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Financial Markets Policy
Commerce, Consumers and Communications
Ministry of Business, Innovation and Employment

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

FMG welcomes the opportunity to provide feedback on MBIE's discussion document on *Regulations to Support the New Regime for the Conduct of Financial Institutions*.

FMG supports in principle the ICNZ submission, which we have been party to preparing. However, we raise some specific concerns below which are from the perspective of FMG, a NZ owned mutual insurer. Our responses focus primarily on the sales incentives queries in the discussion document, which we address up-front.

Given FMG's unique perspective, we would like to meet with the Minister to discuss our submission further. We will reach out in due course to the Minister's office.

Confidential information

We would please request that information with respect to FMG's balanced scorecard approach (under question 5 below) is not published, given the commercial sensitivities.

Responses to individual questions

Sales incentives	
	Do you have any comments on the status quo (no regulations)?
1	We appreciate Cabinet has made a policy decision to prohibit sales incentives based on value or volume. However, it is important to note that performance incentives do continue to play an important and valuable role in financial services. Any prohibition needs to be carefully considered to ensure there are no unintended consequences with respect to the availability and quality of financial advice in New Zealand. The clear intention of these Regulations is to deal with incentives that are "*particularly problematic*". However, the proposals as currently drafted would prohibit some performance incentives which do ensure consistently good client outcomes (see our comments on balanced scorecards in question 5 below). The proposals are effectively one-size-fits-all and do not sufficiently address the fact that different entities, within different industries, pose completely different risks to good client outcomes. FMG for example, as a mutual, is very much aligned to its customer's needs. We are owned by the Members we insure. Good client outcomes are intrinsically linked to good outcomes for the mutual. As such, incentive schemes at FMG have always been developed with good client outcomes in mind.

	Also, as noted in the Consultation Document, there is already a broad, overarching duty under s446M(1)(be) of the COFI Bill to appropriately design and manage incentives so as to mitigate or avoid adverse effects on clients. There are similarly various other requirements under the FMC Act and Regs that ensure sales incentives do lead to good client outcomes (e.g. s431K, duty to give priority to client's interests; s431R(4), duty not to incentivise a Nominated Representative by encouraging them to contravene any financial adviser duty; and Schedule 21A, Clause 4, need to advise client of any potential incentive). There are a range of existing legislative requirements ensuring incentives are fair, transparent and lead to good client outcomes. In that sense, government needs to consider very carefully whether prohibiting **all** volume and value-based incentives is actually necessary. We argue below that additional exemptions are required.
2	Do you have any comments on the option to prohibit sales incentives based on volume or value targets?
	We are concerned with the broad definition currently proposed, covering "***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****).*" (our emphasis). The potential unintended consequences of such a blanket prohibition need to be carefully considered, as there will be some situations where incentives based on volume or value targets are appropriate. As currently drafted, it appears that even a balanced scorecard approach (with volume or value-based targets forming part of a broader package of metrics that need to be met) would be prohibited. As noted under question 5 below, we believe such arrangements should be excluded from any prohibition, as they can help to ensure good client outcomes. Also, as set out in response to questions 7 and 9 below, we support incentives based on volume or value targets continuing to be available for non-client facing roles including senior managers, and for team incentives.
3	What would the likely impacts be for financial institutions, intermediaries and/or clients of prohibiting sales incentives based on volume or value based targets?
	Impact on availability of financial advice Given targets are effective in motivating the sale of products/services, there may be a negative impact on the provision of sales of some products/service. This could negatively impact business growth, profitability and sustainability, which could in turn lead to reductions in products/services offered. It may also drive good financial advisers out of the market, due to the impact on their ability to be appropriately remunerated; this would have direct impact on client's ability to obtain financial advice. This may in turn reduce the product/service options clients have access to and exacerbate current concerns with underinsurance in New Zealand. Compliance costs Implementing changes to comply with the prohibition would be an added cost. System/process changes would be required, leading to increased costs for FMG (and in turn our clients – as compliance costs necessarily flow through into premiums).
4	Do you have any feedback on a more principle-based approach to prohibiting some incentives?

FMG does not support a principle-based approach to prohibiting incentives, given the very broad application and the significant risk of unintended consequences. From our perspective, there is no 'one-size fits all' solution. Incentive schemes need to be evaluated on their individual merits and assessed against the potential behaviours said schemes are driving.

The broad nature of the proposal would likely capture more (non-target related) incentives, by prohibiting any incentive that could influence the choice, value or volume of services/products offered. This could negatively impact access to financial advice and the range of product/services clients can choose from.

This option would also create added uncertainty and be less straight-forward to implement from an operational perspective, likely resulting in more inconsistent outcomes for clients.

If a more principles-based option was chosen, it would be necessary for an exhaustive list of excluded incentives to be identified, with further industry analysis and consultation.

5

Are there sales incentives based on volume or value targets that should be **excluded** from the regulations (i.e. allowed to be offered/given)?

Balanced scorecards [CONFIDENTIAL INFORMATION]

We consider that balanced scorecards, with volume or value-based targets forming part of a broader package of metrics that need to be met, should be excluded from the regulations. Such arrangements do not pose the same actual or potential adverse effects on clients' interests as incentives based solely on volume or value targets.

The benefit of balanced scorecards has been recognised in both Australia and the UK, where an element of volume or value based incentive is permitted.

Confidential information entrusted to the Government

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Retention Targets

As discussed in the COFI industry workshop, there should be an explicit exclusion for any incentives related to retention targets for existing clients.

Retention targets from FMG's perspective are aimed at retaining existing clients (not any specific GWP amount), and so do not pose the same risk as pure volume or value based incentives aimed at acquiring new business.

Senior Managers and Collective/Team Incentives

Please also see our comments in response to questions 7 and 9 below regarding an exclusion for non-client facing roles including senior managers, and team incentives.

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

We refer to our responses to question 5 above and 7/9 below.

Business Profitability Targets

While metrics related to overall business or segment profit or profitability (e.g. with reference to a loss ratio or combined ratio), revenue or GWP would not be captured by a volume or value sales targets prohibition, as these do not directly relate to sales targets, to clarify matters these should be explicitly excluded from the regulations.

We support the exclusion of the types of incentives proposed in the discussion document including salaries, performance benefits not linked to sales targets, linear/flat-line sales incentives and remuneration based on aspects other than sales. If such arrangements were prohibited, we believe there would be a serious risk this would negatively impact clients' access to valuable financial advice and the choice of a range of products/services available to clients.

Life Insurance Incentives

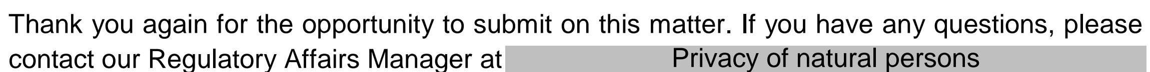
One area that would merit review is around very high up-front life commissions (not volume or value based) and the subsequent 'churn' of that business, which we consider may have material adverse effects on clients' interests. This issue could be addressed by deeming high life insurance incentives to fall within the incentive prohibition.

7	Do you agree/disagree that within financial institutions and intermediaries sales incentives regulations should apply to **all staff**? Why/why not?
	We do not agree that the regulations should apply to all staff/employees. In our view, it is only those in client-facing/frontline roles and their direct managers that either directly interact with clients or who can meaningfully influence outcomes. We consider that incentives based upon volume or value-based targets are entirely appropriate for senior managers. These support business growth and are an important part of the long-term sustainability of the business. We do not consider there is any real risk of inappropriate top-down pressure being applied given the existing principle-based expectations regarding incentives, and the importance of setting and maintaining an appropriate client-centric culture throughout organisations. We also consider it is appropriate for volume or value-based targets linked to sales of the overall company or segment to continue to be permitted for other non-client facing roles, given these individuals are removed from the client-interactions and the conduct issues these regulations are seeking to address. In general terms, given virtually every business in any sector will have expectations on senior, client-facing or all employees to meet sales targets, applying this prohibition to all employees, would move financial institutions further away from other sectors. If the incentive regulations were to apply to all employees this may result in significantly higher compliance costs, which would have to be borne by the business and inevitably passed onto clients. Assessing whether someone is client facing is easily confirmed, based upon whether they directly engage with clients.
8	Do you think that external incentives should apply to any incentive paid to an agent, contractor or intermediary? Why/why not?
	Given the policy decision includes prohibiting target-based sales incentives paid to individuals, it would be logical to apply this consistently regardless of whether they are employees, agents, contractors or intermediaries.
9	Do you agree that both individual and collective incentives should be covered? Why/why not?
	We do not consider that collective incentives would be problematic where the relevant incentive involves a large number of individuals meeting the target. This is because one person on their own has little ability to influence the overall team target. In such cases, issues such as peer pressure or fear of letting the team down are likely to be minimal and the similarities with individual incentives do not arise.
Requirements for fair conduct programmes	
10	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?
	We agree that the key areas addressed under the FCP are very important to ensuring an effective culture and conduct regime, but we do not believe additional regulation will provide any greater protection for clients. Additional regulation, as proposed, would be duplicative and potentially conflicting. High-level guiding principles are preferable in this space, as they allow arrangements to be put in place in a way that is appropriate to the nature, size and complexity of each business, bearing in mind the wide variety of financial institutions (and products/services) covered by the Bill and means of distribution. Looking at the insurance industry, for example, this includes everything from direct distribution by the insurer to complete intermediated distribution (via

	another financial institution (such as a bank), large insurance brokerage, individual or number of financial advisers, non-advice sales), to a broad range of options in between. As demonstrated by the extensive and lengthy consultation on the design and distribution obligations in Australia, this is a very complex area which could result in unintended consequences if proposed regulations are not thoroughly considered. If prescriptive regulations were to be introduced in this regard, these would need to be extensively consulted on, noting that the NZ market is very different to Australia.
Requirement to publish information about fair conduct programmes	
11	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?
	If the requirement to publish summaries of FCPs is to remain, we do not consider that it would be necessary or appropriate to prescribe further requirements about what information needs to be included or how it should be presented. To do so would be overly prescriptive. This would reduce the ability of financial institutions to act independently and flexibility to produce summaries that reflect their specific businesses, products, services, brand propositions, scales, structures and cultures. It is not considered that consistency between summaries would be desirable in this context. Having to satisfy detailed prescriptive requirements may also result in additional costs that may need to be passed onto clients. Any uncertainty about expectations in this regard could be addressed via engagement with the FMA and them issuing guidance and best practice examples.

Conclusion

Thank you again for the opportunity to submit on this matter. If you have any questions, please contact our Regulatory Affairs Manager at



Privacy of natural persons

Yours sincerely,

Privacy of natural persons

Chris Black
Chief Executive
FMG