:

- Ensuring claims handling and settlement is fair, timely and transparent.
- Communicating the progress and outcomes of claims handling and settlement with consumers in a clear, concise, timely and effective manner.
- Managing employees' and agents' involvement in claims handling and settlement (including providing adequate training, communication of claims progress etc.).
- Ensuring employees' and agents' compliance with claims handling and settlement procedures.
- Ongoing monitoring of employees' and agents' compliance with claims handling and settlement procedures.

Pros	Cons
• Provides further certainty for financial institutions on what fair conduct	• May not be necessary to specify through regulations these minimum

programmes should include with respect to claims handling.	requirements for claims handling because fair conduct programmes may cover these requirements in practice anyway. • The concepts of 'fair' and 'timely' are subjective and will often depend on individual circumstances.

100. We are also seeking feedback on a possible definition of claims handling and settlement. This may provide further clarity on what activities are covered by the claims handling and settlement obligations. The exposure draft of the Australian Government Financial Sector Reform (Haynes Royal Commission Response-Protecting Consumers (2020 Measures)) Bill 2020: claims handling[3] may provide a useful starting point for a workable definition.

101. A possible definition of handling and settling an insurance claim may include the following activities:

   a. make a recommendation or state an opinion in response to an inquiry about a potential claim that could influence a decision to make an insurance claim

   b. assist another person make an insurance claim

   c. assess whether an insurer is liable under an insurance product

   d. make a decision to accept or reject all or part of an insurance claim

   e. quantify an insurer's liability under an insurance product

   f. offer to settle an insurance claim

   g. satisfy the liability of an insurer under an insurance claim.

102. This definition means that an insurer would be responsible for these activities and the above obligations would apply when these activities are carried out by the insurer, its employees or its agents. This might include:

   a. the insurer who issued the insurance product

   b. a loss assessor or loss adjustor acting on behalf of an insurer

   c. an insurance fulfilment provider who has authority to reject all or part of a claim

   d. an insurance claims management company

   e. an insurance broker who handles an insurance claim on behalf of the insurer

   f. a person who provides regulated financial advice to an insured and also handles and settles an insurance claim on behalf of the insurer.

[3] ***https://treasury.gov.au/sites/default/files/2019-11/36687_edl_fsrc_rec_4.8_insurance_claims_handling.pdf***

103. This definition would not cover claims advocates, brokers or any persons acting on behalf of the insured.

11	Do you have any comments on the proposals to specify further minimum requirements regarding claims handling and settlement?
12	Do you have any comments on the proposed definition of 'handling and settling a claim under an insurance contract' means? If so, why?

Customer vulnerability

104. Customer vulnerability is an ongoing focus in financial services regulation. Financial services are essential to enable individuals to effectively participate in society and can act as a gateway to accessing other services. For example, bank accounts are often a prerequisite to sign up for other services.

105. Much financial services legislation is underpinned by the concept of an 'average' or 'typical' consumer and what they might expect, understand or need. However, consumers in vulnerable situations ('vulnerable consumers') may be more likely to experience harm, can be impacted disproportionately from poor conduct and are less likely to make a complaint or advocate for themselves.

106. Consumer vulnerability may not always be obvious and can be difficult to identify. While financial indicators such as income or debt fluctuations can suggest vulnerability, other factors such as financial capability, disability, cultural or language barriers or other external factors could also play a role.

107. The Financial Conduct Authority (UK financial services regulator) uses the following definition of consumer vulnerability, which the FMA has referred to in their conduct and culture work:

> *"A vulnerable consumer is someone who, due to their personal circumstances, is especially susceptible to detriment, particularly when a firm is not acting with appropriate levels of care."*

108. All consumers can become vulnerable at any given time, as became clear during times of COVID-19. A consumer in vulnerable circumstances, if responded to in a way which meets their needs and treated fairly and flexibly, is more likely to be a valuable customer. However, these consumers may withdraw from the mainstream financial services market and their problems may be exacerbated if their needs are not met.

109. The FMA has seen good examples of financial institutions adapting and enhancing their vulnerable consumer practices in response to the COVID-19 pandemic. The FMA issued an information sheet in April 2020 regarding their expectations for financial service providers

regarding customer vulnerability.[4] They signalled that they expect to issue guidance on their expectations regarding consumer vulnerability practices in due course.

How the Bill addresses consumer vulnerability

110. The Bill addresses consumer vulnerability in various ways, albeit not directly. For example, we expect the following fair conduct programme requirements in section 446M to have consumer vulnerability lenses and hence a financial institution would have to have policies and processes regarding consumer vulnerability practices:

    a. The requirement in section 446M(1)(ab) to have systems and processes when designing and managing the provision of relevant services and associated products would include managing the provision of financial products to vulnerable consumers and ensuring the needs are met for these consumers, particularly on an ongoing basis.

    b. The requirement in section 446M(1)(ac) to identify, monitor and manage risks associated with conduct that fails to comply with the fair conduct principle would include specific conduct risks that arise when servicing vulnerable consumers.

    c. The requirement in section 446M(1)(bb) for employees, agents and intermediaries to receive training on relevant services and associated products they will be providing. This may include training in identifying and dealing with vulnerable consumers.

    d. The requirement in section 446M(1)(bf) to communicate with consumers in a clear, concise and effective manner would include have policies and processes to communicate with vulnerable consumers who may have different needs, for example, language barriers.

    e. Section 446M(1A)(d) requires financial institutions to have regard to the types of consumers it deals with, in developing their fair conduct programme. This would include consideration of vulnerable consumers.

111. Ultimately, we want to see financial institutions doing the right thing for vulnerable consumers and embedding this into their culture.

112. At this time we do not consider it is necessary to progress any specific regulations regarding consumer vulnerability to be included in fair conduct programmes. We consider the Bill, together with the significant initiatives in train by the FMA on consumer vulnerability (including further guidance to be issued), will mean that fair conduct programmes of financial institutions will include policies and processes for identifying and dealing with vulnerable customers.

13	Do you have any comments on the discussion regarding customer vulnerability?

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[4] FMA, *Customer vulnerability – our expectations for providers*, June 2020: ***https://www.fma.govt.nz/compliance/guidance-library/customer-vulnerability-our-expectations-for-providers/***.

Section 446M(1A) – factors financial institutions must have regard to in developing their fair conduct programme

113. Section 446M(1A) in the Bill was inserted following FEC consideration. The Bill states that:

"in considering what policies, processes, systems and controls are effective for the purposes of subsection (1), the financial institution must have regard to the following:

a. the nature, size, and complexity of its business; and

b. the relevant services and associated products it offers; and

c. the methods by which it provides relevant services and associated products to consumers; and

d. the types of consumers it deals with; and

e. the types of intermediaries that are involved in the provision of its relevant services and associated products and the nature of their involvement; and

f. any other factors that may be provided for in regulations.

114. This provision reflects different business models and operating practices that financial institutions will have, and therefore the conduct risks that may arise within any one financial institution. We expect that each financial institution's approach to developing their conduct programmes should be proportionate to its size, product and customer mix, culture and strategy. For example, we would expect that conduct programmes of a large integrated registered bank would look different to a credit union or cooperative financial institution.

Option – specifying vulnerable consumers as a factor to consider

115. Section 446M(1A)(d) requires financial institutions to have regard to the types of consumers it deals with in developing their fair conduct programme. We are also seeking feedback on whether it would be beneficial to specifically mention vulnerable consumers in the list of factors in s446M(1A), given the heightened risk of these consumers suffering poor outcomes.

14	Do you have comments regarding the option of including vulnerable consumers in section 446M(1A)?
15	Do you think any further factors should be added by regulations to the list under section 446M(1A)?
16	Do you think any other regulations that could be made under new section 546(1)(oa) are necessary or desirable? Please provide reasons for your comments.

3 Sales incentives

Background and context

116. The Government has signalled an intention to take action in relation to sales incentives following findings in the FMA and RBNZ conduct and culture reviews of banks and life insurers, FMA's thematic reviews of incentive structures, and the Australian Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry.[5] The findings are essentially that sales incentives were driving poor conduct in financial institutions. In particular, Cabinet has agreed to regulate sales incentives based on volume or value targets.[6]

117. The Bill contains the following powers in relation to incentives:

    a) A regulation-making power which allows for the prohibition or regulation of any practice, activity, or other conduct in connection with offering or giving incentives (clause 16, section 546(2)(of)).

    b) The Bill imposes duties on financial institutions and intermediaries to comply with regulations that regulate incentives.[7]

    c) A broader overarching obligation around design and management of incentives contained in new section 446M(1)(be) of the Bill. This obligation is for financial institutions to have effective policies, processes, systems and controls for designing and managing incentives to mitigate or avoid the actual or potential adverse effects of incentives on the interests of consumers, so far is reasonably practicable.

118. The purpose of this section of the discussion document is to seek feedback on potential options and approaches to aid in making the regulations under the regulation-making power.

119. We note that the purpose of these regulations is not to deal with all types of incentives that could lead to poor outcomes for consumers. The intention for the proposed regulations discussed in this section is to address the incentives that are particularly problematic (sales target based incentives). The Government considers that these types of incentives cannot be adequately managed, and therefore should be prohibited by the regulations, while the broader overarching obligation around design and management of incentives contained in new

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[5] ***https://www.fma.govt.nz/assets/Reports/Life-Insurer-Conduct-and-Culture-2019.pdf,***
https://www.fma.govt.nz/assets/Reports/Bank-Conduct-and-Culture-Review.pdf,
https://www.fma.govt.nz/assets/Reports/Conflicted-remuneration-in-the-life-and-health-insurance-industry.pdf,
https://www.fma.govt.nz/assets/Reports/181114-Bank-Incentive-Structures.pdf

[6] DEV-19-MIN-0237, 19 September 2019, ***https://www.mbie.govt.nz/dmsdocument/6930-conduct-of-financial-institutions-introduction-of-a-new-conduct-regime-minute-of-decision-proactiverelease-pdf***

[7] New sections 446N and 446O.

section 446M(1)(be) will ensure all remaining incentives are designed or managed in such a way as to mitigate or avoid the adverse effects on consumers.

120. During the select committee process, the FEC added requirements under section 546(1)(of) that must be met before the Minister can recommend regulations relating to incentives. These include, that the Minister must be satisfied that the matters to which the regulations relate are not more appropriately dealt with in an Act, and other matters the Minister must have regard to.

121. The intention of inserting these requirements for the use of the incentives regulation-making power was to respond to submitters' concerns that the power was too broad as initially drafted and would enable the Minister to ban all incentives. If all incentives were banned this would considerably affect the livelihoods of financial advisers and therefore negatively impact the availability of financial advice. This is not the intent of the Bill. If the Government had intended to totally ban all incentives, it would have been more appropriate to do this through primary legislation.

What is an incentive?

122. Clause 9, new section 446P of the Bill defines an incentive as:

> *Incentive, in relation to a relevant service or any associated product, means a commission, benefit or other incentive (whether monetary or non-monetary and whether direct or indirect) that is offered or given to a person (A) if-*
>
> i. *The commission, benefit, or other incentive is offered or given to A in connection with A (directly or indirectly) being involved in the provision of the service or the products; and*
>
> ii. *A's entitlement to the commission, benefit or other incentive, or the nature or value of the commission, benefit or other incentive, is determined or calculated in any way by reference (directly or indirectly) to the volume or value of the services or products*.

Types of sales incentives

123. This section describes some of the types is incentives commonly used by financial institutions. The way these incentives are structured can increase the conflict between the interests of consumers and the interests of the person selling or advising on financial products and services.

Monetary incentives

124. Monetary incentives are incentives that are provided in legal tender. This would include performance benefits such as variable pay programmes and merit-based pay increases. An example is where a financial institution offers a $10,000 bonus to any in-house sales or distributions staff, or any intermediary who distributes their products, if they sell thirty of a certain type of mortgage. Another example could be where a $2,000 bonus is offered to the

first salesperson to sell 20 insurance products. A third example might be where a salesperson is offered a cash bonus for increasing their own personal sales by 10 per cent compared to the previous year.

125. Some monetary incentives are structured in a way where the *rate* at which the reward is earned increases as sales increase. For example, the incentive paid to a mortgage adviser on mortgage sales may be 0.2 per cent for the $1 million worth of mortgages sold, but this “accelerates” or increases to 0.5 per cent after $1 million.

Soft incentives

126. Soft incentives are non-monetary benefits provided to salespeople or advisers to encourage them to sell a financial institution’s product. This would include soft incentives provided as performance benefits. Examples of soft incentives include gifts, prizes, trips, shares of stock options in the employer’s business, professional development (e.g. training or software), events (e.g. free tickets to conferences), sponsorships, loans, or payment of membership fees. The dollar value of these incentives can be very large, e.g. overseas trips with values in excess of $20,000.

127. Soft incentives can also create a strong incentive to sell because of their monetary equivalent value or due to the standing that comes with them e.g. salespeople or advisers want to be seen to be qualifying for an exclusive holiday because it shows others that they are successful at their job.

Incentives for referrals

128. Referrals are when frontline staff refer consumers for a further conversation in order to sell a product. An example is when a consumer visits a bank and is referred by the bank teller to have a conversation with another adviser or salesperson, for example a personal banker or mortgage adviser. The bank teller is provided an incentive for making a certain number of these referrals in a given period.

Inducements

129. An inducement is where the opportunity to earn, win or otherwise qualify for a reward is offered and the threshold or gateway for the opportunity to earn, win or otherwise qualify for the reward is calculated with reference to the volume or value of product sold. An inducement differs slightly from an incentive (or a soft incentive) in that it is not an outright reward but the opportunity to receive a reward.

130. An example might be where a financial institution offers a competition entry as a reward for reaching or exceeding the sales target, such as every five home and contents insurance packages sold gives the seller an entry in the draw to win a cruise. Another example may be where there is no specific target, but sales performance qualifies the seller for some other sort of reward e.g. the top 10 salespeople for a specific product get to into a draw to win a trip, or win a $2,000 bonus.

Problems related to sales incentives

131. Problems in relation to sales incentives have been identified in the FMA and RBNZ's conduct and culture reports, and the FMA's thematic reports into conflicted remuneration in the life and health insurance industry and bank incentive structures. The problems are broadly that:

    a) sales incentives of any kind can create a conflict between the interests of the sales person or adviser and the customer (conflicted remuneration)

    b) the inherent conflicts of interest in sales incentives are exacerbated by how incentives in the financial services industry are structured

    c) sales incentives can drive poor customer outcomes e.g. consumers being sold unsuitable products

    d) financial institutions are not adequately managing the risks associated with conflicted remuneration.

132. The following discussion provides an overview of the first three of these problems with incentives. All four are discussed in more detail in the regulatory impact statement for the Bill.[8]

133. We note that the issue of financial institutions not generally managing the risks associated with conflicted remuneration is not covered in this section of the discussion paper. This is because the requirement for financial institutions to design and manage incentives at clause 9, section 446M(1)(be) of the Bill will address the problem that financial institutions are not adequately managing the risks associated with conflicted remuneration.

Sales incentives can create a conflict between the interests of the salesperson or adviser and the customer (conflicted remuneration)

134. There is no inherent conflict between selling products and services and a customer's interests. In fact, it will often be in a customer's interest to be provided with products or services. However, any person who stands to benefit directly from the sale of a product or service when making a sale is potentially conflicted. This is especially the case if the person making the sale is expected to provide a service (such as providing financial advice) to a customer but gets paid for, or benefits from, the sale rather than the provision of the service. At the point of sale they have their own interests to consider as well as the interests of the person to whom they are selling. If those interests do not align then there is a conflict of interest. This means that any form of variable remuneration or incentive linked to sales can create a conflict of interest. These conflicts of interest increase the risk that a consumer will be sold a product and service that they do not need or that does not meet their needs.

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[8] MBIE, *Regulatory Impact Statement: Regulatory regime to govern the conduct of financial institutions*, 11 September 2019, ***https://www.mbie.govt.nz/assets/regulatory-impact-statement-regulatory-regime-to-govern-the-conduct-of-financial-institutions.pdf***

Conflicts of interest are often exacerbated by how sales incentives are structured

135. The way incentives are structured can exacerbate the conflict of interest between the salesperson or adviser receiving the incentive and their customers or clients. Common incentive structures in the financial services industry that increase conflicts of interest include sales targets based on volume or value of product. Value-based targets incentivise staff to sell or advise customers to take out larger policies than they might need, or a bigger loan than might be optimal for that consumer. Volume-based targets incentivise staff to sell more products, which may encourage staff to sell products to people they are not necessarily suited to. These incentive structures are commonly used in New Zealand's financial sector, although they differ between products and financial institutions.

136. Incentives that have a target component are especially problematic. This is because as the reward or target is approached, it creates an increasingly strong incentive to sell or recommend the particular product or service to the customer in order to receive the reward. For example, a sales person may not be eligible for any reward for the first nine sales they make, but are eligible for a reward for their tenth sale. As they approach the tenth sale their personal interest in making the sale grows stronger and this may conflict with the interest of the customer.

Conflicts of interest can lead to inappropriate sales or advice practices and poor consumer outcomes

137. These conflicts of interest can influence salespeople or advisers in their interactions with consumers and lead to inappropriate sales practices and poor consumer outcomes in the pursuit of sales. Generally, this means that salespeople and advisers could sell or recommend products or services that consumers do not want or need, or that do not meet consumers' needs or expectations. This can lead to particular harm, including:

    a. A consumer may be over-insured or under-insured.

    b. A consumer 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.

    c. Consumers overall may pay higher premiums due to insurers paying incentives to sales people and advisers.

    d. Consumers switching their investment product from one provider to another, without understanding that the fees may be higher.

    e. Consumers requesting an increase to their credit card limit could instead be encouraged to sign up for a new credit card with a higher fee, despite it not meeting their needs better than their current credit card.

138. The FMA and RBNZ reports found that sales often are seen as more important than good customer outcomes. The bank conduct and culture report concluded that the sales performance measures for front line staff and their managers meant "that the risk of

inappropriate sales practices occurring is high. It is therefore unsurprising that we were told by some salespeople of inappropriate sales practices taking place."

139. These problems, including evidence of inappropriate sales practices, are discussed in more detail in the regulatory impact statement for the Bill.

Objectives and criteria

140. The high-level outcome sought by the conduct regime generally is to improve the sales conduct of certain financial institutions and their intermediaries in respect of services and products provided to consumers, thereby reducing the risk of harm to those consumers.

141. To achieve the high level outcome above, we are seeking the following objectives for these regulations as they relate to sales incentives:

- Appropriately **reduce or manage conflicts of interest**, or potential conflicts of interest, between the interests of consumers or the interests of those who would otherwise be entitled to receive incentives
- **Reduce mis-selling** of financial products and services to consumers
- **Retain access to financial products and services** that promote good customer outcomes.

142. We will use these objectives as the criteria for analysing the options for these regulations. We consider these objectives are closely aligned with the criteria contained in the Bill for use of the regulation-making power for incentives (clause 16 section 546(5)). We will also have regard to Treasury's principles for best practice regulation.[9]

Counterfactual (no regulations)

143. We note that Cabinet has already made a decision to prohibit sales target based on value or volume. Not making any regulations would therefore be inconsistent with this previous policy decision. Given this, keeping the status quo is unlikely. However, for the purposes of this discussion paper, we have provided a counterfactual of what we expect not making regulations would look like.

144. The status quo would involve not making the regulations to support the incentives duties in sections 446O and 446N of the Bill. Regardless of the incentive regulations, there will be some other controls on incentives in the financial services industry. Financial institutions will be subject to a broad obligation as part of having an effective fair conduct programme to design

[9] ***https://treasury.govt.nz/information-and-services/regulation/regulatory-stewardship/keeping-regulation-fitpurpose/best-practice-regulation***.

and manage incentives to mitigate or avoid the actual or potential adverse effects of incentives on the interests of consumers.[10]

145. Anyone providing financial advice has a duty to prioritise clients' interests under the Financial Services Legislation Amendment Act (**FSLAA**) (which came into force March 2021). As well as this, financial advice providers will be prohibited from giving or offering incentives that are intended to encourage, or have the effect of encouraging, a nominated representative (but not a financial adviser) to engage in conduct that breaches a duty under sections 431I to 431P (for example, the duty to comply with the code of conduct or the duty to prioritise client's interests).[11] The reason that this does not apply to financial advisers is because this could have the effect of banning all incentives, which was not, and is not, the policy intent of FSLAA or the Conduct regime.

146. There is also the broader overarching obligation around design and management of incentives contained in new section 446M(1)(be) of the Bill, as discussed above. This obligation is for the financial institutions to have effective policies, processes, systems and controls for designing and managing incentives to mitigate or avoid the actual or potential adverse effects of incentives on the interests of consumers. This will go some way to solving some of the problems associated with sales incentives, however there are some incentives which we think are so risky (sales targets) that they cannot be designed or managed in such a way as to mitigate the adverse effects on consumers.

147. This is why despite the broader obligation around design and management of incentives and the other forms of controls on incentives described, we believe that making regulations prohibiting sales targets based on volume or value is necessary to lessen the potential risks that incentives create.

148. We acknowledge that banks and some insurers have made or initiated changes since the FMA-RBNZ reviews and removed some incentive structures. For example, all New Zealand banks have committed to removing sales measures for frontline staff and their managers.[12] However, progress from life insurers has been slower. Some insurers have committed to removing sales incentives for employees and their managers, however, not all insurers have committed to removing indirect sales incentives.[13]

149. Current positive moves may in some cases not be based on goodwill and willingness to promote good customer outcomes, but may be due to the threat of regulation. If regulation does not follow, industry and consumer pressure alone may not be enough to permanently change behaviour across the industry. Failure to follow with regulations may also signal that it is acceptable for financial institutions to continue offering the types of incentives that are harmful for consumers and some banks and insurers could choose to roll back these positive changes and revert back to using incentives that they had previously committed to removing.

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[10] Clause 9, section 446M(1)(be).
[11] Section 431R(4) FSLAA.
[12] ***https://www.rbnz.govt.nz/news/2019/06/banks-commit-to-removing-sales-incentives-for-frontline-staff***
[13] ***https://www.rbnz.govt.nz/news/2019/09/fma-and-rbnz-disappointed-with-insurers-response-to-conduct-and-culture-review***

17	Do you have any comments on the Status Quo (no regulations)?

Preferred option: Prohibit sales incentives based on volume or value targets

150. This option would prohibit banks, insurers, and non-bank deposit takers, and their intermediaries, from offering incentives which are linked to sales volume or value targets.

151. This option would address the harms of sales incentives discussed in the problem section above. This is because prohibiting sales incentives based on volume or value targets removes one of the types of incentives that is structured in a way that exacerbates the conflict of interest, causing a higher risk of poor outcomes for consumers.

152. This option would cover any incentive (whether monetary or non-monetary and whether direct or indirect) that is determined or calculated in any way by reference to the volume or value of relevant services or associated products, and which has any target component to it (broadly defined).

153. Examples of incentives that might be covered include:

    a. an adviser is entitled to a monetary bonus for placing $5 million worth of life insurance policies (monetary incentive, individual)

    b. an all-expenses paid holiday is offered to a salesperson or adviser for selling 30 of a specific mortgage product (soft incentive, individual)

    c. a manager of a team is entitled to a paid holiday if their team sells a certain number of life insurance policies (soft incentive, team)

    d. a salesperson is offered a cash bonus for increasing their own personal sales by ten per cent compared to the previous year (monetary incentive)

    e. people who sell 10 of a specific type of life insurance policy go in the draw to win a $2,000 bonus (monetary incentive, inducement)

    f. a $1,000 bonus is offered to an individual that refers 100 customers to an insurance adviser in a quarter (monetary incentive, referral)

    g. a mortgage broker is eligible to receive an incentive of 0.3 per cent of the value of mortgages sold in any month on the first $3 million of sales, and 0.4 per cent of the value of mortgages sold in any month above the first $3 million. Each sales value at which the rate of incentive increases is a target based on the value of the product (accelerator).

154. There is a risk that institutions may attempt to incentivise their staff or intermediaries more through other out of scope means and incentive structures. However, we note that these regulations can be adapted and updated if required and that the proposed regulations would be implemented alongside the obligation in section 446M(1)(be) of the Bill to design and

manage incentives generally. We therefore consider that the risk of avoidance is mitigated or mitigatable.

155. We imagine the regulations would prohibit the offering or giving of volume or value target based sales incentives generally, provide a non-exhaustive list of specific target based incentives or examples of the incentives that are covered by the prohibition and provide a list of incentives that are not prohibited by the regulations (explained in the section below 'incentives excluded from the regulations'), for the avoidance of doubt.

Pros	Cons
• Would address the particularly problematic types of incentives that create stronger conflicts of interest the closer to the incentive that the salesperson/adviser gets, thereby reducing these conflicts of interest and reducing risks of mis-selling of financial products and services. • Lessens the focus on sales performance, and encourages the use of alternative incentive structures that are more focused on good customer outcomes. This reduces the risk that sales are prioritised over good outcomes, and of product and services being mis-sold to consumers. • Would allow industry to continue remunerating staff and intermediaries on the basis of salary, linear incentives and non-sales based incentives, thereby sustaining the financial advice industry and retaining consumer access to financial products and services that promote good customer outcomes. • Aligns with changes already being made by individual financial institutions (to reduce the sales focus of their incentive structures) to be more proactive, consistent across the sector, and focused on good long-term customer outcomes. • Applies to both intermediaries and in-house sales and advice equally so does not create an incentive for financial institutions to shift sales channels to avoid the duty.	• Would involve moderate compliance costs due to restructuring of industry incentive structures and practices and amendment of agency agreements between financial institutions and intermediaries. If businesses struggle to meet these compliance costs, and decide instead to leave the industry, this <u>could</u> reduce access to financial products and services that promote good customer outcomes. • This may reduce overall pressure to sell through removing some types of incentives, but this option could drive pressure to sell to manifest in other less visible ways which could mean that conflicts of interests are not reduced as much as expected and risks of mis-selling of products and services remain. • Risk of institutions incentivising through other out of scope means (mitigated by 446M) which would mean that conflicts of interests are not reduced as much as expected and risks of mis-selling of products and services remain.

• A complete prohibition of volume or value based targets provides more certainty than a principles based approach.	

18	Do you have any comments on the option to prohibit sales incentives based on volume or value targets?
19	What would the likely impacts be for financial institutions, intermediaries and/or consumers of prohibiting sales incentives based on volume or value based targets?

Alternative approach: Principle-based prohibition

156. We have also considered whether there is an alternative approach to prohibit sales incentives in a principles-based way, rather than a blanket prohibition of targets. For example, we considered an approach such as prohibiting any incentive that could reasonably be expected to influence:

a. The choice, volume or value of relevant services or associated products that are offered or provided to a consumer by a financial institution, its employee, agent, or by an intermediary; or

b. The financial advice given to a consumer by a financial institution, its employee, agent, or by an intermediary.

157. This approach would provide the benefit of being broader, but more flexible than the preferred option while still addressing the harms of sales incentives discussed in the problem section above. This would allow financial institutions and intermediaries to make their own assessments around whether the incentives they offer could reasonably be expected to influence salespeople or advisers to offer, provide or advise on particular products and services. However, this may also allow too much flexibility in that it could leave wiggle-room for financial institutions and intermediaries to stretch the boundaries by explaining why their incentives would not reasonably be expected to influence salespeople or advisers.

158. There are some incentives that wouldn't be captured by the preferred option that might be captured by a more principle-based approach, such as high upfront commissions. For example, an upfront commission of 230% of a life insurance premium would be outside the scope of the preferred option as it does not contain a sales target. However, under a principle-based approach this could be covered as a commission of 230% of a life insurance premium could be reasonably expected to influence the choice or value of the product advised, offered or provided to a consumer. This could influence the sales person or adviser to encourage a consumer to take out a larger sum-insured than necessary, as that would provide the salesperson or adviser with a higher commission. It could also reasonably be expected to influence the salesperson or adviser's choice of which life insurance products to advise, offer

or provide to a consumer if other insurance policies do not provide such a high up front commission.

159. However, we are concerned that as this approach would likely cover more types of incentives than the preferred option, it could have a more drastic effect on industry remuneration. This would have a negative effect on the availability of financial advice, and therefore negatively impact consumer access to financial products and services that promote good customer outcomes. This would not be in keeping with the objectives of the regulations, or the outcomes sought for the regime more generally.

160. We are interested in submitters' feedback about a more principles-based approach and suggestions as to how such an approach could be made to work to avoid having such a negative effect on the availability of financial advice.

20	Do you have any feedback on a more principle-based approach to prohibiting some incentives?
21	How could a more principles-based approach to prohibiting some incentives be made workable?
22	If a more principles-based option was chosen, should there be some incentives specifically excluded?
23	Do you think there are any other viable options other than what has been put forward by this discussion document? Please explain in detail.
24	Are there sales incentives based on volume or value targets that should be excluded from the regulations (i.e. allowed to be offered/given)?

Incentives excluded from the regulations

161. We propose that the following types of remuneration would <u>not</u> be included within the scope of the option and alternative approach described above:

Salary-based remuneration

162. This is where a person selling financial products or services receives a salary. This would not be regulated by these regulations as they do not fall within the definition of an 'incentive' in the Bill.

163. As salaries are fixed and not linked to volume or value of products sold, we also do not see salaries as creating a building conflict of interest between the interest of the salesperson and the interests of the consumer.

Performance benefits

164. Where performance benefits such as bonuses, pay rises, promotion, shares or stock options in the employer's business are not linked to sales targets, this would not be regulated by these regulations.

165. For example, where if a bonus, pay rise, promotion or other performance-based incentive was offered to salespeople or advisers for achieving a particular customer satisfaction score, or complying with company policies.

Linear sales incentives

166. Linear or flat-line sales incentives (can be either monetary or soft incentives) refers to incentives that are not linked to a target, e.g. they are the same for each product sold, or a percentage of each product sold, where the percentage does not change. A financial institution could base these on value or volume provided they are one for one. These would not be covered by the regulations under the preferred option, however depending on the feedback we receive, linear incentives may be covered by a more principle-based approach to prohibiting some incentives.

167. Linear sales incentives less risky than targets because they do not build a stronger conflict of interest the closer to the target you get which is why they would be specifically excluded from the preferred option.

168. As an example, if an incentive is offered for selling one product or service, such as a $500 incentive for each mortgage product sold, regardless of the number of mortgages sold, or the amount of those mortgages. This would not be a target and therefore not covered by the preferred option.

169. However, types of incentives such as this would be subject to the obligation on financial institutions to manage all incentives and their impact on the interests of consumers through their fair conduct programmes – see section 446m(1)(be) of the Bill.

Remuneration based on aspects other than sales

170. Remuneration based on aspects other than sales will not be covered by these regulations. This may include rewards or benefits for measures like customer satisfaction or compliance with company policies, even if these are targets. An example might be where a bank provides a bonus to a salesperson for meeting a customer satisfaction target.

171. Remuneration based on aspects other than sales promote other, non-conflicted behaviours over sales and are often aligned with good customer outcomes.

Disincentives

172. Incentives are often thought of as providing a positive benefit or reward. However, we have also considered situations where failure to meet a target offers some sort of negative

consequence or penalty, rather than missing out on an incentive. This might include negative salary consequences or performance management for failure to meet an incentive target.

173. We do not consider that it is necessary to include these employment practices within the regulations as existing employment law protections would prevent businesses from framing their remuneration practices negatively to avoid the prohibitions of the proposed regulations, in particular the following legislation:

a. Wages Protection Act 1983

b. Good faith obligations under the Employment Relations Act 2000.

25	Do you think there are any other types of incentives that should be excluded from the regulations? Please provide reasons for your comments.

Who should be covered by incentives regulations?

174. The Bill provides that every financial institution must comply with incentives regulations.[14] The Bill also provides that every intermediary that offers or gives an incentive to any of its employees or agents or to another intermediary in connection with the provision of a financial institution's relevant services or associated products must comply with the incentives regulations.[15]

175. There are, however, certain open questions about who within financial institutions and intermediaries the incentives regulations should apply to.

Scope of involvement

176. The Bill restricts who incentives regulations may apply to in clause 16, section 546(4). It provides that incentive regulations may apply in relation to an incentive that is or may be offered or given to a person in connection with their being involved in the provision or a relevant service or associated product only to the extent that the involvement consists of one or more of the following:

a) negotiating, soliciting, or procuring contracts for the service or the acquisition of the product

b) carrying out other services that are preparatory to those contracts being entered into

c) giving regulated financial advice in relation to the product.

177. This provision was added at the select committee stage to reflect an intention that the incentives regulations should apply only to those persons involved in the "chain of distribution" i.e. the sale of, and giving of regulated advice in relation to, services and

[14] Clause 9, new section 446N.
[15] Clause 9, new section 446O.

associated products and other persons who provide certain types of support services to persons directly selling or advising who may also be paid incentives for their involvement.

178. Paragraphs a) and c) in the list above are intended to capture people involved in the sale and distribution of relevant services and associated products e.g. salespeople and advisers. The inclusion of paragraph b) was intended to other people involved in assisting with the sale and distribution process who may be paid incentives for their involvement. This may include the likes of dealer groups who provide a range of support services to intermediaries.

179. We acknowledge that paragraph b) is broad and may appear to capture a wide range of intermediaries. For example, it may include lawyers or registered valuers. However, we consider that where such intermediaries are involved and are paid incentives of the type that are proposed to be prohibited, it is appropriate that these intermediaries should be covered by the incentives regulations. We therefore do not propose to narrow the scope of involvement down further.

Option 1 (preferred option): all employees, agents and intermediaries of financial institutions and intermediaries

180. We propose that the incentives regulations should apply to all employees, agents and intermediaries of a financial institution or intermediary that are offering, giving, or receiving an incentive based on volume or value based targets. The incentives regulations would apply regardless of whether the person who would be otherwise be eligible for the incentive is in a customer-facing role such as sales, or in a managerial or executive position.

181. We would expect that incentives from sales targets based on volume or value are usually only in use for frontline or customer facing staff (e.g. salespeople, advisers and their managers), as frontline staff are the ones making sales or providing advice, and their managers may be incentivised based on their staff's ability to meet their targets. However, in recognition that a culture of pressure to meet sales targets could be driven from more senior positions down to staff in the frontline, we propose that all staff who are offered incentives based on volume or value based targets be included.

Pros	Cons
• Lessens conflicts throughout institutions and intermediaries businesses as it covers everyone • Would help to reduce top down pressure on sales staff to prioritise sales as senior managers and executives are also not subject to the same sales pressures	• Potentially wider than it needs to be, as staff being executives and senior managers who do not deal directly with consumers are within scope.

Option 2: Frontline employees, agents and intermediaries and their managers only

182. This option would make incentive regulations apply only to frontline staff (e.g. sales people and advisers) and their managers. Senior managers and directors would not be covered. The level at which the conflict of interest operates between the consumer and person receiving an incentive is at the level of the person selling or advising on the product. For staff who are more removed from the sales and advice process, if incentives of this type were offered, their ability to influence the consumer is far lower and therefore less problematic.

183. However, as sales focussed culture is often is pushed from those in more senior positions down to staff in the frontline, if senior staff are being remunerated by the types of incentives we propose to prohibit, they may be pushing pressure onto frontline staff to prioritise sales over good customer outcomes.

Pros	Cons
• Lessens conflicts of interest at the point of interaction with consumers (frontline), which is where the conflict of interest operates.	• Does not reduce top down pressure on sales staff to prioritise sales as senior managers and executives not included. This could mean that sales pressures are projected down the chain from more senior staff, to those having interactions with consumers. • Risk of regulatory arbitrage as this option is narrower than Option 1, therefore potentially easier to get around.

Internal and external incentives

184. The intention of the incentives regulations is that they will apply both internally and externally, i.e. to incentives offered or given both within an institution or intermediary and between institutions and intermediaries. This means the incentives regulations would apply:

a) In relation to a financial institution (under section 446N): to all covered incentives to any employee, agent or intermediary of the financial institution

b) In relation to intermediaries (under section 446O): to all covered incentives offered or given to any employee, agent or another intermediary of the intermediary.

Individual and collective incentives

185. We expect that the regulations would apply to both individual and "collective" incentives. A collective incentive is where a unit of two or more individuals meets a sales target, and each

individual in the unit qualifies for a commission, benefit or other incentive. We note that the definition of incentive in the Bill only covers incentives is offered or given to individuals. However, this may also cover situations where the individual qualifies for the incentive on the basis of collective effort.

186. The motivation for including collective targets, like regional or team targets is the same as that for including individual targets: they increase the conflict between the interests of the salesperson/adviser/agent/distributor and the interests of consumers. Collective targets can sometimes be worse than individual targets in terms of the conflicts they create because they may build a culture of peer pressure, or fear of letting the team down, as well as the conflict between the salesperson's own interests, and those of the consumer.

187. We have also seen evidence of collective targets being used as a way of sidestepping the conduct and culture work that the FMA is asking of financial institutions e.g. financial institutions insisting that they have removed sales targets, but still using regional targets where there are a very small number of sales people/advisers in each region, meaning that the targets were still acting as a very strong incentive on the advisers and salespeople to sell.

26	Do you think that the scope of who can be covered by the regulations poses a risk of unintentionally capturing other intermediaries that are paid incentives but should not be covered?
27	Do you agree/disagree that within financial institutions and intermediaries sales incentives regulations should apply to all staff? Why/why not?
28	Do you agree/disagree that within financial institutions and intermediaries sales incentives regulations should only apply to frontline staff and their managers? Why/why not?
29	Do you think that external incentives should apply to any incentive paid to an agent, contractor or intermediary? Why/why not?
30	Do you agree that both individual and collective incentives should be covered? Why/why not?
31	Do you have any other comments on the discussion related to incentives?

4 Requirement to publish information about fair conduct programmes

Background and objectives

188. The Bill requires financial institutions to make certain information about their fair conduct programmes publicly available on their websites and upon request.

189. The purpose of requiring publication of information is to assist consumers to be reasonably aware of how a financial institution is complying with the fair conduct principle, to make informed decisions when dealing with the financial institution, and to understand how to make a complaint should they be treated unfairly. The information provided should be in summary form to help consumers digest it easily. It should also be dynamic, responding to changes in institutions' practices, being updated to keep consumers accurately informed.

190. The objective is not to require financial institutions to publish extensive detail about their fair conduct programmes. For example, it does not require details of financial institutions' specific policies, processes, systems or controls across their relevant services and products. While this information may be relevant and useful to consumers at different points of interaction with the financial institution, we expect that this detailed information should made available to consumers only as relevant and appropriate (e.g. on the financial institution's website, during an advice conversation, upon request). Specific disclosure obligations already exist to cover the specific information needs of consumers e.g. under the CCCFA or FSLAA.

191. This section provides a discussion on the information which financial institutions should make available to their consumers. It discusses whether further requirements should be prescribed in regulations to assist financial institutions and consumers in respect of this requirement.

Current requirements

192. The Bill already contains some detail relating to the information required to be published. At new section 446HA(2), the Bill outlines that the information must be in sufficient detail to assist consumers to:

    a. be reasonably aware of how the financial institution will comply with the fair conduct principle; and

b. make informed decisions about dealings and interactions with the financial institution in relation to the relevant services and associated products that the financial institution provides; and

c. understand how to make a complaint about those relevant services and associated products.

193. The Bill currently does not contain any detail relating to the manner or form in which the information should take, or details relating to the specific content that should be included. Instead, it contains outcomes which the provision of information aims to achieve. There is, however, a regulation-making power in section 446HA(4) to prescribe further detail about how financial institutions comply with the section.

194. Based on the current wording of the Bill, we expect that the published information would likely include:

a. A description of how the financial institutions will adhere to the fair conduct principle in practice.

b. A description of what customers can expect from a dealing or interaction with the financial institution.

c. A summary of the process for making a complaint or, at a minimum, the contact details to make a complaint.

Options

Option 1: Prescribe no further detail

195. This option would rely on the detail currently available in new section 446HA, and would leave financial institutions with the flexibility to decide how to meet the statutory requirements, including the manner and form in which summaries are published.

Pros	**Cons**
• It is not overly prescriptive, which leaves room for financial institutions to apply the requirements flexibly to their business, products and services. This flexibility may make it easier to align the summaries with other organisational documents. • This flexibility may make compliance less costly for financial institutions. • It allows financial institutions to evolve best practice, as understanding and compliance maturity increases.	• Financial institutions may be uncertain about what is required to meet the test to provide "sufficient detail" regarding the required matters, or how much weight to give the different matters. This could lead to over or under-compliance. In practice, however, we note that this risk may be mitigated through conversations about what a consumer summary should look like with the FMA and evolving industry practice.

	• This approach may mean that the information is not as effective for consumers, because it does not contain sufficient detail.

Option 2: Prescribe further detail

196. This option would involve prescribing further minimum requirements particularly as to the form and manner of publication. For example, regulations could include requirements relating to:

a. Readability and presentation: this could include a requirement that the summaries must be worded and presented in a clear, concise and effective manner, including that the font, format and font size must be easily readable.

b. Internal conduct systems: this could include a high-level description of the steps and processes that the financial institution has in place to treat consumers fairly in relation to each of the matters set out under the fair conduct principle and/or the minimum requirements under their fair conduct programmes.

c. Internal review and reporting: this could include a description of how the financial institutions will measure or review the effectiveness of their programme.

d. The complaints process: this could also include the expected timeline of the complaints process, and the expected outcome(s). It could also explain the alternative options, should the complaint not be upheld internally.

Pros	**Cons**
• This option would provide more clarity to financial institutions as to what is required or expected of them under this section. • It would ensure that the information is published in a clear, consistent consumer-friendly form, without overloading the consumer. • It would also ensure a degree of consistency across all financial institutions.	• This option may be overly prescriptive, placing too great a burden on financial institutions to extract relevant information for consumers. • It may also restrict the evolution of how the information is published as industry understanding about what is helpful for consumers develops.

32	Is more detail needed to outline what information should be published regarding financial institutions' fair conduct programmes to assist financial institutions to meet this requirement, or to assist consumers in their interactions with financial institutions?
33	Do you have any comments on the options outlined above? What do you think the costs and benefits would be to financial institutions and consumers of the two options?

34	This discussion document outlines two options regarding the requirement to publish information about the fair conduct programmes. Do you have any other viable options?

5 Calling in contracts of insurance as financial products under Part 2

197. Insurance is covered as a “financial service” under the fair dealing provisions in Part 2 of the FMC Act. This is because “acting as an insurer” is a financial service under section 5 of the Financial Service Providers (Registration and Dispute Resolution) Act 2008 (FSP Act). This means, for example, that misleading conduct in relation to insurance services is covered by section 21 of the FMC Act, which provides that a person must not, in trade, engage in conduct that is liable to mislead the public as to the nature, characteristics, suitability for a purpose, or quantity of financial services.

198. The definition of “acting as an insurer” under section 4 of the FSP Act refers to contracts of insurance, so in practical terms, contracts of insurance are covered by Part 2. However, contracts of insurance are not expressly caught as a “financial product” and therefore not covered for the purposes of section 20.

199. Section 18(b) (as amended by FSLAA) contains a ‘call-in’ power enabling “financial advice products” to be declared by regulations to be “financial products” for the purposes of Part 2. “Financial advice products” includes contracts of insurance. Calling in contracts of insurance as financial products would mean that section 20 would expressly apply to those products.

200. Sections 19 and 21 of the FMC Act already provide substantive coverage of misleading conduct in relation to insurance. MBIE considers that it would be useful for clarification and consistency to expressly declare contracts of insurance to be financial products for the purposes of Part 2, given their existing indirect coverage through the definition of “acting as an insurer”. It is also consistent with the extension of the FMC Act in relation to insurance-related conduct through the current Bill.

201. Misleading conduct in relation to insurance products can currently be enforced by the Commerce Commission under sections 9 to 13 of the Fair Trading Act. Section 48P of the Fair Trading Act deals with when the Commission needs to seek the consent of the FMA for a proceeding in relation to financial products or services. Calling in contracts of insurance as financial products would have the additional benefit of making it clearer that misleading conduct in relation to insurance products is prima facie a FMA / FMC Act matter rather than a Commerce Commission / Fair Trading Act matter.

202. We do not expect declaring insurance contracts as financial products under Part 2 will result in any additional compliance requirements in practice given the existing coverage of financial services. However, a declaration would avoid any confusion as to whether misleading conduct in relation to contracts of insurance is covered by Part 2.

35	Do you have any comments on the proposal to declare contracts of insurance as financial products under Part 2?

6 Exclusions of certain occupations or activities from the definition of "intermediary"

Background

203. As well as regulating financial institutions, the Bill covers the activities of third party "intermediaries" by requiring financial institutions to have effective policies, processes, systems and controls in place over the intermediaries through which they distribute and manage their relevant services and products.[16] This currently includes processes and systems for conducting pre-engagement checks, providing product training, setting conduct expectations and processes for dealing with misconduct, and monitoring whether consumers are being treated consistently with the fair conduct principle.

204. We note that the definitions and obligations that apply in relation to intermediaries in the Bill are currently the subject of a separate discussion document, *Treatment of intermediaries under the new regime for conduct of financial institutions*. That discussion document currently proposes to narrow the definition of an "intermediary" to sales and distribution activities only.

Discussion

205. We are seeking feedback on whether any regulations are necessary or desirable under the proposed amended definition of an "intermediary" to exclude particular occupations or activities. This could be because certain occupations are already professionally regulated (e.g. lawyers, accountants, engineers) and their degree of involvement in the provision of relevant services or associated provisions is minor or indirect. These people arguably therefore do not need to be subject to oversight by financial institutions even if they might be technically involved in the provision of a financial institution's relevant services or associated products.

206. We would be interested in stakeholders' view on whether this would be an appropriate rationale for excluding certain occupations from the definition of an "intermediary", and whether there are any other bases on which to consider exclusions.

207. We note that any exclusions for people who are professionally regulated would not cover people providing regulated financial advice. This is because providing financial advice is fundamental to a consumer's choice about whether to acquire or dispose of a financial

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[16] Clause 9, new section 446M

product, which can have significant impacts on consumer wellbeing depending on the nature of the product and quality of advice. It is therefore vital for any product and advice regulation to work well together.

36	Do you think it would be appropriate to exclude people who are subject to professional regulation from the definition of an intermediary (e.g. lawyers, accountants, engineers)?
37	Do you think that any other occupations or activities should be excluded from the new proposed definition of an "intermediary"? If so, why?

7 Lloyd’s insurance market

208. The Lloyd’s insurance market (Lloyd’s) has a unique structure for the provision of insurance, differing from other financial institutions captured by the Bill. The Bill’s requirements do not apply naturally to entities within the Lloyd’s market. For example, Lloyd’s underwriting members would technically be considered financial institutions under the Bill but do not provide most functions of a traditional insurer, including many that are subject to conduct obligations in the Bill.

209. To address this, officials are carrying out targeted consultation with Lloyd’s to find an effective way to apply the Bill’s requirements to its market. This will likely involve applying the both the conduct and licensing requirements to more appropriate members of the Lloyd’s market, which is more likely to achieve fair outcomes for consumers. This may also involve tailoring some of the Bill’s requirements.

8 Recap of questions

Requirements for fair conduct programmes	
1	Do you have any comments on the status quo i.e. no further regulations to support the minimum requirements for fair conduct programmes in the Bill?
2	Do you have any comments on MBIE's proposal position that no regulations are needed at this time to support section 446M(1)(a)?
3	Do you have any comments on the proposals regarding distribution of relevant services and associated products?
4	Do you have any comments on MBIE's position that no regulations are needed at this time to support section 446M(1)(ac)?
5	Do you have any comments on the proposal to specify further minimum requirements regarding remediation of issues? Are there any further specific remediation principles that should be specified in regulations?
6	Do you have any comments on MBIE's position that no regulations are needed at this time to support section 446M(1)(bb) to (bd)?
7	Do you have any comments on MBIE's position that no regulations are needed at this time to support section 446M(1)(be)?
8	Do you have any comments on MBIE's position that no regulations are needed at this time to support section 446M(1)(bf)?
9	Do you have any comments on MBIE's position that no regulations are needed at this time to support section 446M(1)(d)?
10	Do you have any comments on the proposal to specify further minimum requirements regarding consumer complaints handling?
11	Do you have any comments on the proposals to specify further minimum requirements regarding claims handling?
12	Do you think there is need to define what 'handling a claim under an insurance contract' means? If so, why?
13	Do you have any comments on the discussion regarding customer vulnerability?
14	Do you have comments regarding the option of including vulnerable consumers in section 446M(1A)?
15	Do you think any further factors should be added by regulations to the list under section 446M(1A)?

16	Do you think any other regulations that could be made under new section 546(1)(oa) are necessary or desirable? Please provide reasons for your comments.
Sales incentives	
17	Do you have any comments on the Status Quo (no regulations)?
18	Do you have any comments on the option to prohibit sales incentives based on volume or value targets?
19	What would the likely impacts be for financial institutions, intermediaries and/or consumers of prohibiting sales incentives based on volume or value based targets?
20	Do you have any feedback on a more principle-based approach to prohibiting some incentives?
21	How could a more principles-based approach to prohibiting some incentives be made workable?
22	If a more principles-based option was chosen, should there be some incentives specifically excluded?
23	Do you think there are any other viable options other than what has been put forward by this discussion document? Please explain in detail.
24	Do you think there are any types of incentives other than those discussed in the paper that should be excluded from the regulations? Please provide reasons for your comments.
25	Do you think that the scope of who can be covered by the regulations poses a risk of unintentionally capturing other intermediaries that are paid incentives but should not be covered?
26	Do you agree/disagree that within financial institutions and intermediaries sales incentives regulations should apply to all staff? Why/why not?
27	Do you agree/disagree that within financial institutions and intermediaries sales incentives regulations should only apply to frontline staff and their managers? Why/why not?
28	Do you think that external incentives should apply to any incentive paid to an agent, contractor or intermediary? Why/why not?
29	Do you agree that both individual and collective incentives should be covered? Why/why not?
30	Do you have any other comments on the discussion related to incentives?
31	Do you think that the scope of who can be covered by the regulations poses a risk of unintentionally capturing other intermediaries that are paid incentives but should not be covered?
Requirement to publish information about fair conduct programmes	

32	Do you have any comments on the options outlined above? What do you think the costs and benefits would be to financial institutions and consumers of the two options?
33	This discussion document outlines two options regarding the requirement to publish information about the fair conduct programmes. Do you have any other viable options?
Calling in contracts of insurance as financial products under Part 2	
34	Do you have any comments on the proposal to declare contracts of insurance as financial products under Part 2?
Exclusions of certain occupations or activities from the definition of "intermediary"	
35	Do you think it would be appropriate to exclude people who are subject to professional regulation from the definition of an intermediary (e.g. lawyers, accountants, engineers)?
36	Do you think that any other occupations or activities should be excluded from the new proposed definition of an "intermediary"? If so, why?