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Friday 18 June 2021

Financial Markets Policy
Commerce, Consumers and Communications
Ministry of Business, Innovation & Employment
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Regulations to support the new regime for the conduct of financial institutions

This submission on the Ministry of Business, Innovation and Employment (MBIE) Discussion Document: Regulations to support the new regime for the conduct of financial institutions, April 2021 (the Discussion Document), is from the Financial Services Council of New Zealand (FSC).

As the voice of the sector, the FSC is a non-profit member organisation with a vision to grow the financial confidence and wellbeing of New Zealanders. FSC members commit to delivering strong consumer outcomes from a professional and sustainable financial services sector. Our 95 members manage funds of more than $95bn and pay out claims of $2.8bn per year (life and health insurance). Members include the major insurers in life, health, disability and income insurance, fund managers, KiwiSaver and workplace savings schemes (including restricted schemes), professional service providers, and technology providers to the financial services sector.

Our submission has been developed through consultation with FSC members and represents the views of our members and our industry. We acknowledge the time and input of our members in contributing to this submission.

The FSC's guiding vision is to be the voice of New Zealand's financial services industry and we strongly support initiatives that are designed to deliver:

- strong and sustainable customer outcomes
- sustainability of the financial services sector
- increasing professionalism and trust of the industry.

Key points of Submission

We welcome the opportunity to provide feedback on regulations to support the new regime pursuant to the Financial Markets (Conduct of Institutions) Amendment Bill (the Bill).

Overall, the FSC supports MBIE's criteria and objectives regarding introducing regulations and agree that no regulations are required to meet these objectives in the areas that MBIE has identified. We also do not support the introduction of regulation in relation to customer complaints, distribution obligations, remediation of issues and the publication of Fair Conduct Programmes. This is because additional regulations are not only unnecessary but overlap with what is already contained in existing legislative and industry requirements. To balance certainty of financial institutions' obligations under the Bill, with the flexibility of principles based legislation, we also reiterate the

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need for clear guidance on areas of potential uncertainty which should be subject to industry wide consultation prior to the implementation of the Bill.

Whilst we understand that further regulation is required in some form for sales incentives, it is important to recognise that there are differing views and structures within the FSC membership. At the front of mind when issuing regulations must be the customer and restricting what leads to poor customer outcomes. Any options prohibiting specific sales incentives including or alternatively providing a principles based approach needs to be balanced with the risk of unintended consequences. We stress the need for sufficient time to consider alternatives and for our members to contractually agree any changes with intermediaries.

I can be contacted on Privacy of natural persons to discuss any element of our submission.

Yours sincerely

Richard Klipin
Chief Executive Officer

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Your name and organisation

Name	Richard Klipin, Chief Executive Officer
Email	Privacy of natural persons
Organisation/Iwi	Financial Services Council of New Zealand

[Double click on check boxes, then select 'checked' if you wish to select any of the following.]

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☐ MBIE intends to upload submissions received to MBIE's website at ***www.mbie.govt.nz***. If you do not want your submission to be placed on our website, please check the box and type an explanation below.

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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?

We consider that the Bill itself provides sufficient detail whilst still retaining flexibility to allow financial institutions to tailor Fair Conduct Programmes to their specific industry, business model size and complexity. In addition, good conduct and culture principles and the protection of consumer rights are currently upheld via existing legislative and regulatory obligations and requirements. Examples of this include:

- Existing duties set out in the Financial Services Legislation Amendment Act (FSLAA) and Credit Contracts and Consumer Finance Act 2003 (CCCFA).
- Assessments being undertaken of customer vulnerabilities under the Banking Ombudsmen Scheme (BOS) and the Council for Financial Regulators common understanding of the characteristics of a vulnerable consumer.
- Commitments to and reporting of Good Customer Outcomes made through the Reserve Bank of New Zealand (RBNZ) and the Financial Markets Authority (FMA) Conduct and Culture Reviews.
- Requirements to have customer complaints systems, including the requirements under their External Dispute Resolution (EDR) scheme to have internal complaints handling services and to publicise the availability of that service.

The flexibility to tailor Fair Conduct Programmes ensures that they are “right- sized” and reduces the risk that financial institutions take an overly compliant approach or interpret obligations too narrowly to the detriment of consumers (as discussed at paragraph 38 of the Discussion Document). However, some of our members have expressed concerns that there are possible risks of not having a prescribed minimum form of requirements for a Fair Conduct Programme nor guidance. Possible risks include inconsistencies between programmes (and intermediaries seeking out those which are less onerous), making customer comparisons difficult and compliance challenges for intermediaries.

The FSC recommends that consideration be given to the provision of guidance and our members have provided mixed views on its timing. On the one hand some members consider that sufficient time should be allowed for the legislation to embed, as well as the changes introduced by FSLAA and CCCFA. On the other hand, some members support earlier guidance so that expectations can be understood upfront prior to the Bill’s implementation to avoid multiple iterations Fair Conduct Programmes and changes to contracts between financial institutions and third parties. Both views appear to support developing guidance in consultation with the industry to avoid unnecessary complexity and compliance costs, with suitable timeframes for implementation.

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)?

We agree that further regulations to support section 446M(1)(a), which addresses the overlap of existing consumer legislation, are not needed at this time.

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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.

We do not agree with what is proposed at paragraph 52 of the Discussion Document. We consider that there is already sufficient detail in the Bill regarding obligations relating to "management" allowing flexibility for financial institutions. In addition, there are already industry and legislative requirements and expectations in this area meaning that further obligations may be unnecessary.

We consider that the proposal does not provide meaningful clarity about the conduct that MBIE is expecting of financial institutions over and above what is currently contained in the Bill and considering different distribution models. Any regulations in this space would need to be extensively consulted on which is likely to delay the progression of conduct licensing. For example, consideration would need to be given to whether some classes of relatively simple products should be excluded from the requirements for considering the likely customers such as example transactional accounts.

Industry and legislative requirements
The Code of Professional Conduct for Professional Advice Services under FSLAA includes obligations that customers are provided with suitable financial advice, given the nature and scope of the advice, and that products offered to customers are appropriate.

All 95 of the FSC's current members must adhere to the FSC Code of Conduct. FSC Code Standard 5 requires members to design and distribute products responsibly. The FSC Code of Conduct Guidance then sets out what this obligation may involve, such as:

- What processes do you have in place to support products and services being designed with customer needs in mind?
- What processes and systems do you have in place to periodically review and monitor all of your products from a customer outcomes perspective?
- What actions do you take when you find that products and services are not working as designed and are delivering poor customer outcomes?
- What processes do you have in place to support and maintain responsible distribution of your products and services?
- What do you know about the skills and capabilities of the people distributing your product?
- How do you work with your intermediaries to support good customer outcomes?
- What action do you take when you find irresponsible distribution of your products and services?
- How does your organisation's sales culture drive good customer outcomes?

As a result of the above obligations and learnings from the Conduct and Culture Review, most, if not all, financial institutions will already be identifying and designing their products to meet consumer needs and managing their products over the course of the product lifecycle by monitoring (to the extent that is reasonable) that their products are being

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distributed to the intended market and ensuring the ongoing suitability of the products for the same. If it becomes apparent over time that there is a lack of consistency in the industry over what constitutes good product management, regulations or regulatory guidance can be issued to specifically address these points.

Flexibility

We agree with the 'cons' to this suggested option as outlined at paragraph 54 of the Discussion Document. Specifically, that further regulation would reduce flexibility, increase compliance costs unnecessarily and could lead to poor outcomes for some consumers. Flexibility is important as it allows the design and management of relevant services and products to occur in a way that is appropriate for each business bearing in mind the wide variety of financial institutions (and services and products) covered by the Bill. For example, sales to a consumer who falls into an identified group even when it is not appropriate or conversely, preventing a sale to an 'unlikely' but appropriate consumer. It would also be a roadblock to innovation and may result in under insurance, which has been identified as an issue in New Zealand.

We are concerned that the proposal appears to impose requirements to make qualitative and quantitative assessments about customers and the products they hold. Whilst we understand the sentiment behind this proposal, caution is encouraged with respect to imposing obligations on financial institutions to make determinations about suitability. This proposal would also create a duplication or overlap between the roles and services of product manufacturers and financial advice service providers who are primarily responsible for ensuring the suitability of products for their customers. Product providers seldom have sufficient and reliable information to make these other than at the most basic level.

Risk Management

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

We consider that no regulations are necessary to support section 446(1)(ac) of the Bill and the requirements for managing conduct risk. We note that detailed risk management programme requirements are also already provided for under both the Insurance (Prudential Supervision) Act 2010 and the Australian Prudential Regulation Authority's Prudential Standard CPS 220 where applicable.

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)?

We agree with this position and note that the outcome of the Discussion Document on the treatment of intermediaries will determine whether further regulations are required in respect of intermediaries.

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?

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We appreciate MBIE's concerns in respect of remediation of issues under section 446M(1)(ad) of the Bill. However, many of the FSC's members and other financial institutions have already developed their own remediation processes. There are also existing legislative requirements and guidance (for example the Director Due Diligence Requirements in section 59B of the CCCFA and associated guidance material) that impose obligations around the remediation of issues.

In addition, although we agree that customer remediation is a fundamental element of a Fair Conduct Programme, remediation of issues is a broad topic with numerous, and often complex and unique considerations. Issues can range from simple one off or ad hoc issues through to widespread, complex, or historical issues involving possibly multiple products, distributors, and systems. Each remediation involves a careful balancing of timeliness and accuracy and the assessment of customer impact. In addition, the scope of an issue may not become clear until it has been fully investigated. This involves consideration around applying sensible de minimis and different customer engagement approaches depending on both the nature of the remediation and the characteristics of customers.

Therefore, whilst we fully support the high level principle based guidance in section 446M(1)(a) and appreciate MBIE is trying to provide further certainty on what 'reasonable steps' constitutes, we consider it is vital that financial institutions retain flexibility to appropriately respond to each unique issue identified. However, if MBIE determined that further clarity is required, we consider that regulatory guidance over regulations, with worked examples of good practice to support the obligations set out in section 446(1)(ad), would be a better regulatory tool to address these issues, providing clarity around regulatory expectations and consistency across financial institutions. Care needs to be taken to ensure consistency in language, the impact of other legislative obligations and guidance and the operationalisation of the requirements and how customers may be impacted. Therefore, the following are our comments on each of the proposed remediation requirements at paragraph 66 of the Discussion Paper:

a) **Review and remediation processes must be comprehensive, efficient, timely and transparent.**
Whilst we support this requirement in principle and believe our members already approach remediation of issues in this way, what is considered 'timely', particularly for complex remediations, is subjective and therefore may create more uncertainty for financial institutions.

We encourage inclusion of a definition of timely as at present the Bill is silent on limitation periods for remediation activities and we seek further clarification on whether or not this should align with existing legislation, namely that the requirement regarding remediation is tied to the Limitation Act 2010 timeframes. This is because it is reasonable that financial institutions have some certainty in terms of their liability for historical events. In addition, any historical remediation or legacy products may cause further issues as financial institutions cannot retain records indefinitely due to Privacy Act 2020 requirements.

b) **Review and remediation processes must be fair, equitable and transparent taking into account consumer's interests and needs, and financial institutions must take all reasonable steps to remediate all affected customers.**

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We support this requirement in principle but consider it could be more appropriately included in guidance. As stated in the Discussion Document, it may not always be possible for compensation to be fair, equitable and transparent, for example, when customers are uncontactable, or privacy restrictions apply. It may also be difficult for organisations to demonstrate exactly how they are being "transparent" in a remediation process, and further clarity would need to be provided on how these requirements should be interpreted.

We also note that "All reasonable steps" is used here and in our view is a higher threshold than "reasonable steps" in section 446M(1)(a). This leads to further uncertainty as it creates different thresholds between any regulations and guidance and the requirements under the Bill. "Reasonable steps", in line with the requirements under the Bill is a more appropriate threshold than "all reasonable steps" and we also consider that "what is reasonable in the circumstances" should be added.

Whilst we recognise that consumers should have the right to be fully compensated for their losses, the cost of remediation activities can, in some cases, significantly outweigh the overall compensation amounts. Therefore, some of our members have suggested that consideration should be given to the provision of further detail and clarification in this area and possibly a de minimis threshold set out in guidance. As previously stated, guidance is preferable to regulations as it is more flexible and is more easily able to be amended over time. However, any guidance would be required to be extensively consulted on as a de minimis threshold should not just take into account monetary considerations, such as whether or not a specific amount should be stipulated, but other factors such as scale and cost of remediation and the specific factors that apply to each financial institution.

c) **Once conduct that fails to comply with the fair conduct principle has been identified, financial institutions should take all reasonable steps to ensure that the misconduct ceases and that consumers are not continuing to be adversely affected.**
We support this requirement in principle, however if it was included in regulations, it may cause issues for financial institutions. For example, there may be situations where it is not possible for misconduct to reasonably cease immediately, such as where there is a system issue that needs to be investigated. As with (b) above, we consider "reasonable steps in the circumstances" is a more appropriate threshold than "all reasonable steps".

d) **Review and remediation processes must be adequately resourced.**
We suggest this requirement is covered by a) above, namely that review and remediation processes must be comprehensive, efficient, timely and transparent. The efficiency of the remediation process should be the focus, rather than the resourcing of the exercise. As discussed above, each remediation differs and is unique to each financial institution. Therefore, each remediation will require different skills and expertise from different areas of a business.

e) **Adequate records of remediation processes.**
We support this requirement in principle.

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f) Communicating with customers about the progress and outcome of review and remediation processes in a clear, concise, timely and effective manner.
We support this requirement in principle, but do not agree with how it is currently worded. Whilst it is important to communicate clearly with customers, such communications must be appropriate and scalable to the remediation activity. Some issues may require regular progress updates, whilst others may simply be resolved by one off communications to the impacted customer or customers about the issue and how it has been resolved. Requiring progress updates for all remediation activities is onerous and, in many cases, would not necessarily be well received by customers. In addition, sometimes it may not be possible or appropriate to communicate with certain customers. For example, remediation requiring payment of an insubstantial sum to a relative of a deceased policyholder under a life insurance product may cause unnecessary distress. Further, as MBIE points out in the Discussion Document, there are added complexities when financial institutions are unable to contact customers after taking reasonable steps to do so.

g) Review of remediation processes to ensure conduct risks and issues are being adequately managed.
We support this requirement in principle but consider that it could be more appropriately included in guidance.

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

We agree that no further regulations are required to support section 446M(1)(be) and the requirements for design and management of incentives. Please refer to our responses below for our position on the proposals for prohibiting certain types of incentives.

We also note that following the Conduct and Culture Reviews initiated by the FMA and the RBNZ, many of our members have made significant changes to incentive structures. The expectations expressed by regulators, proposed prohibitions options set out in the Discussion Document and the existing regulatory framework under the Financial Markets Conduct Act 2013 (FMCA) are considered adequate to address the underlying concerns with incentives.

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

We agree that no further regulations are required to support section 446M(1)(bf) and the requirements for communicating with customers.

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

We agree 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?

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We do not consider further requirements are necessary for handling customer complaints. There are extensive legislative and industry requirements relating to complaints already present in the industry and we reinforce the need for flexibility. We set out these existing requirements and our concerns below.

Dispute Resolution Schemes
All financial institutions are required to be a member of an approved EDR scheme pursuant to the Financial Service Providers (Registration and Dispute Resolution) Act 2008. Each EDR scheme requires participating members to have internal complaints handling services and to publicise the availability of that service. The schemes each have rules and timeframes directed at ensuring customer complaints are dealt with in a fair, timely and transparent manner.

Therefore, regulating prescriptive complaint handling rules may have the effect of making EDR schemes redundant given they do not have any regulatory powers to ensure these new legal requirements are upheld. It may also conflict with the current EDR practice of not being limited by law or statute, to promote best practice across the financial industry.

We note that the FSC provided a submission in respect of the recent consultation regarding dispute resolution scheme rules, and we consider it important that any changes in respect of customer complaints handling takes into account any rule changes recommend for dispute resolution schemes (and vice versa).

FSLAA Requirements
Standard conditions for full licensing under FSLAA require a Financial Services Provider (FSP) to have an internal process for resolving client complaints relating to their financial advice service that provides for;

- complaints to be dealt with in a fair, timely and transparent manner; and
- records to be kept of all complaints and any action taken in relation to them including the dates on which each complaint was received, and any action was taken in relation to that complaint.

Therefore, the same concerns as dispute resolution schemes apply in respect of the FSLAA requirements.

Existing industry Codes
A rules based approach may see various codes across the industry such as the FSC's Code of Conduct, the Insurance Council of New Zealand's Fair Insurance Code and New Zealand's Code of Banking Practice (CoBP) become redundant if the proposed regulation varied from these codes' existing directives. In particular, customer complaints are covered in the FSC Code of Conduct Code Standard 4, that FSC members must seek and consider customer feedback and Code Standard 9 requires that Members must treat customers fairly. Although, we appreciate that these codes may not be enforceable by regulators, they go a significant way to alleviating the concerns set out in the Discussion Document. We consider industry led conduct initiatives are an important tool to build trust and confidence in the industry.

Consumer complaints handling generally
Complaint handling requires a level of subjectivity and flexibility, which may be impeded by a prescriptive approach. This could potentially be to the detriment of consumers. A prescriptive complaint regulated environment may also incur additional administrative

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requirements that could result in diminishing a financial institution's complaint handling culture. This is because compliance may take time, energy and focus away from achieving the best possible outcomes for customers and could potentially create an environment that encourages 'complaint fatigue', or the active avoidance of recording complaints to avoid 'red tape'.

We are similarly concerned that additional requirements, may result in having to create overly complex complaint capture systems, potentially undoing much of the work the industry and the EDR schemes described above have achieved. Additional regulations on complaints handling may add complexity when overlaid with existing obligations and unnecessarily increase compliance costs.

We consider the principles based requirements in the Bill to be sufficient as the Fair Conduct Principle will apply to customer complaints (section 446C(1)(d)). Financial institutions will also be required to make publicly available a summary of their Fair Conduct Programme that provides sufficient detail to assist consumers to understand how to make a complaint (s446HA(2)(a)(iii)). However, if MBIE considers further detail on complaints handing is required, we recommend that it is best addressed in standard conditions for a licensee, to demonstrate at a high level that they have complaints handling policies and procedures in place, which are also transparent to customers including the details of the EDR scheme they belong to. This would be consistent with other FMCA licences.

11. Do you have any comments on the proposals to specify further minimum requirements regarding claims handling and settlement?

In principle, we agree with the proposed elements in the Discussion Document. However, we do not consider that it is necessary to include these in regulations.

For example, it is in the interests of financial institutions to promptly resolve claims as this assists both the customer and the financial institution, such as assisting with rehabilitation services which supports the customer and minimises the long term costs of claims. Delays in resolving claims may also often occur for reasons outside a financial institution's control, for example, waiting on medical reports or appointments due to availability constraints with providers. In addition, the timeliness of claims for life insurers may be affected by customer behaviour and responsiveness. We note that claim delays and bottlenecks in relation to claims due to natural disasters (such as the Christchurch earthquake) may not impact life insurers in the same way. However, we acknowledge that delays could occur for life insurers in situations such as delays in the granting of probate or letters of administration which are beyond their control.

We note that a customer has the ability to express dissatisfaction through internal and external complaints processes if they experience unwarranted delays. Therefore, regulations on claims handling and settlement are unnecessary. However, if MBIE considers further requirements are required, we suggest guidelines are more appropriate and can address the differences between difference insurance types.

12. Do you think there is need to define what 'handling and settling a claim under an insurance contract' means? If so, why?

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We are broadly supportive of a definition being introduced for 'handling a claim under an insurance contract'. However, as outlined in our response to Question 11 above, our view is that different types of insurance types operate and work differently, and as such not all insurance types should be combined in the same definition. For example, the characteristics of the products themselves, the intermediaries and how they are involved, and the difference in claim frequency means that claims handling is different for each insurance type.

Any definition would need to be carefully drafted and comprehensively consulted on given the potential implications for different insurance types. Our preliminary view, prior to any detailed consultation, is that a definition of "handling and settling a claim" should focus on when a decision to pay, decline or settle an insurance claim is made whilst capturing the process in making those decisions. Therefore, under such a test simply providing information, an opinion or professional service to an insurer, which it uses in the course of assessing, handling or managing a claim, would not fit under this definition.

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

We agree that specific regulations regarding customer vulnerability in Fair Conduct Programmes are not required. The Bill, the financial advice regime under the FMCA, the CCCFA, the new Responsible Lending Code, the various industry codes and the Guidelines to help Banks meet the needs of older and disabled customers are considered sufficient to ensure that Fair Conduct Programmes will include policies and processes for identifying and dealing with vulnerable customers. We also note that the Council of Financial Regulators has recently agreed on a common understanding of the characteristics of a vulnerable consumer and the FMA has developed a non-binding framework (and has indicated further guidance will be included in its revised Guide to Good Conduct due to be released for consultation later this year).

We also support the Discussion Document which specifically calls out the situational nature of vulnerability, acknowledging that that people can move both in and out of vulnerable circumstances over time, and that vulnerability is a not static state.

14. Do you have comments regarding the option of including vulnerable consumers in section 446M(1A)?

Whilst we agree in Question 13 that specific regulations regarding customer vulnerability in Fair Conduct Programmes are not required, some of our members support consideration of "potential customer vulnerability" in the list of factors to consider. If this is to be considered, please refer to the appendix of this submission for additional drafting to support its inclusion.

15. Do you think any further factors should be added by regulations to the list under section 446M(1A)?

No, the current list is appropriate, subject to our response to question 14 above.

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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.

No further regulations are necessary or desirable.

Sales Incentives

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

Our members and the industry have understood regulations on sales incentives have always been intended to be part of this regime. As Cabinet has agreed to regulate sales incentives based on volume or value targets, the status quo does not seem appropriate. However, as outlined in the following questions on sales incentives, consideration and care is required when drafting regulations on what is prohibited to provide certainty to the industry but also in supporting the retention of incentives that can lead to good customer outcomes. Consideration should also be given to what is currently operating effectively in the industry either due to change of practices or existing legislation.

18. Do you have any comments on the option to prohibit sales incentives based on volume or value targets?

As MBIE has identified, both options have advantages and disadvantages, and neither can achieve both the regulators' intentions as well recognising the diverse range of financial institutions' operating models. Where harmful incentives are expressly prohibited, regulations will need to ensure that there are also supporting elements to ensure that there are no unintended consequences. We urge MBIE to consult further on this topic and provide draft regulations for consideration by the industry. Without considering draft regulations, it is difficult to provide examples of the unintended consequences that could be created. We also note that any changes regarding incentives would require changes in the contracts between intermediaries and financial institutions. We encourage this factor to be taken into account when considering implementation timeframes.

We agree with MBIE that volume or value targets that create conflicts of interest should be prohibited and many of our financial institution members have already removed volume or value based incentives that pose the most harm to customers. A clear prohibition on certain incentives would also create a level playing field in the industry and focus the primary attention on needs assessments and the delivery of good customer outcomes. In addition, this could avoid uncertainty and remove the scope for argument around whether a particular volume or value based incentive supports or detracts from good customer outcomes.

However, some of our members consider that there are risks of unintended consequences arising out of a blanket prohibition. There may be volume or value target based incentives in some financial institutions that support good customer outcomes, for example, but not limited to, access to software and additional training that do not conflict with customer interests. These incentives are usually volume or target based as there is a cost to the financial institution for provision of the software or training service. These types of incentives are important to building a strong financial advice industry and support Financial

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Advice Providers (FAPs) as they transition through the FSLAA. We discuss further unintended consequences of this option at Question 19, below.

We note that FAPs are already required to make disclosures in relation to commissions and other incentives, in accordance with the FMCA. We consider that any proposal to prohibit sales incentives based on volume and value targets, should consider these existing obligations and clearly define what is in scope. More broadly, we note that the definition of "incentive" at s446P of the Bill, may be too wide and the inclusion of the word "indirect", could cause interpretation issues that may capture benefits beyond the scope of what the Bill is seeking to curtail. For example, non-monetary benefits provided to all employees in an organisation could be inadvertently captured. We suggest that the definition of what is considered an incentive should be reviewed and clarified to avoid impacting benefits not linked to sales measures.

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?

As noted under Question 18 above, there may be unintended consequences if any form of blanket prohibition implemented.

Some FSC members have indicated that there are situations where internal volume or value targets may be appropriate to support sustainable growth. For example, some senior executives may have obligations to their Board and their shareholders to grow the business. Growth is important to ensure the long term sustainability of a business with growth targets often included within 'balanced scorecards'. These scorecards also include metrics related to customers, conduct and risk management which mitigate the potential risks to customers. We consider it reasonable to include metrics relating to business growth (even if value or volume based) in any balanced scorecard structure.

In addition, some of our members consider volume or value based incentives are important in building a strong financial advice industry and supporting FAPs with their compliance and supervision responsibilities as they transition through the FSLAA. These may be in the form of non-financial benefits such as additional training programmes or access to software that can have benefits for both the intermediary and the customer as noted under Question 18 above. Removing these incentives may also result in the advice industry having to fund these activities themselves directly or not at all.

However, there are also positive impacts if this option was implemented. This includes providing certainty for financial institutions, and for some FSC members they have already reviewed their incentive structures to ensure they align with the RBNZ and FMA's expectations (which align with this option).

20. Do you have any feedback on a more principle-based approach to prohibiting some incentives?

Some of our members are supportive of an approach that allows for certain volume or value based incentives that are likely to have positive outcomes for customers, such as better trained advisers. However, as some of our members have expressed concerns that this may create an uneven playing field and the scope for differing arguments on what constitutes

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good customer outcomes, we strongly encourage MBIE to consult further on this topic and provide draft regulations for consideration by the industry.

21. How could a more principles-based approach to prohibiting some incentives be made workable?

As noted at Question 18, we consider that both of MBIE's proposed options have advantages and disadvantages and that neither, on their own, can achieve both the regulators' intentions as well as pre-empting the range of different structures that apply across a diverse range of financial institutions.

A principles based approach could be advantageous in certain respects as it should (subject to drafting) allow for volume based incentives that support good customer outcomes as noted at Questions 18 and 19.

However, as with any principles based regulations, there will be uncertainty about what will and will not be acceptable and this may create an uneven playing field as financial institutions may interpret the principles differently. We therefore urge MBIE to consult further on this topic and provide draft regulations for industry consideration.

If a principles based option was preferred, MBIE should consider whether there needs to be an onus on financial institutions to be able to continuously demonstrate that the incentive does not create an unreasonable conflict of interest and require monitoring to ensure that conflicts are not unintentionally created.

22. If a more principles-based option was chosen, should there be some incentives specifically excluded?

We consider that there potentially needs to be some incentives specifically excluded as noted in response to question 25. This detail needs to be carefully drafted to exclude practices that lead to poor customer outcomes but also supplemented with an approach to permits incentives that lead to good customer outcomes. Therefore, as considerable care needs to be taken with drafting, we encourage MBIE to consult further on the content of the draft regulations (whether prescriptive or principles based).

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.

At this stage we have no other options to suggest other than reinforcing the need for further consultation on the content of the draft regulations.

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)?

As discussed above, most of our members support excluding from regulations sales incentives based on volume or value targets that have positive customer outcomes and do not pose the same risk for customers. However, there are also other member views that these may be difficult to define and demonstrate given they could equally support sales volumes and continued high costs of acquisition. These include professional development

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training for FAPs for some financial institutions and growth targets in a balanced scorecard for senior executives designed to support the long term sustainability of businesses.

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

We support the exclusion of the types of incentives discussed in the Discussion Document, including salaries, performance benefits not linked to sales targets, linear or flat line sales incentives (such as ones not linked to a target, which are the same for each product sold or where the percentage for each product sold does not change) and remuneration based on aspects other than sales.

We query whether referrals based on volume or value are likely to create a conflict and drive poor customer outcomes so should also be expressly excluded. As noted in our response to Question 19, we would also like to ensure that training based rewards are not prohibited as these may help to further enhance skills of those selling the products which helps to mitigate risks to customers.

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?

We do not consider there to be 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?

A principles approach would be flexible enough to apply to all staff.

Page 46 of the Discussion Document notes that collective targets are being used to sidestep the conduct regime. We disagree with that comment. Collective targets are widely used by businesses across many different industries as a means of maintaining or growing market share which, in turn, ensures the continued existence of their business. We do not consider it unreasonable to have such measures in place provided they are reasonable and do not create a material conflict of interest. Given that New Zealanders are largely underinsured and do not have adequate savings for their retirement, business growth in the financial sector is beneficial and demonstrates that the country's financial capabilities are increasing through the efforts of our members and the Government.

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?

As outlined in response to the questions in this section, we agree that within financial institutions and intermediaries the prohibition option relating to sales incentives regulations should only apply to frontline staff and their managers.

However, some of our members consider that there are challenges in differentiating between what constitutes a manager and a senior manager. Treating different staff

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differently poses further practical challenges and compliance burdens. We do not consider this should drive a wider scope of application of incentive regulations and would welcome engagement to arrive at a workable definition of 'immediate manager.'

29. Do you think that external incentives should apply to any incentive paid to an agent, contractor or intermediary? Why/why not?

Yes, we see no reason for excluding agents, contractors or intermediaries from incentives regulations. We note that this is the first time the term "contractor" is used in respect of obligations under the Bill and is contrasted from the role of an agent. Therefore, clarification is required on whether contractor differs from an agent, and if so the reasons for the distinction.

30. Do you agree that both individual and collective incentives should be covered? Why/why not?

If a principles based approach is preferred, we support both individual and collective incentives being covered. Where there is an express prohibition, we do not consider that collective incentives should be prohibited, provided they do not create a material conflict of interest.

31. Do you have any other comments on the discussion related to incentives?

We have no further comments at this time.

Requirement to publish information about fair conduct programmes

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?

We do not consider further detail is required and therefore support option 1 in the Discussion Document.

We consider that overly prescriptive requirements will not aid a consumer's understanding of a financial institution's Fair Conduct Programme. The current drafting of section 446HA provides sufficient flexibility for financial institutions to adopt the requirements to their own business structure, products and services, along with ensuring that consumers are able to compare one provider's Fair Conduct Programme with another.

The risk of being overly prescriptive is that it becomes a 'tick-box' compliance exercise as opposed to something informative, unique and relevant to each financial institution. We also note that by prescribing no further detail, the disclosure that a financial institution has adopted a conduct regime under guidance from the FMA provides confidence to the market that sufficient measures are in place. For example, the suggestion in the Discussion Document regarding the complaints process, and publishing expected timelines and outcomes of complaints, does not convey the complexity and variability that can arise for each different complaint, and may therefore appear misleading to consumers. We also note

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that the complaints process is already sufficiently covered by the current wording in the Bill and the complaints handling obligations discussed in Question 10 of this submission.

Furthermore, regulations around things like font, format and font size unnecessarily add compliance costs and complexity. We also note that internal conduct systems are already covered by the current wording in the Bill and internal review and reporting is unlikely to be of any interest or provide any benefit to consumers. We encourage further consumer surveys to be undertaken to understand what customers want and need to know and what they would like to receive.

However, as some of our members have expressed that guidance may be helpful to assist with consistency and comparability for consumers, if further minimum standards are introduced and guidance is issued, we recommend that any detail published should be in summary form. In addition, we do not agree with the requirement to include internal conduct systems due to the considerable amount of work and detail it would take to describe every step and process.

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?

We support Option 1. As mentioned above, further detail pursuant to Option 2 may result in requirements that are overly prescriptive and may ultimately not be useful to the end consumer.

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?

There are no further options we would like to propose.

Calling in contracts of insurance as financial products under Part 2

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

We support this inclusion as we note the Bill has contracts of insurance as a service and such a change would provide the required clarification.

We note however that there are already adequate protections under the duty of good faith (which is unique to insurers), the Fair Trading Act 1986, FMCA (through the FSLAA provisions, including section 431P (false or misleading statements or omissions)), and the Consumer Guarantees Act 1993 which expressly only apply to insurance policies.

Exclusions of certain occupations or activities from the definition of intermediary

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)?

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Please refer to our response to questions 3-5 of the Discussion Document relating to intermediaries.

37. Do you think that any other occupations or activities should be excluded from the new proposed definition of an "intermediary"? If so, why?

Other comments

Implementation timeframes and review period

As noted in our submission on the Bill, the financial services industry is currently experiencing an unprecedented period of regulatory change at a time of economic instability as a result of Covid-19. We encourage further consideration on the timeframes of this regime to allow for further consultation, exposure drafts and drafting and provision of guidance.

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Appendix: Proposed Amendments to the Financial Markets (Conduct of Institutions) Amendment Bill

Legislative Provision	Current Wording	Drafting Issues	Proposed Solution
446I Duty to comply with fair conduct programme	(1) Every financial institution must take all reasonable steps to comply with its fair conduct programme.	As outlined throughout this submission.	(1) Every financial institution must take ~~all~~ reasonable steps to comply with its fair conduct programme.
		Not yet defined.	In either section 6 of the Bill, Regulations or Guidance: **Reasonable** means commercially prudent and regarding the customer as would be considered standard in the industry in similar circumstances.
446M(1A)(e)	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: (d) the types of consumers it deals with;	As noted in response to Question 14 of this submission.	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: (d) the types of consumers it deals with and customers who may be in vulnerable circumstances;