

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

Your name and organisation

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Organisation (if applicable)	Financial Advice NZ

Responses to consultation document questions

Prohibited incentives

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?

We believe the draft regulations give effect to Cabinet’s decision to prohibit sales incentives based on values and volumes targets.

However, we believe that the way the regulations are drafted extends the intent to other forms of the incentives which was not the intent of the cabinet decision.

We further believe the regulation was never to extend to the wider incentive structure but to be focussed on volume and value based targets and soft incentives.

This regulation has been widened by drafting the words ‘**or other thresholds**’ which extends the intent of the cabinet decision and causes significant unintended consequences to the sector and consumers.

The draft definition of incentives is too wide.

We consider the phrase ‘**or other thresholds**’ should be removed.

This policy was meant to be the ‘tip of the spear’ and cut through to where there could have been poor behaviour – we believe widening these words will have unintended consequences to the sector as a whole and significantly change the landscape of the sector and the ability for people to access financial advice, which will lead to poor consumer outcomes.

As per below is how the cabinet paper, legislation and regulations have been drafted and implemented which reflects what we believe to be a **significant drafting issue** which needs to be changed. The words ‘or other thresholds’ are not expressed until the regulations are drafted. The introduction of these words changes the intent and implementation of the cabinet paper significantly.

Cabinet Paper 16 March 2022 – As stated in the Cabinet Paper

Regulations 9 - Agreed that financial institutions and intermediaries be prohibited from offering sales incentives based on volume or value targets to their employees (except for senior managers and executives), agents and intermediaries.

CoFI – S446(M)

S446(M) states the meaning of incentive and provides examples as to the interpretation of

the definition of incentives.

The examples used highlights the areas of incentives relating to volume and value. In the Act incentives are not extended to other thresholds in the examples.

Example 1

A person (A) is given a bonus based on A's individual performance in selling life policies. A's performance is measured by reference to the value of the premiums payable. The bonus is an incentive.

Example 2

A person (A) is a manager of a team of people who sell life policies. A will be entitled to a paid holiday if the team sells a certain number of life policies. The paid holiday is an incentive.

It further explains through an example what a non target incentive is:

Example

A financial adviser is paid a commission based on a fixed percentage of premiums paid under insurance contracts arranged by the adviser. The commission is an incentive regardless of the fact that no target is involved.

The drafted regulation states what a prohibited incentive is:

Regulation 237B

.... Is a prohibited incentive, in relation to relevant services or associated products, if 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.

Example

Prohibited incentive

The employee of a life insurer is offered a \$1,000 bonus for selling 100 life policies in a 3 month period.

Example

Incentive that is not prohibited (linear basis)

An employee (A) is paid a 55% commission for each life policy that (A) arranges. The percentage does not depend on any target or threshold. (The % does not change based on the volume or value of life policies).

The use of the words 'or threshold' may mean other areas of incentives such as persistency rates which are a common method of an incentives calculation will also be prohibited. We believe the intent of the cabinet paper and the legislation was never to be this far reaching.

An example of the unintended reach of the regulations would be the impact on persistency rates which for some providers is a key component of a scorecard.

The current remunerations structures (which are not broken and are not based on value and volume as per the cabinet paper intent) may no longer be allowed under the new draft regulations. This may mean the whole remuneration model for the sector will need to be reviewed.

The sector is extremely fatigued from the last four years of implementation of the new regime and it would be a poor outcome that advisers are put under significantly more pressure due to the drafting of the regulation and its unintended consequences.

As per MoBIE website in relation to this regulation it states:

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.

Other remuneration (incentive) structures which are currently being used by intermediaries have not been evidenced by conflicts of interest nor risk the sale of unsuitable financial products to consumers. We believe these regulations are not fixing a problem which has been identified.

In addition to this we believe this drafting has not taken in the intent of what the legislation was trying to achieve by drafting wording which widen the interruption significantly.

We further believe there has been no consideration of the implementation of the new regime which 'places client's interests first'.

We recommend the removal of the words 'or other thresholds' in the regulation.

2

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

The examples provided are clear and make sense. However, we believe that the wording of the regulation has to be correct in the first instance and examples only add clarity.

We believe with the wording 'or other thresholds' makes this ambiguous and will lead to legal interruption which may have an adverse effects on the sector and the ability for consumers to access financial advice.

The CCCFA was a good example of poorly worded legislation and regulation even with the use of examples – the examples did not override the interruption of the legislation by the legal counsel of financial institutions. We would be disappointed if this has the same outcomes as CCCFA.

3

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

As per 1 and 2.

Recipient of incentive

4

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

This regulation will restrict FAP business models innovation and growth from intermediary to adviser. There has been no systemic failure in this area and there has been no commentary that this is an area of concern in the sector which requires additional regulation.

S237(D) – We have significant concerns regarding this section. We believe the cabinet paper and the legislation and regulations have unintended consequences as they are drafted for the sector which will significantly impact on the growth of the sector and the ability of New Zealanders to seek quality financial advice.

The new regime has meant that we have seen a move of financial advice businesses merging

and obtaining more economies of scale due to increased compliance and regulatory costs. This has and will continue to have an impact on the way the sector grows.

Sector growth needs to be able to develop new innovative remuneration structures which are not solely based on 100% commissions to be a vibrant, modern sector.

The introduction of S237(D) we believe could significantly impact on the growth of the sector the way it is drafted.

Example

A financial advice business has a current model which is salary based and at a certain value of sales they move to a salary plus a linear commission model. This model was established to allow for advisers to have a salary so when times were harder or entering the industry they would have a base salary to pay their living costs regardless of the sales they made. This encourages good behaviour especially when there is a downturn in the market.

The way the regulations are drafted in S237(D) this would not allow for this business model to be applied.

In addition to this in the MoBIE consultation paper states:

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.

We do not believe there has been instances identified where a FAP has caused “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.”

We believe in the first instance that S237(D) should be removed and reviewed in 2 years to see if there is any evidence of harm.

If S237(D) remains in the way it is drafted there will be significant unintended consequences for both the sector and its growth, and significant harm to consumers as they will not be able to access quality financial advice.

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?

Behaviours in an organisation are based on the conduct and culture firstly at a board level then at a senior management level which then flows down through the organisation. We believe that if you want good conversations and behaviours, they should be modelled from the top therefore to exclude directors and senior managers from this seems odd!

We know the tone is set from the top down.

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

Regulation 237(B) The drafting of this regulation has been widened by using the words 'or other thresholds' which extends the intent of the cabinet decision and causes significant unintended consequences to the sector and consumers.

We believe there is a significant drafting issue and the words 'or other thresholds' should be removed.

We believe Regulation 237(D) will have significant unintended consequences for the sector.

The issue which the cabinet decision was trying to solve was not allowing for sales targets and incentives to unduly influence the placement of product for consumers.

Financial incentives based on volume or value by intermediaries to other intermediaries has never been identified as an issue let alone a systemic issue which needs to be addressed through regulations.

There are significant unintended consequences to the sector if this section is implemented.

New models are evolving in the sector which is providing an option of being salary and commission based. These models are allowing new advisers to enter the market and make a living while they develop their skills and businesses. The models allow a combination of salary until a certain point where the adviser can then obtain commissions so they get certainty of income and also being able to access commissions at a certain volume or value.

This regulation would stop this model from evolving.

A challenge for the sector is having professional financial advisers so that consumers can access financial advice. This regulation will stop an important business model and other business models maturing in the sector which will grow the number of advisers and the accessibility of advice to consumers.

Finally the draft regulations seem to ignore the new FSLAA Code of Professional Conduct which require financial advisers to place the clients interest first.

We strongly recommend you allow the new regime to have an establishment period before you make significant changes to the sector which could have poor outcomes for both consumers and the availability of quality financial advice.

We believe in the first instance that S237(D) should be removed as this was not the intent of the cabinet paper and if necessary reviewed in 2 years to see if there is any evidence of harm.