

Consultation paper: Exposure draft regulations on sales incentives under the new conduct regime

Bank of New Zealand's response

9 November 2022

1 Introduction

- 1.1 Bank of New Zealand (BNZ) has prepared this response to the exposure draft regulations (Draft Regulations) on sales incentives under new conduct regime, 28 September 2022 (the Consultation).
- 1.2 BNZ is committed to core principle of the Financial Markets (Conduct of Institutions) Amendment Act 2022 (CoFI) to treat consumer fairly and understands that the regulation of incentives plays a role in ensuring that occurs. This is because sales incentives, as shown by recent reviews and research, can create conflicts of interest and increase the risk of the sale of unsuitable financial products to consumers.
- 1.3 The focus of this submission is to highlight aspects of the Draft Regulations which we do not believe will assist in achieving the policy objective 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.
- 1.4 We welcome the opportunity to provide our feedback on the Consultation. BNZ is aware that the New Zealand Bankers Association ('NZBA') has also made a submission on the Bill. BNZ has contributed to that submission and supports it.
- 1.5 We would be happy to discuss any of our feedback and should MBIE have any questions in relation to this submission, please contact Paul Hay, Paul_Hay@bnz.co.nz.

Paul Hay

GM, Regulatory Affairs, Bank of New Zealand



2 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?

2.1 We consider the Draft Regulations do give effect to Cabinet’s decision to prohibit sales incentives based on volume or value targets. However, given the application of the prohibition requires interpreting different sections and definitions within the Act (specifically the definitions of “incentive” and “involved”), we submit that the drafting could be simplified to assist financial institutions in interpreting or applying the requirements.

2.2 We think the prohibition on incentives could be more simply drafted by:

- including definitions of senior managers and executives and including an express exclusion from the prohibition for senior managers and executives;
- amending Regulation 237(a) to expressly provide that the prohibition only applies to employees who are “involved in the provision of the financial institution’s relevant services or associated products”; and
- removing the definition of “prohibited incentive” (see more below).

3 Do you have any comments on the examples chosen of a prohibited incentive and a non-prohibited incentive?

3.1 We consider the examples provided for in section 237B are helpful to understand the difference between a simple incentive linked to a target (which is prohibited) and a linear incentive (which is not prohibited). We think it may also be useful to provide additional examples of other incentives that are not prohibited – e.g., behavioural targets. Most financial institutions no longer have incentives that are based on volume or value targets but do use balanced scorecards with behavioural measures included.

3.2 It may also be useful to include an example of where an incentive is determined *indirectly* by reference to a threshold as this is a grey area where guidance would be helpful.

4 Do you have any other comments on the way the draft regulations define prohibited incentives?

4.1 It is not clear that the definition of "prohibited incentive" in Regulation 237B materially differs from the definition of "incentive" in the newly inserted section 446M of the FMC Act. We consider that you could remove 237B and then re-number the draft regulation's new 237C and 237D accordingly and replace "prohibited incentive" with "incentive", whilst making it clear that "incentive" has the meaning given to it in the Act.

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

5.1 We have the following queries in relation to the drafting:

- where the Draft Regulations refer to "an employee", should this also refer to "contractor" as well? Or is this intended to be covered by "agent" in subclause (c)?
- Should Directors be expressly excluded? Our understanding is that they directors are not usually considered "employees" and would not typically be involved in the provision of service or products to a consumer, but we would prefer that there is no doubt.
- We note that (b) and (c) specifically refer to a person "...that is involved in the provision of the financial institution's relevant services or associated products...". As mentioned in our response to question 1, we consider that these words should also be included for "employees" in (a).

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

- 6.1** As an initial comment we note that the Financial Markets Conduct Act 2013 defines Directors and Senior Managers, but the Cabinet decision on incentives refers to "senior managers and executives". We assume this is because the reference to senior manager in this context goes further than executives and include those persons reporting to the executive team, but this is not clear. Given this uncertainty we think it would be helpful to define what is meant by the words "senior managers and executives" in the Cabinet paper expressly exclude these from the prohibition on incentives.
- 6.2** We understand the reasoning for not expressly exempting senior managers and executives, given this may create inconsistent application of the prohibition between small and larger organisations. However, we have concerns that by not including a specific exclusion for senior managers and executives, there is more uncertainty as to who the prohibition applies to, and this could lead to inconsistency of application in the industry. It appears that each financial institution will be required to determine which employees in its organisation are directly or indirectly "involved" in the provision of the service or the product" and to put controls in place to ensure these distinctions are maintained. This may create unintended consequences e.g., prohibiting senior managers from assisting in difficult or complicated customer interactions. It is highly likely to lead to inconsistent application across the industry.

7 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?

- 7.1** We consider the prohibition on incentives as an important part of embedding good culture at financial institutions and this is reflected in core obligations within CoFI to treat customers fairly and to have a Fair Conduct Programme. Regardless of any prohibition on incentives, there is still a risk that a sales culture may re-emerge and it is imperative that the structure of incentive arrangements at any institution is reviewed in the context of the wider culture at that institution.

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