

Submission on Exposure draft regulations on sales incentives under new conduct regime

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Fidelity Life is New Zealand’s largest locally-owned life insurer providing insurance for individuals, businesses and employers. Our purpose is to protect New Zealanders’ way of life. Everything we do is driven by this purpose.

Responses to consultation document questions

Prohibited incentives	
1	<p><i>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?</i></p> <p>As discussed further below, Fidelity Life considers that there is a risk that the draft regulations will apply more widely than Cabinet intended and uncertainty about the application of the exclusion of the prohibition to senior managers and executives.</p>
2	<p><i>Do you have any comments on the examples chosen of a prohibited incentive and a non-prohibited incentive?</i></p> <p>We support the use of examples in the drafting as the extra clarification is helpful. As the scenarios used are simplistic it would be helpful to have additional examples using more complex scenarios, more closely reflecting the variations of business models across the market. This will assist in resolving uncertainty caused by the wide scope of the definition and the absence of an explicit exclusion for senior managers and executives.</p>
3	<p><i>Do you have any other comments on the way the draft regulations define prohibited incentives?</i></p> <p>Our understanding of Cabinet’s intention is that the prohibition was intended to apply to sales incentives. The definition of “prohibited incentive” uses the definition of “incentive” in s237B of the Financial Markets (Conduct of Institutions) Amendment Act 2022 (the Act) which is very broad. It applies in relation to a relevant service or any associated product. “Relevant service” is defined in s446E of the Act and includes acting as an insurer. The definition of an incentive therefore applies widely across an insurer’s business. While appropriate in the context of the Act its use in the definition of a “prohibited incentive” could prohibit incentives that relate to good customer outcomes that are unrelated to sales targets but that relate to business of acting as an insurer. The definition of “prohibited incentive” makes no reference to sales but rather “to the volume of value of the services or products”, which is much wider. We consider the definition in the regulation should be restricted so that it applies in relation to the sales of the services or products.</p> <p>However, restricting the prohibition to sales may still result in unintended consequences because the scope of the prohibition will still be very wide. It could, for example, apply in the case of financial advisers’ access to supplementary training and professional development opportunities where entitlement to that incentive may include a measure that relates to the</p>

volume or value of sales. This type of incentive ultimately benefits the customer and leads to better customer outcomes. If it has to be offered to all persons in a group in order to avoid running afoul of the regulation, the opportunities for such development may become more limited because of the extra resource that will be required to provide them.

While s446M(3) of the Act sets out what determining or calculating a matter by reference to the volume or value of the services or products includes, that subsection applies without limitation. As mentioned above, we think there is scope for uncertainty, particularly in relation to determining a matter by reference to value. We refer below to an example used in the 16 March 2022 paper to the Cabinet Economic Development Committee of *incentives designed to grow the business, such as incentive based on increases in market share*. We think the application of the prohibition to that type of scenario is less clear, although note, as also discussed below, the Cabinet Paper refers to incentives that *“may technically be caught by the prohibition”*.

Recipient of incentive

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

As discussed below, we consider the definition of “relevant person” should specifically exclude senior managers and executives.

Exclusion of senior managers and executives from the incentive prohibition

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

The lack of an explicit exclusion for senior managers and executives in the current drafting gives rise to uncertainty about when the exclusion will apply and will may make it difficult for a financial institution to rely on it. As the definition of “incentive” applies to a person who is “directly or indirectly” involved in the provision of the service or the product it may not be clear where the line is to be drawn. The 16 March 2022 paper to the Cabinet Economic Development Committee appears to support this view as it refers to a “possible technical breach” when discussing incentives for senior managers or executives which it appears were regarded as being acceptable. Paragraph 38 states:

“It is uncommon for senior managers and executives 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). This approach is aligned with the FMA’s expectations for banks 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 the senior level where they may technically be caught by the prohibition, but are less likely to drive strong conflicts of interest at the point of sale.”

We think the draft regulations should make it clear that the prohibited incentives do not apply to senior managers and executives to put the matter beyond doubt. Any incentive offered to senior managers and executives will still be subject to the broad obligation for financial institutions to design and manage incentives to mitigate or avoid any adverse impacts on the interests of consumers, which, as the Minister noted in the Cabinet paper, *“should address the risk of ‘top down’ sales pressure resulting in poor customer outcomes.”*

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?

Other Comments
