



**MINISTRY OF BUSINESS,
INNOVATION & EMPLOYMENT**
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Consultation paper

Exposure draft regulations on sales incentives under
new conduct regime

28 September 2022

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How to have your say

Submissions process

The Ministry of Business, Innovation and Employment (MBIE) seeks written submissions on the issues raised in this document and the draft regulations by 5pm on **Wednesday 9 November 2022**.

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

Please use the submission template provided at: <https://www.mbie.govt.nz/have-your-say/consultation-on-exposure-draft-of-regulations-under-the-cofi-act-2022-prohibition-of-certain-sales-incentives>. This will help us to collate submissions and ensure that your views are fully considered. Please also include your name and (if applicable) the name of your organisation in your submission.

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

You can make your submission by:

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

Financial Markets team
Building, Resources and Markets
Ministry of Business, Innovation & Employment
PO Box 1473
Wellington 6140
New Zealand

Please direct any questions that you have in relation to the submissions process to FinancialConduct@mbie.govt.nz. During the consultation period we will be available to meet with stakeholders. If you would like to meet with us, please let us know.

Use of information

The information provided in submissions will be used to inform MBIE's policy development process and will inform advice to Ministers. We may contact submitters directly if we require clarification of any matters in submissions.

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MBIE intends to upload PDF copies of submissions received to MBIE's website at www.mbie.govt.nz. MBIE will consider you to have consented to uploading by making a submission, unless you clearly specify otherwise in your submission.

If your submission contains any information that is confidential or you otherwise wish us not to publish, please:

- indicate this on the front of the submission, with any confidential information clearly marked within the text
- provide a separate version excluding the relevant information for publication on our website.

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Glossary

CoFI Act	Financial Markets (Conduct of Institutions) Amendment Act 2022
CoFI regime	New regime being introduced under the Financial Markets (Conduct of Institutions) Amendment Act 2022
Financial institutions	Registered banks, licensed insurers, and licensed non-bank deposit takers providing one or more relevant services under the CoFI Act
FMA	Financial Markets Authority
FMC Act	Financial Markets Conduct Act 2013
MBIE	Ministry of Business, Innovation and Employment
Reserve Bank	Reserve Bank of New Zealand

1 Introduction

A new regime requires financial institutions to comply with regulations relating to sales incentives

1. The Financial Markets (Conduct of Institutions) Amendment Act 2022 (**CoFI Act**) received royal assent on 29 June 2022. This legislation represents a fundamental evolution of conduct regulation of the retail banking and insurance sectors in New Zealand. It introduces a conduct licensing regime for banks, insurers, and non-bank deposit takers (collectively, **financial institutions**) and aims to ensure that financial institutions treat consumers fairly.
2. Under the new CoFI regime, financial institutions will be required to comply with a principle to treat consumers fairly (the **fair conduct principle**), and must establish, implement, and maintain an effective fair conduct programme to ensure that they comply with the principle. Financial institutions will need to operate under a licence issued by the Financial Markets Authority (**FMA**) in order to provide core banking and insurance products and services to consumers in New Zealand. The FMA anticipates licensing applications will open from mid-2023. The Government expects the CoFI regime to fully come into force in early 2025.
3. Once the CoFI regime comes into force, financial institutions and intermediaries involved in the chain of distribution to consumers will be required to comply with regulations that regulate incentives. This is a core duty in the CoFI Act. It was introduced following the FMA and Reserve Bank reviews of banks and life insurers (as well as previous thematic reviews and the Australian Royal Commission into banking and financial services). These reviews found that sales incentives were driving conflicts of interest and risking the sale of unsuitable financial products to consumers.

Consultation has already taken place on the approach to take to regulating sales incentives

4. In September 2019, Cabinet decided to regulate sales incentives based on volume or value targets, following public consultation on an options paper about the design of the new conduct regime. In May 2021, MBIE released a discussion document seeking feedback on potential options and approaches to regulations under the CoFI Act. One matter on which feedback was sought was the approach to take with sales incentives based on volume or value targets. The discussion document is linked here: <https://www.mbie.govt.nz/dmsdocument/14057-regulations-to-support-the-new-regime-for-the-conduct-of-financial-institutions>
5. The majority of submitters preferred a specific prohibition of sales incentives based on volume or value targets instead of an alternative principles-based prohibition, which would prohibit

any incentives reasonably expected to influence choices offered to consumers or financial advice.

6. In February 2022, taking into account feedback received through consultation, Cabinet agreed to prohibit financial institutions and intermediaries from offering sales incentives based on volume or value targets to their employees (except senior managers and executives), agents and intermediaries. The minute recording Cabinet's decision is linked here:
<https://www.mbie.govt.nz/dmsdocument/19332-financial-markets-conduct-of-financial-institutions-amendment-bill-further-policy-decisions-and-regulations-minute-of-decision-proactiverelease-pdf>

This document seeks feedback on an exposure draft of regulations to prohibit certain kinds of sales incentives

7. This document seeks your feedback on the exposure draft regulations to prohibit sales incentives in accordance with Cabinet's policy decisions above by 5pm on **Wednesday 9 November 2022**.
8. We are seeking your feedback to ensure we have not overlooked any technical points in how the policy decisions have been drafted, to ensure that the drafting achieves the policy intent and to ensure that the drafting does not give rise to any unintended consequences.
9. After the consultation period closes, MBIE will analyse the feedback received and consider any changes that may be required to the regulations. The draft regulations are expected to be made in Q1 2023 and come into force in early 2025 at the same time as the rest of the new conduct regime.

Not legal advice

10. The information in this document is general information provided to help with reading the draft regulations and is not legal advice. Please refer to the text of the regulations and seek legal advice if you wish to understand how the regulations would apply to specific circumstances.

2 Content of the regulations

'Incentive' is defined in the legislation

11. 'Incentive' is defined in section 446M of the Financial Markets Conduct Act 2013 (**FMC Act**), inserted by section 12 of the CoFI Act. Incentive means a commission, benefit or other incentive (whether monetary or non-monetary and whether direct or indirect):
 - a. that is offered or given to a recipient in connection with the recipient being directly or indirectly involved in the provision of the service or the products
 - b. that is determined or calculated by reference to the volume or value of the services or products.
12. Under section 446M(2) of the FMC Act, the definition of 'incentive' applies regardless of whether a person's entitlement, or the nature or value, is also determined or calculated by reference to one or more matters unrelated to the volume or value of the services or products involved. For example, if the recipient is only entitled to a bonus if performance indicator relating to customer satisfaction is also satisfied, this factor does not prevent the bonus from being an incentive.
13. Section 446M(3) of the FMC Act provides some non-exhaustive examples of determining or calculating a matter by reference to the volume or value of the services or products.

The draft regulations prohibit incentives determined or calculated by reference to a target or other threshold

14. Cabinet decided to prohibit sales incentives that are based on volume or value targets as these types of incentives create a strong conflict between the interests of consumers and the interest of the person eligible to receive the incentive, which increases as the persons nears the target.
15. The draft regulations define 'prohibited incentive' as an incentive where a person's entitlement to the incentive, or the nature or value of the incentive, is determined or calculated in any way by reference (directly or indirectly) to a target or other threshold that relates to the volume or value of the services or products.
16. The draft regulations set out examples of a prohibited incentive and a non-prohibited incentive. Incentives on a linear basis (a per product or per service basis) do not fall within the prohibition as they are not determined or calculated in any way by reference to a target or threshold.

- 17. In order to give effect to Cabinet’s policy decision, the prohibition is intended to apply in all circumstances involving a volume or value sales target or other threshold, even where a person’s entitlement to the incentive is also determined or calculated by reference to other matters (consistently with section 446M(2) of the FMC Act). For example, incentives based on volume or value sales targets which form part of a balanced scorecard approach fall within the scope of the prohibition.¹ These types of incentives create a strong conflict even if other non-sales metrics are also used to assess a person’s performance. Excluding these from the prohibition would undermine Cabinet’s policy decision by enabling financial institutions to continue to offer incentives based on volume or value targets.
- 18. However, only the volume or value sales target-based portion of the balanced scorecard is subject to the prohibition. Balanced scorecards can continue to be used provided they do not contain metrics based on volume or value sales targets.

1	Do you consider that the draft regulations give effect to Cabinet’s decision to prohibit sales incentives based on volume or value targets? If not, why not?
2	Do you have any comments on the examples chosen of a prohibited incentive and a non-prohibited incentive?
3	Do you have any other comments on the way the draft regulations define prohibited incentives?

The draft regulations provide that the prohibition applies to financial institutions and intermediaries who offer or give incentives to a ‘relevant person’

- 19. The prohibition in the draft regulations applies to financial institutions and intermediaries who offer or give prohibited incentives to a ‘relevant person’. The proposed definition of ‘relevant person’ in relation to financial institutions and intermediaries is consistent with Cabinet’s policy decision that the prohibition will apply to a financial institution or an intermediary’s employees (except senior managers and executives), agents and intermediaries.
- 20. The definition of incentives in section 446M(1) of the FMC Act is also relevant to the scope of the regulations. This definition defines incentive as something that is given to a person in connection with the person (directly or indirectly) being involved in the provision of the financial institution’s services or products.

¹ A balanced scorecard is an approach to performance measurement and remuneration that includes various metrics; for example, sales targets, other performance measures like an assessment by the recipient’s manager, and customer-focused metrics such as customer satisfaction.

21. 'Involved' is defined in section 446Q(3) of the FMC Act as a person who does either or both of the following:
 - a. arranges a contract for the service or for the acquisition of the product² or
 - b. gives regulated financial advice in relation to the product.
22. An example of a person being 'involved' is provided in section 446M(1) of the FMC Act. A person who is a manager of a team of people who sell life policies is 'involved'. This means that, if the manager is entitled to a paid holiday if the team sells a certain number of life policies, the paid holiday will be an incentive.
23. In practice, the legislative requirement that the recipient of an incentive be directly or indirectly involved in the provision of the service or the products means that the prohibition will not apply if a commission or benefit is offered to a person who is not directly or indirectly involved, even if they are a 'relevant person' within the meaning of the draft regulations.

4

Do you have any comments on the definition of 'relevant person' in relation to a financial institution or an intermediary?

Exclusion of senior managers and executives from the incentive prohibition

24. Cabinet decided to exclude senior managers and executives from the incentives prohibition. As explained in the Cabinet paper supporting this decision, this was because the greatest conflict of interest is likely to occur at the mid-to-lower levels of an organisation where individuals are more directly involved in the chain of distribution. It is less common for senior managers and executives (particularly in large organisations) to receive sales incentives based on volume or value targets (although they may receive incentives designed to grow the business, such as incentives based on increases in market share). The Cabinet paper is linked here:
<https://www.mbie.govt.nz/dmsdocument/19329-financial-markets-conduct-of-financial-institutions-amendment-bill-further-policy-decisions-and-regulations-proactiverelase-pdf>
25. This approach is aligned with the FMA's expectations for banks and insurers following the conduct and culture reviews in relation to the removal of sales incentives for frontline staff and their managers. It allows for incentives to be offered as part of reasonable remuneration at more senior levels where they are less likely to drive strong conflicts of interest at the point of sale.
26. As the Minister has since advised Cabinet, the draft regulations do not explicitly exempt senior managers and executives from the prohibition. This is because the definition of 'incentive' under section 446M(1) of the FMC Act only captures a person who is (directly or indirectly) involved in the provision of the service or the products. As explained above, 'involved' has a

² 'Arrange' is defined in s446P(1) of the Act.

specific definition in the FMC Act and means either arranging the contract or giving regulated financial advice.

27. To the extent that senior managers and executives are not 'involved' in the provision of the service or the products, they would not be captured by the prohibition. To the extent that a senior manager or executive is 'involved' (e.g. in a small financial institution or financial advice company where one person is the sole director and manager) then we consider it is appropriate that the prohibition applies to them.

5

Do you have any comments on the application of the draft regulations to senior managers and executives?

6

Do you have any other additional general comments on the exposure draft regulations?

For example, do you see any unintended consequences arising from the draft regulations in relation to any other matters? Are there any areas where the application of the draft regulations is unclear and could benefit from additional examples or guidance?