

Bank of New Zealand

**Response to the Ministry of
Business Innovation &
Employment Options Paper**

Conduct of Financial Institutions

June 2019

PROACTIVELY RELEASED

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1. Introduction

- 1.0 Bank of New Zealand ('BNZ') has prepared this response to the Ministry of Business, Innovation & Employment ('MBIE') Options paper on Conduct of Financial Institutions ('Options Paper'). BNZ welcomes this opportunity to respond to the Options Paper and acknowledges the hard work that MBIE has done to develop options to ensure conduct and culture in the financial sector will deliver good outcomes for all customers.
- 1.1 BNZ considers the options proposed in the Options Paper are of such importance that a strong industry response was also warranted and BNZ has also contributed to, and supports, the submission of the New Zealand Bankers Association.
- 1.2 For ease of reference, a summary of BNZ's key points is set out below, with BNZ's detailed submissions set out in section 3.

2. Executive Summary

- 2.0 BNZ commends MBIE on its commitment to ensuring that conduct and culture in the financial sector is delivering good outcomes for all customers. BNZ strongly supports the 5 stated policy objectives set out in the Options Paper.
- 2.1 The focus of this response is to highlight aspects of the Options Paper that may unintentionally compromise customer outcomes or inadvertently undermine the achievement of the policy objectives. In BNZ's view the most fundamental issue in this respect is the question of who the conduct regulation should apply to. Without extending the regulation to all financial service providers, it is not clear to BNZ how MBIE's stated objective of ensuring conduct and culture in the financial sector is delivering good outcomes for all customers can be met. Customers using alternative financial service providers offering the same or similar services to banks and insurers simply will not receive the same protections and there will be no regime to hold such financial service providers to account. BNZ considers that vulnerable customers (especially financially vulnerable customers who may not easily access bank lending) are most at risk and strongly advocates that the proposed regime be rolled out across the financial service provider sector. This is discussed further in section 3.
- 2.2 In addition, a summary of BNZ responses is set out below each of which are addressed in further detail in section 3.

Options for overarching duties

BNZ supports the introduction of all the 6 proposed duties to govern conduct.

Options to improve product design

BNZ agrees with MBIE's preferred options to ensure financial products are suitable for customers i.e. Option 1: 'Give the regulator the power to ban or stop the distribution of specific products' and Option 3: 'Requirement for manufacturers to identify

intended audience for products AND a requirement for distributors to have regard to the intended audience when placing the product’.

BNZ does not support Option 2: ‘Ban certain products’ for the same reasons identified in the Options Paper.

Options to improve product distribution

BNZ supports MBIE’s preferred options to address conflicted remuneration i.e.

Option 1: ‘A duty to design remuneration and incentives in a manner that is likely to promote good customer outcomes’; and Option 2: ‘A ban on target-based remuneration and incentives, including soft commissions (this would apply to both in-house staff and to intermediaries)’.

In addition, BNZ would welcome the introduction of Option 4: ‘impose parameters around the structure of commissions (i.e. commissions paid to intermediaries)’ and considers this is necessary to give full effect to Option 2.

BNZ does not support Option 3: Prohibit all in-house remuneration and incentive structures linked to sales measures and our reasons for this are set out in the section 3 below.

BNZ has concerns that Option 5: ‘A duty on manufacturers to take reasonable steps to ensure the sales of its products are likely to lead to good customers outcomes’ could lead to unintended consequences by limiting competition. This is discussed further in the section 3 below.

Options relating specifically to insurance claims

BNZ supports MBIE’s preferred option regarding insurance claim handling i.e. Option 1: ‘Duty to ensure claims handling is fair, timely and transparent’.

BNZ does not support Option 2: ‘Requirements to settle claims within a set time, with exceptions for certain circumstances’ and our reasons for this are set out in the section 3 below.

Options for tools to ensure compliance

BNZ is broadly supportive of the suggested tools for enforcing the regime. However, BNZ invites further discussion in relation to:

- Option 2: Entity Licensing – BNZ has concerns that the financial licensing regime in New Zealand is becoming increasingly piecemeal and inefficient. BNZ supports entity licensing and sees this reform as an opportunity to look at the licensing regime as a whole and work towards a simpler, consolidated model.
- Option 5: Executive accountability – BNZ thinks that the policy objectives will be better met by the introduction of a regime that creates clear lines of

executive accountability rather than a legislative liability imposing framework covering directors and executives.

Part 4 - Who should the conduct regulation apply to?

As above, BNZ considers that it is very important that the regime should apply to all financial service providers offering the same or similar services to banks and insurers and we set out our detailed reasons for this position in section 3 below.

Overlap with existing legislation

BNZ agrees that a new conduct regime for financial institutions would overlap with a number of existing pieces of legislation and notes the Options Paper identifies potential overlaps with the Credit Contracts and Consumer Finance Act 2003 (“CCCFA”), Fair Trading Act 1986 and Financial Markets Conduct Act 2014. However, BNZ considers that thought also needs to be given to potential overlaps with:

- the Consumer Guarantees Act 1993;
- the Financial Services Legislation Amendment Act 2019 and the accompanying disclosure regulations for advice to retail clients;
- the insurance contract law review;
- Phase 2 of the Reserve Bank Act review;
- the proposal to increase the protections available to whistle blowers under the Protected Disclosures Act 2000;
- MBIE’s Review on protecting businesses and consumers from unfair commercial practices;
- the Financial Service Providers (Registration and Dispute Resolution) Act 2008;
- the review of Section 36 of the Commerce Act, relating to the misuse of market power;
- the Farm Debt Mediation Bill; and
- the NZBA Guidelines to help banks meet the needs of older and disabled customers.

Given the current range of consultations and signalled potential changes to the legislative framework, BNZ considers that it is very difficult to thoroughly evaluate the issues relating to legislative overlap at this stage.

Should MBIE have any questions in relation to this response, please contact:

Paul Hay
GM Regulatory Affairs
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DDI:
Mobile:
Email:

Privacy of natural
persons

3. DETAILED RESPONSE TO OPTIONS

3.1 OPTIONS FOR OVERARCHING DUTIES

3.1.1 Which overarching duties should and should not be included in the regime? Are there other duties that should be considered? Do you agree with the pros and cons of each duty? Do you have any estimates of the size of the costs and benefits of these options? Are there other impacts that are not identified?

BNZ supports the inclusion of all 6 overarching duties. BNZ considers the duties are appropriate and broadly consistent with existing expectations in the financial services sector and in some cases existing laws. BNZ supports the principles-based approach as an effective and efficient way of delivering good customer outcomes, while avoiding prescriptive regulation which may constrain organisational responses and ultimately, the achievement of the intended outcomes. The Hayne Final Report and the reviews by the Reserve Bank of New Zealand ('RBNZ') and the Financial Markets Authority ('FMA') into the retail banking and insurance industries in particular, have focussed organisations on uplifting their policies and procedures to ensure they deliver good customer outcomes. Although many of these work streams are still in development, for example, addressing the needs of vulnerable customers, BNZ is committed to continuing to develop a strategy that it believes would put it in a good position to meet each of these duties. BNZ sees real benefit for customers in giving these duties legislative weight and the increase in accountability that will come as result.

BNZ does not consider that any other duties need to be considered and agrees with the pros and cons identified. In particular, BNZ agrees there may be significant compliance costs to implement new systems to ensure we are meeting these duties on an ongoing basis. For example, BNZ considers that Option 6 'A duty to ensure complaints handling is fair, timely and transparent' may require the use of specialist analytical resources to analyse complaints to ensure robust root cause analysis. And, once root causes are identified, adequate resources are committed to address the root cause issues. A full scoping of the costs required to implement the duties has not yet been completed. However, improving conduct and culture is an integral part of BNZ's strategy and BNZ is not of the view that any of the costs will outweigh the benefits to customers.

BNZ also agrees that there may be some initial uncertainty about how to meet the duties and that it is important that financial institutions and insurers have enough certainty to assess in advance if they are compliant with the law. BNZ agrees that a code of practice could be beneficial to address this (see para 3.1.3 below).

3.1.2 Do you think the overarching duty for managing conflicts of interest should be general (as it is currently worded) or focus on conflicts of interest that arise through remuneration? What are some examples of conflicts of interest that arise outside of conflicted remuneration and incentives?

BNZ supports the general drafting of the conflicts of interest duty. Framing the duty in this way recognises the diverse way in which conflicts of interest may arise and is consistent with the goal to ensure that customers are treated fairly in **all** circumstances. A financial institution's ability to make sound, objective business decisions can be compromised in a variety of circumstances not just where there is an obvious remuneration conflict. For example, an employee may experience a conflict of interest due to a special relationship they have with a customer e.g. where a friend or family member applies for a banking product or service, or where an employee wishes to undertake secondary employment, or where promoting the interests of one customer over another provides a benefit other than remuneration.

3.1.3 Is a code of practice required to provide greater certainty about what each overarching duty means in practice?

BNZ is supportive of the freedom and flexibility to manage its businesses effectively that comes with a set of principles-based duties rather than prescribed requirements. That said it considers that the duties would benefit from guidance or a code of practice developed by the regulator or an independent body, in consultation with the industry, to help to facilitate consistency within the industry and provide greater clarity on what is expected to comply with each of the 6 duties.

For example, Option 1: 'A duty to consider and prioritise the customer's interest, to the extent reasonably practicable' would benefit from guidance to discourage conservatism. There is a risk that, absent guidance, this duty will be interpreted too narrowly, and create perverse scenarios where customers' best interests are not met due to overly cautious interpretations and risk aversion.

In addition, Option 4 'A requirement to have the systems and controls in place that support good conduct and address poor conduct' would benefit from guidance on what "good conduct" and "poor conduct" looks like and what "systems and controls" might be effective to incentivise the right behaviour.

In our view Option 5: 'A duty to manage conflicts of interest fairly and transparently' would also benefit from further guidance on what managing a conflict of interest requires - the examples suggest that clear and transparent disclosure may be enough in some circumstances but there may also be an expectation to eliminate the conflict in certain circumstances.

3.2 OPTIONS TO IMPROVE PRODUCT DESIGN

3.2.1 Which options for improving product design do you prefer and why? Do you agree with the pros and cons of the options? Are there other impacts that are not identified? Are there other options that should be considered? Do you have any estimates of the size of the costs and benefits of the options?

BNZ supports Option 1: 'Give the regulator the power to ban or stop the distribution of specific products' in principle but subject to the comments below.

BNZ recognises that giving the regulator the power to ban or stop the distribution of products is important where the product will clearly not deliver good outcomes for customers. However, BNZ considers that if the decision is taken to ban, then that should be a last resort power and a high threshold needs to be set for a total ban.

BNZ thinks this option needs to be based on clearly articulated principles and would benefit from guidance to prevent market uncertainty. For example, clarity would be helpful in defining what a “poor value product” might look like (is its value assessed against a range of customers outcomes?); and how suitability of a product should be determined (“suitability” can change over time and financial institutions and insurers may only be able to assess suitability at certain points in time).

Further clarification and criteria are also required for what constitutes a “ban” as opposed to “stopping distribution”, including how a regulator would give effect to a “ban”. Specifically, BNZ would hope there would be some engagement with the industry, or notification period, before implementing a ban to see whether there are solutions that may achieve outcomes customers are intending to achieve with the product.

MBIE identifies that giving effect to a “ban” would be an extremely costly exercise. BNZ agrees. A ban implies that existing contracts/policies would need to be unwound and that premiums or fees would need to be repaid. In addition, financial institutions and/or insurers would need additional resource for data mining, communicating with customers, setting up transition arrangements for customers using the banned product, product analysis, remediation and potentially an ongoing arrangement for compliance and monitoring with the regulator.

Additional impacts are:

- a “ban” will leave some customers with no access to a product and/or service and may leave some customers exposed to an uninsurable risk; and
- a “ban” creates uncertainty in the market (the sector needs certainty to function effectively and efficiently).

As an alternative, MBIE could consider revising Option 1 to provide the regulator with additional powers allowing them to instruct manufacturers to revise products which have particularly poor customer outcomes. If concerns exist about a product, the better customer outcome might be for the product to be retained but on revised terms (e.g. lower premiums, enhanced terms). This might help ensure that the customer retains the cover they desire and would likely be a less intrusive and expensive option for the sector to undertake. Providing the regulator with additional powers/options before a “ban” is contemplated would be more flexible and beneficial for both consumers and the industry.

Separately it is important that customers have certainty that, to the extent products have been approved under another regime e.g. as a regulated product under the Financial Markets Conduct Act 2013 (“FMCA”), they cannot be subsequently banned by the regulator.

BNZ does not support Option 2 “Ban certain products’ for the same reasons identified by the Options Paper.

BNZ’s preference is for Option 3: ‘Requirement for manufacturers to identify intended audience for products AND a requirement for distributors to have regard to the intended audience when placing the product’ and BNZ is actively working towards implementing this requirement.

From product concept and design onwards, BNZ agrees the customer's interests and needs should be at the forefront. This should mean that when the customer interacts with a financial institution/insurer at critical times and life stages, they have a great outcome because their banking and insurance products meet their needs. BNZ recognises that "customer needs" training and matching of specific products to those "customer needs" should be incorporated into product training for our front lines and that there are currently some gaps in this. Mandating this option will assist focusing the industry on addressing these gaps.

BNZ does not agree that there will be significant cost increases for financial institutions for Option 3 as it understands the industry is already working with this goal in mind. In this regard, BNZ would be happy to share its product development methodology with officials. This was provided to the FMA/RBNZ during the conduct and culture review. This would enable BNZ to ensure that it is operating at best practice level and give the regulator some comfort about the rigour of the design process and how an audience for products is identified.

3.2.2 If a design and distribution requirement like option 3 were chosen, are there particular products for which this is more necessary than others? If so, please explain what and why.

This option would appear suitable for all products.

3.3 OPTIONS TO IMPROVE PRODUCT DISTRIBUTION

3.3.1 Which options to improve product distribution do you prefer and why? Do you agree with the pros and cons of the options? Are there other impacts that are not identified - such as unintended consequences or impacts on particular business models? Are there other options that should be considered? Do you have any estimates of the size of the costs and benefits of the options?

BNZ supports Option 1: 'A duty to design remuneration and incentives in a manner that is likely to promote good customer outcomes'. BNZ is continuing to develop its understanding of what 'good customer outcomes' are and how its business can be best structured and run to deliver these outcomes. BNZ has overhauled its 'Performance Framework' so that the focus of performance for BNZ staff is on meeting customer needs. Its effectiveness in delivering real benefits to customers will be carefully monitored.

BNZ supports Option 2: 'Ban target-based remuneration and incentives, including soft commissions (applies to both in-house and to intermediaries)' for staff serving retain customers subject to the following comments. BNZ has gone further than what is proposed at Option 2 in terms of its commitments to the FMA and how BNZ has designed its discretionary reward framework. BNZ has made a commitment that from 1 October 2019, no retail customer facing staff at BNZ will have sales, product and/financial targets. While BNZ supports Option 2, it notes that this Option does not go as far as the commitments that the FMA was seeking from banks in New Zealand (and on which BNZ undertook to make changes to its discretionary reward framework). BNZ would support further consideration whether Option 2 should be aligned with the FMA's expectations to prevent asymmetries in the market. In addition, BNZ, in supporting Option 2, considers that

the control measures set out in Option 4 are necessary to extend this option to intermediaries. It would ensure that regulated control mechanisms apply to institutions that have commission structures.

BNZ does not support Option 3: 'Prohibit all in-house remuneration and incentive structures linked to sales measures' in the broad form proposed. For this option it agrees with the cons stated in the Options Paper and is of the view that the concerns with conflicted remuneration should be able to be adequately met by Options 1, 2 and 4. However, BNZ is open to working with MBIE to see how this could be introduced in the retail market across all competitors. Any introduction in the wholesale markets would need to be closely examined to not prevent unintended consequences.

BNZ supports Option 4: 'Impose parameters around the structure of commissions (ie commission paid to intermediaries)'. Regulating commission provides an even playing field for brokers and reduces the risk of bad customer outcomes caused by brokers choosing providers based on their preferred structures and types of commission. It is also a difficult issue for the financial industry to change via a coordinated industry led response without regulation because of competition law issues.

BNZ supports Option 5: 'A duty on manufacturers to take reasonable steps to ensure the sales of its products are likely to lead to good customer outcomes' in principle. However, guidance may be needed to clarify what constitutes reasonable steps in this context. BNZ has concerns that depending on the expectation of 'reasonable steps' this duty may result in reduced competition in the market as some product manufacturers may be unwilling to incur the additional compliance costs of oversight mechanisms for sole traders or small advice firms. As a result, these adviser groups might be left with the option of being able to advise on a very limited product set or joining an aggregator group.

This option might also have an unintended consequence of shifting perceived accountability for good customer outcomes away from the adviser and onto the product manufacturer.

BNZ considers that it is possible that the concerns that Option 5 seeks to address could be dealt with by the product design requirement for distributors to have regard to the intended audience when placing the product and Option 4.

As an alternative, MBIE might like to consider a duty on manufacturers to report known occurrences where the product distribution has led to poor customer outcomes. The regulator would then be able to regulate the distributor.

3.4 OPTIONS RELATING SPECIFICALLY TO INSURANCE CLAIMS

3.4.1 What is your feedback on imposing a duty to ensure claims handling is fair, timely and transparent? Do you agree with the pros and cons? Are there other impacts that are not identified? Are there other options that should be considered? Do you have any estimates of the size of the costs and benefits of this option?

BNZ agrees with the preferred option (Option 1: Duty to ensure claims handling is fair, timely and transparent) and this is the preference over option 2 (Requirement to settle claims within a set time, with exceptions for certain circumstances). BNZ agrees with the stated pros and cons.

3.4.2 If this option were to be adopted, should an attempt be made to clarify what fair, timely and transparent mean? Why? Why not? What are the benefits and costs of doing so?

BNZ agrees that additional regulator guidance on what constitutes fair, timely and transparent would be beneficial to avoid any ambiguity or uncertainty. This guidance should be directed at both insurers and consumers to ensure information symmetry. It might also be useful if the guidance also provided guidance on the frequency of communications to the consumer, so they remain well informed throughout the claims process.

3.4.3 What is your feedback on requiring the settlement of claims within a set time? Are there other impacts that are not identified? How do you think that exceptions should be designed? Should there be different time requirements for different types of insurance? Do you have any estimates of the size of the costs and benefits of this option?

BNZ does not support Option 2 'Requirement to settle claims within a set time, with exceptions for certain circumstances' because the obligation to settle a claim within an inflexible timeframe is inappropriate for several insurance products. Life and disability benefit products for example often have 'stand down' periods built into them. In addition, careful drafting would be required to provide certainty as to when any set timeframe might commence. For example, should the commencement start from the claim notification or the date on which all relevant information is received? Further information is often required during the processing of a claim which could further exacerbate this uncertainty. BNZ considers that specifying exceptions and timeframes for different products is likely to be difficult and contentious. That said, BNZ does agree that justice delayed is justice denied and settlements should be timely and economic incentives to encourage timely settlement of claims could be considered.

3.5 OPTIONS FOR TOOLS TO ENSURE COMPLIANCE

3.5.1 Do you agree with this option to empower and resource the FMA to monitor and enforce compliance? Do you agree with the pros and cons? Are there other impacts that are not identified? Are there other options that should be considered? Do you have any estimates of the size of the costs and benefits of the options?

BNZ supports Option 1 "Empower the resource the FMA to monitor and enforce compliance" and recognises that the FMA will need further resourcing to effectively enforce the regime. This support is on the basis that the conduct licensing regime applies equally to all financial institutions undertaking the relevant financial services (i.e. not limited in application to banks and insurers).

3.5.2 What is your feedback on the option to require banks and insurers to obtain a conduct licence? Do you agree with the pros and cons? Are there other impacts that

are not identified? Are there other options that should be considered? Do you have any estimates of the size of the costs and benefits of the options?

BNZ agrees with the pros listed in the Options Paper for conduct licensing of financial institutions. However, BNZ considers the cons are overstated and can be mitigated, although as noted below we think the licensing regime could be streamlined. BNZ is very familiar with how the conduct licensing regimes under the FMCA work in practice as BNZ (and its subsidiaries) hold conduct licences as a fund manager, a DIMS provider and a derivatives issuer. BNZ recognises the many benefits that come with a licensing regime including that:

- licensing helps to clarify the standards of conduct required in the market and to 'raise the bar' across an industry. This enhances consumer protection and confidence and promotes fair, efficient and well-functioning financial markets;
- a licensing regime will assist in meeting the objectives of the Options Paper, to have in place a robust regime to encourage good conduct, and to enforce corrective measures for misconduct;
- where applied across all financial institutions undertaking the same financial services, licensing will promote a level playing field and avoid less-compliant businesses competing on the basis of regulatory arbitrage;
- a licensing regime makes it more likely all players will be held to a common standard and under a common level of scrutiny;
- the loss of a licence is the ultimate sanction for failure to meet the conduct standards, comparable to a bank's conditions of registration;
- upfront checking of the systems, processes and controls of financial institutions will ensure a minimum level of conduct capability for market participants; and
- more specific guidance (through the application process, as well as afterwards) may provide greater certainty and lower risk for all.

Considering the benefits for consumers and for the market, our view is that licensing should cover all financial service providers carrying on the same financial activities, rather than being limited to insurers and banks only. This is because:

- if the regime is not extended to all providers of the same financial services, customers using non-licensed financial service providers (who offer the same or similar services to licensed providers) are at risk of not receiving the same level of service, or of inadvertently taking greater levels of risk;
- it avoids regulatory arbitrage, where entities seek a competitive advantage through less compliant offerings, or through structuring to avoid application of the regime;
- having exceptions to licensing for certain types of financial services will be confusing for consumers and detrimental to market and consumer confidence;
- licensing will ensure a level playing field for all market participants;
- this approach is consistent with the current FMCA conduct licensing regime, e.g. all derivatives issuers and DIMS providers, whether banks or not, are required to be licensed; and

- a consistent regime will align with comparable international jurisdictions, for example both Australia and the UK have broad licensing regimes for financial services e.g. licences or authorisations for the offering of credit. These apply not just to banks but to all lenders, ensuring a consistent and high-quality conduct regime for all types of market participants that deal with consumers.

BNZ acknowledges that licensing imposes costs on businesses and the regulator, but these can be mitigated by ‘right-sizing’ licensing, as was undertaken for the current conduct licensing regimes under the FMCA. We consider the benefits to market and consumer confidence, and having a fair playing field, far outweigh the costs of having a consistent and robust licensing regime.

Finally, we agree with the concern expressed in the Options Paper that conduct licensing would result in a dual licensing regime overseen by RBNZ and FMA, i.e. that such a regime could be overly complicated. For example, BNZ is a registered bank (i.e. prudentially licensed), and in addition BNZ and its subsidiaries hold licences as a fund manager, a DIMS provider and a derivatives issuer. Next year it will apply for a transitional license as a financial advice provider (‘FAP’) under the new regime introduced into the FMCA by the FSLA Act. Adding another licence to this list would complicate matters further. The administrative burden of these licenses can create a culture that is overly concerned with form, with this effect being more pronounced the greater the complication of the licensing regime.

However, rather than an argument not to have additional licence coverage, we consider this consultation process offers an opportunity to consider ways to simplify the licensing regime. BNZ would like MBIE to consider how some aspects of these licences could be consolidated as is the case with the Australian Financial Services Licence, or FCA authorisations in the UK. Without simplification there would almost certainly be some duplication of effort, and the introduction of inefficiencies, for both financial institutions and regulators on an ongoing basis. We believe this consolidation option, enabling a single financial services license would be a hugely beneficial outcome for both regulators and industry, and should be a priority for this reform.

3.5.3 What is your feedback on this broad range of regulatory tools? Do you agree with the pros and cons? Are there other impacts that are not identified? Are there other options that should be considered? Do you have any estimates of the size of the costs and benefits of the options?

BNZ supports this option.

3.5.4 Do you think that the maximum pecuniary penalties available for breaches of any conduct duties should be the same as the existing FMC Act penalties? Is there a case for making the penalties higher?

BNZ considers that the maximum pecuniary penalties available for breaches of any conduct duties should be the same as the existing FMC Act penalties. FMA and RBNZ’s conduct and culture review did not find systemic issues in the New Zealand

banking system that would warrant an increase in penalties. However, if it is determined that the current FMCA penalties are insufficient, BNZ would prefer that those penalties are also increased rather than having 2 different penalty amounts. The drafting should ensure that there isn't a double penalty regime.

3.5.5 What is your feedback on the option of executive accountability? Do you agree with the pros and cons? Are there other impacts that are not identified? Are there other options that should be considered? Do you have any estimates of the size of the costs and benefits of the options?

BNZ agrees that it is important to establish conduct expectations and incentivise compliance for executives and senior management.

BNZ in principle supports the introduction for New Zealand of a regime similar to the Australian Banking Executive Accountability Regime (BEAR), subject to the New Zealand regime being crafted in such a way that the New Zealand and Australian regimes reconcile and do not cause conflicts for those subject to both regimes.

As an indication of our support for a BEAR-type regime for New Zealand and our belief in its benefits, we note that BNZ has determined already that Australian BEAR-type responsibility should be applied to its Executive Team (ET) members and the level below the ET. Responsibility statements for all BNZ ET members are to be finalised by 30 June 2019.

As well as ensuring that senior individuals are held accountable for the entity's efforts to meet the conduct duties, BNZ considers that a BEAR-like regime is likely to be able to drive the desired cultural change within financial services entities, which has been signalled by multiple regulators across Australia and New Zealand recently, including in terms of conduct expectations. BNZ considers that a BEAR-type regime is therefore preferable to a legislative liability-imposing framework (such as under the FMC Act).

In addition, although we agree that a principles-based regime strikes the right balance for conduct, we do not consider that principles-based obligations sit well with personal liability. Personal liability should be the preserve of specific obligations, whereas principles are by nature far too uncertain in terms of scope and reach for personal liability. Director liability in such a context is likely to have a chilling effect on appetite to join the boards of financial institutions. The significant nature of existing duties on bank directors, covering both prudential and conduct related obligations should be noted in this context.

We note that the liability regime under the FMCA was developed over a significant period of time with considerable care taken to get the right balance for personal liability with appropriate defences. At the very least, further thought needs to be given to appropriate defences that could apply in a conduct context. In our view, given that licensing is also proposed, the right setting for breach or failure to meet conduct standards should be that the entity loses its license as the ultimate sanction. This is the prudential setting that applies in relation to bank registration and compliance with the related condition of registration and BNZ submits this is a highly effective model in delivering the required organisational focus and compliance outcomes.

We also observe that the NAB Self-Assessment on governance, accountability and culture, published in November 2018 (and modelled on the APRA Prudential Inquiry into CBA) viewed the introduction of Australian BEAR as having positively impacted accountability within the organisation. The Report noted that “At the Board and [Executive Leadership Team] level, the focus on assigning and ensuring clarity of accountability, has recently improved with the introduction of BEAR....those ELT members recently appointed to new roles further observed that the Accountability Statements [which are a core aspect of BEAR] provided for greater discipline and rigour in managing handovers, particularly understanding the status of risks and issues...BEAR is improving clarity of accountabilities and is motivating a focus on the practices that support their demonstration at the ELT and Board level” (pp 43-44 of NAB Self-Assessment). BNZ supports these observations made by NAB in its Self-Assessment.

3.5.6 What is your feedback on the whistleblowing option? Do you agree with the pros and cons? Are there other impacts that are not identified? Are there other options that should be considered? Do you have any estimates of the size of the costs and benefits of the options?

BNZ agrees organisations need a robust whistleblowing program to manage employee concerns. To address the concerns raised in the FMA and RBNZ’s conduct and culture review, BNZ has taken steps to make whistleblowing easier internally through, amongst other things, the addition of an independent whistleblowing channel. BNZ supports the escalation option set out in para 205 whereby employees could go to the regulator where the employee considers that the organisation has not acted appropriately in relation to their concerns. BNZ would not support an option which enabled an employee to bypass internal channels and report directly to a regulator on the basis that BNZ considers that if it is aware of an issue it can address it in most cases more quickly than an external regulator.

3.5.7 What is your feedback on the option of regular reporting on the industry? Do you agree with the pros and cons? Are there other impacts that are not identified? Are there other options that should be considered? Do you have any estimates of the size of the costs and benefits of the options?

BNZ supports reporting of summary industry data. Provided industry reporting is well designed, BNZ agrees that it can provide transparency to customers and give regulators and banks a view of industry trends to enable proactive action. Further thought needs to go into the purpose of the report and its intended audience. In this regard BNZ notes that the Banking Ombudsman has commenced an initiative to report on industry complaint statistics – volumes, common themes, etc. BNZ is actively supporting the Ombudsman in this work. It may be confusing to customers if complaints are reported in different places with different metrics so care should be taken to ensure the reporting is consistent, ideally from a single source (such as the Banking Ombudsman).

In terms of design BNZ’s preference would be for the regulator to compile a descriptive report on a regular basis, like the RBNZ’s dashboard. This would also ensure uniformity of data across the sector. Currently there is a lack of consistency

across the financial and insurance industries about how different metrics are defined. Developing definitions of the matters to be reported will be a challenge for the regulator. However, BNZ considers this is important because if financial institutions were to publish their own data, there would be significant variances in format/style which would undermine the ability of consumer comparison and regulator insights.

BNZ agrees with the costs particularly the burden on internal resource to be able to provide information in the format required. However, BNZ does not consider this outweighs the potential benefits.

Finally, any report should not require any institution to share private information of customers and exceptions may also be needed to protect sensitive information of the bank.

3.5.8 What is your feedback on the role of industry bodies? Do you agree with the pros and cons? Are there other impacts that are not identified? Are there other options that should be considered? Do you have any estimates of the size of the costs and benefits of the options?

BNZ considers that the role that industry bodies currently play is appropriate. To the extent the proposed conduct reform requires further guidance, BNZ agrees such guidance is best provided by the regulator. Our view assumes that industry bodies are consulted to establish best practice guidelines for their respective sectors and that consideration is given by the drafters of the guidance as to whether it is consistent existing industry codes.

Both the ICNZ and FSC, for example, could set benchmarks on what constitutes fair, timely and transparent claims handling for their members, with FMA regulating activity against these benchmarks. This would reduce compliance costs because the guidance would be built by those who have to comply with it. It would also reduce regulator burden by placing the workload onto the sector. BNZ agrees that approval from the regulator of any guidance is necessary and would mitigate any perception that guidance meets the needs of those bound by them rather than those they are ultimately meant to protect.

3.6 WHO SHOULD THE CONDUCT REGULATION APPLY TO?

3.6.1 Questions: What is your feedback on the options regarding who the conduct regime should apply to? In particular: Do you agree with the pros and cons of the options? Are there other impacts that are not identified e.g. do the proposed overarching duties conflict with existing regulation that applies to other financial institutions? Are there other options that should be considered? Do you have any estimates of the size of the costs and benefits of these options? Which options do you prefer and why?

BNZ prefers Option 2 because this will provide the best benefits for customers. Without extending the regime to all financial service providers, it is not clear to BNZ how MBIE's stated objective of ensuring conduct and culture in the financial sector in delivering good outcomes for all customers can be met. Customers

using alternative financial service providers offering the same or similar services simply will not receive the same protections.

In particular, BNZ disagrees with the 'con' stated that there is currently only clear evidence of poor customer outcomes and practices in banking and life insurance. On the contrary there is significant evidence of poor customer outcomes in the "high cost" lender space, which was the impetus for the current proposed reforms to the Consumer Credit Contracts Act 2003. In recent history New Zealand consumers and the New Zealand Government have also suffered significant losses because of poor conduct by finance companies. Given this, BNZ submits that it is important the regulatory costs are extended to the whole sector and is not convinced there is any justification to limit the reform to banking and life insurance.

However, noting the likely increased costs to FMA relating to option 2, BNZ's preference is as per paragraph 222 in the paper, for phased compliance to apply to all financial service providers.

3.6.2 Overlap with existing regulation

BNZ agrees that a new conduct regime for financial institutions would overlap with a number of existing pieces of legislation. However, it may also overlap with other proposed legislation currently being considered. BNZ considers that this is a fundamental issue on which further work to review and assess the position and best path forward will be required in the near future.

In particular, there is a range of both existing and proposed legislation which may overlap or conflict with a new conduct regime. In addition to the Fair Trading Act, FMCA, and CCCFA as referred to in this part of the Options Paper, items of legislation which may have a bearing on this and should therefore be considered for impact include:

- the Consumer Guarantees Act 1993
- the Financial Services Legislation Amendment Act 2019 and planned new disclosure regulations (status: currently consultation on disclosure requirements in the new financial advice regime)
- the Insurance Contract Law Review (status: options paper out for public consultation)
- Phase 2 of the Reserve Bank Act Review
- the Protected Disclosures Act 2000 proposals to increase the protections available to whistle blowers (status: State Services Minister reviewing consultation feedback)
- MBIE's Review on protecting businesses and consumers from unfair commercial practices (status: submissions closed 25 February 2019)
- Capital Markets 2029 industry review by the FMA and NZX (status: submissions close 7 June 2019)
- Review of section 36 of the Commerce Act (status: submissions closed 1 April 2019)
- the Farm Debt Mediation Bill (status: new Cabinet Paper to be submitted mid-2019)
- NZBA Guidelines to help banks meet the needs of older and disabled customers (in force from 1 January 2020)

Given the current range of consultations and signalled potential changes to the legislative framework, we do not consider that it is possible at this stage to identify all the potential areas of overlap, conflict and impacts. In our view that task is best done once the legislative position is more certain, lest the position change in the interim.

On balance, however, and subject to the caveats above, BNZ prefers a modified version of Option 1: Overlay preferred package of options onto (and into) existing regulation. In particular, the existing FMCA (once amended by FSLAA) provides a well developed and tested framework, in to which new obligations can be inserted. We consider that this is likely to create broader coverage across the financial services industry and is likely to be simpler for front-line staff to understand what rules apply to them (and therefore simpler for entities to design the necessary training and processes). We therefore agree that it will provide a consistent regulatory umbrella for all conduct taking place within financial institutions.

We do not believe the Option 1 “Con” is likely (that it may create confusion in practice for financial institutions about which regulatory requirements need to be complied with). To the contrary, we submit that integrating the new obligations - whether as duties, or as part of an extended licensing regime, will make for a more coherent regime, with less confusion.