

**IAG New Zealand submission**

to the

**Ministry of Business Innovation and Employment**

on the

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

9 November 2022

## Introduction

This submission is a response by IAG New Zealand Ltd (IAG, we) to the Ministry of Business Innovation and Employment (MBIE) on the exposure draft regulations on sales incentives under the new conduct regime and the associated consultation paper, both of which were released on 28 September 2022.

IAG is New Zealand's leading general insurer. IAG employs over 3,500 people, insures more than 1.8 million New Zealanders and protects over \$715 billion of commercial and domestic assets across New Zealand. We received around 461,000 claims in the last financial year and paid \$1.7 billion to our customers in settling them.

This submission may hold commercially sensitive information. While IAG is happy to appear on any public list of submitters, we ask that the certain contents of our submission remain confidential under Section 9(2)(b)(ii) of the Official Information Act 1982 and would be happy to provide a redacted copy for publication purposes.

IAG's contacts for matters relating to this submission are:

**Bryce Davies**, Executive Manager Corporate Relations

T: 09 969 6901

E: [Bryce.Davies@iag.co.nz](mailto:Bryce.Davies@iag.co.nz)

**Andrew Saunders**, Government Relations Manager

T: 04 903 4005

E: [Andrew.Saunders@iag.co.nz](mailto:Andrew.Saunders@iag.co.nz)

## 1. Overarching comments

- 1.1 IAG supports the introduction of the new conduct regime. We have also welcomed the Government responding to sectoral concerns with the initial design of the conduct regime through evolution of the legislative framework, and with ongoing consultation on the detailed policy settings within it.
- 1.2 In this submission we outline some issues with how the proposed prohibition on 'incentives' has been drafted, risks and implications associated with banning all target-related incentives, and identify amendments required to address these.

### Risks and implications of banning all target-linked incentives

- 1.3 We agree that:
  - appropriately designed remuneration provided to employees, agents and intermediaries is a critical part of supporting a customer centric culture and consistently achieving good customer outcomes; and
  - a focus on target-based sales incentives with insufficient safeguards has the potential to create undue pressure to make sales in certain contexts, as was identified in the RBNZ/FMA report on Life Insurer Conduct Culture.<sup>1</sup>
- 1.4 While we agree that poorly designed incentives can create a conflict of interest with consumers, and that some regulation around the use of sales incentives can be useful, we are concerned that the absolute prohibition on target related incentives may have unintended consequences that go beyond the policy intent.
- 1.5 It is important to recognise that the only way insurers can provide financial protection to customers is by selling them an insurance product that responds to the financial risks they face. Our corporate responsibility is anchored in delivering for our customers on the promises we make at sales time. We are mindful that we need to sell a customer a suitable insurance product to enable that, and if we don't, we leave them potentially unprotected and exposed to unbearable financial losses. Less uptake of insurance products leads to an increase in the protection gap.
- 1.6 In this context, it is appropriate to encourage the sale and distribution of products to customers through incentives so long as the design of the incentive doesn't conflict with the interests of the customer (i.e., by encouraging the sale of products that potentially aren't appropriate for the customer). It is also important to recognise that other aspects of the new conduct regime will work together to minimise the risk of mis-selling (e.g., the requirements related to product design that are intended to both avoid poorly designed products and to reduce the risk of products being sold to unsuitable people).

---

<sup>1</sup> Refer for example to page 17 of the January 2019 report titled "Life Insurer Conduct and Culture, Findings from an FMA and RBNZ review of conduct and culture in New Zealand life insurers".

- 1.7 We consider that volume or value targets used as part of a balanced set of measures, with effective controls, can be appropriate. Balanced scorecards containing a mix of financial (including potential sales related targets) and non-financial metrics (such as consumer-centric metrics) can appropriately balance the need to provide financial protection to customers and support positive customer outcomes, since the maximum incentive outcomes cannot be awarded where non-financial metrics have not been achieved. Additionally, the risk of negative customer outcomes and mis-selling can be further minimised through the use of conduct gateways, whereby no incentive can be awarded where inappropriate behaviours or actions have occurred.
- 1.8 Given the above, we are concerned that prohibiting the use of volume or value-based targets entirely:
- is disproportionate to the specific risks identified in relation to sales/distribution in the 2018/19 RBNZ/FMA conduct and culture reviews of banks and life insurers, which were centred on the mis-selling of products in a specific context rather than sales in general (as outlined in paragraphs 135-137 of the April 2021 consultation paper<sup>2</sup>);
  - does not recognise that pursuing the sale of products to customers is a fundamental part of a competitive market and that it is only through selling products to customers that insurers can provide the protection insurance offers;
  - risks preventing entities from rewarding business growth/profit targets and potentially some customer metrics (noting that broader entity-level metrics can't in any case be influenced by individual frontline employees and therefore don't create a conduct risk); and
  - could put New Zealand out of step with other jurisdictions such as Australia that do that do not take such a prescriptive approach but rather rely on entities to design their remuneration frameworks in a way that both protects consumer interests, while also achieving the strategic commercial objectives that are critical to a thriving and substantiable financial services sector.<sup>3</sup>
- 1.9 We consider allowing volume or value targets within balanced scorecards, with conduct gateways attached and potentially limits on the weighting on financial metrics, to be a more balanced and comprehensive approach. It would also allow for performance measures to be cascaded through a financial institution, creating alignment and clarity throughout as to what the organisation values. It also reduces the risk that prohibiting one type of incentive (i.e., any that are target related) leads to entities exploring non-target-related incentives that could be equally if not more problematic.

---

<sup>2</sup> MBIE, “Regulations to support the new regime for the conduct of financial institutions”, April 2021.

<sup>3</sup> For example, in the Australian context:

- The Sedgwick Review of retail banking remuneration arrangements recommended a max scorecard weighting of 33% on financial measures for frontline employees, while APRA’s new Prudential Standard, CPS 511 Remuneration, takes an even less prescriptive approach, requiring entities to include a material weight on non-financial measures in designing variable remuneration plans.
- The Australian Treasury on 31 October 2022 proposed (as part of the Quality of Advice review) not to expand the ban on 'conflicted rem' that applies to Australian Financial Services

## Recommended amendments to the draft regulations

- 1.10 To achieve the policy intent of prohibiting certain types of sales incentives (originally agreed in September 2019<sup>4</sup> and then finalised in 2022<sup>5</sup>) in order to address the issues identified by the FMA/RBNZ in 2018/19 it is necessary to amend the regulations to make their scope more explicit. The current drafting is too broad in its application, extending the scope beyond what is intended, thereby creating uncertainty and unnecessary limitations on entities linking growth to remuneration.
- 1.11 Amendments to the regulations are required in relation to both what is a prohibited incentive and who it applies to (i.e., “relevant persons”) to target the application to that intended and realise the advantages of an explicit prohibition. We recommend the following amendments are made to the regulations:
- The words “sold or distributed to a consumer” or similar are added “after “services or products” at the end of regulation 237B.
  - The following is added to the end of the text of regulations 237C(a) and 237D(a) - “that is involved in the provision of the financial institution’s relevant services or associated products”.
  - The headings of regulations 237C and 237D are simplified.
  - Further examples are added under regulation 237C to clarify the application of “relevant person” in relation to senior managers and executives.
- 1.12 The rationale for these changes is outlined in further detail below in Section 2 of this submission.

---

licensees to the provision of general insurance and life insurance products, the rationale being there are other mechanisms in place to manage potential conduct risk (anti-hawking, design and distribution obligations etc).

<sup>4</sup> In September 2019 Cabinet “agreed to regulate sales incentives based on volume or value targets (this regulation would apply to banks, insurers, non-bank deposit takers and the intermediaries of these institutions creating these types of incentives)”, (DEV-19-MIN-0237 refers).

<sup>5</sup> In February 2022 Cabinet “agreed that financial institutions and intermediaries be prohibited from offering sales incentives based on volume or value targets to their employees (except senior managers and executives), agents and intermediaries”, (DEV-22-MIN-0003 refers).

## 2. Responses to consultation document questions

In this section we provide responses to the specific questions posed in the consultation paper.

### 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?*

To achieve the policy intent of prohibiting certain types of sales incentives (originally agreed in September 2019 and then finalised in 2022<sup>6</sup>) it is necessary to amend the regulations to make their scope more explicit.

The regulations have always been intended to prohibit offering sales incentives based on volume or value targets, however, as outlined above in Section 1 of this submission the broader framing used to achieve this in the draft regulations extends the scope beyond what is intended and creates uncertainty both as to:

- whether they are limited to just sales related incentives (i.e., there are a number of financial and other measures that may be indirectly related to the volume or value of products/services (e.g., profit measures or customer measures could relate to volume)); and
- whether senior managers and executives are excluded from the prohibition (refer also to further comments in response to Question 5 below).

We note these two points are to some degree interconnected and that changes are required in relation to both what is a prohibited incentive and who it applies to (i.e., relevant persons) to limit the prohibition to the scope intended. To achieve this, we recommend the following amendments are made:

- The words “sold or distributed to a consumer” or similar are added “after “services or products” at the end of regulation 237B.
- The headings of regulations 237C and 237D are simplified.
- The following is added to the end of the text of regulations 237C(a) and 237D(a) - “that is involved in the provision of the financial institution’s relevant services or associated products”.
- Further examples are added under regulation 237C to clarify the application of “relevant person” in relation to senior managers and executives.

These recommended drafting changes to the regulations are shown as follows as amendments to the draft regulations:

1. *Amend regulations 237B and 237C as follows:*

**“237B What is a prohibited incentive**

In regulations 237C and 237D, an incentive (as defined in section 446M of the Act) is a prohibited incentive, in relation to relevant services or associated products, if a person’s

<sup>6</sup> Refer to footnotes 5 and 6 above.

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 sold or distributed to consumers.”

**“237C Financial institution must not offer or give prohibited incentives ~~based on volume or value targets~~”**

(1) For the purposes of section 446K of the Act, a financial institution must not offer or give a prohibited incentive to a relevant person.

(2) In this regulation, relevant person, in relation to a financial institution, means—

- (a) an employee of the financial institution that is involved in the provision of the financial institution’s relevant services or associated products; or
- (b) an intermediary that is involved in the provision of the financial institution’s relevant services or associated products; or
- (c) an agent of the financial institution that is involved in the provision of the financial institution’s relevant services or associated products.”

2. *Include examples below regulation 237C to clarify the application of “relevant person”.*

3. *Amend regulation 237D as follows:*

**“237D Intermediary must not offer or give prohibited incentives ~~based on volume or value targets~~”**

(1) For the purposes of section 446L of the Act, an intermediary must not offer or give a prohibited incentive to a relevant person in connection with the provision of a financial institution’s relevant services or associated products.

(2) In this regulation, relevant person, in relation to an intermediary, means—

- (a) an employee of the intermediary that is involved in the provision of the financial institution’s relevant services or associated products; or
- (b) another intermediary that is involved in the provision of the financial institution’s relevant services or associated products; or
- (c) an agent of the intermediary that is involved in the provision of the financial institution’s relevant services or associated products.”

As discussed further below, amendments are also required to proposed regulations 237C and 237D in the regulations to make clear who the prohibitions apply to (please refer to answers to Questions 4 and 5 below).

2

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

The use of examples in the regulations is welcomed. In relation to proposed regulation 237B they can be used to provide greater certainty as to the sorts of incentives are prohibited.

The first example of a prohibited incentive illustrates a straightforward and self-evident example of the sort of incentives that are intended to be prohibited. It would also be useful to include further examples of the types of incentives that are intended to be prohibited, if there are any others that have been specifically contemplated?

The second example, which makes clear that “linear” incentives are not prohibited, provides important certainty for financial institutions and intermediaries in relation to the conventional commissions that underpin the distribution of intermediated insurance products and much of the related financial advice provided in New Zealand. We note the example references a 5% commission, which is a lower commission rate than would apply to many insurance products. While using 5% may be fine for the purposes of the illustrative example, it is important to recognise that commission rates are often materially higher than this and so it should not be inferred from the example that having a commission rate in the order of 5% is salient to whether an incentive is prohibited by the regulations.

3

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

No further comments.

#### Recipient of incentive

4

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

We consider the proposed definition of “relevant person” generally works to achieve the policy intent in relation to intermediaries and agents (subclauses (b) and (c) of regulation 237C) but not fully in relation to employees. Before exploring this further and how it might be remedied we note the following:

- The definition of “incentive” itself (refer section 446M(1)(a) of the *Financial Markets Conduct Act 2013* (FMCA)) contains the qualification “the commission, benefit, or other incentive is offered or given to A in connection with A (directly or indirectly) being involved in the provision of the service or the products”.
- That “involved in” is defined in section 446Q(3) but the meaning of “directly or indirectly” is not defined or expanded upon.
- The qualification “that is involved in the provision of the financial institution’s relevant services or associated products” in proposed regulation 237C is provided in relation to intermediaries and agents, but not in relation to employees.

“Involved in” has been reasonably tightly defined in the primary legislation, but the issue is “incentive” is defined as something payable in relation to persons directly or indirectly involved in the provision of the service/product. The application of “directly” involved is straightforward and clearly includes the people involved in the transaction with the consumer, which is the intended focus of the prohibition.

It is however well established in case law considering causation that the word “indirectly” allows for a more remote link in the chain of causation than the proximate and immediate cause. Within an insurer with multiple divisions and layers of management, who is, and is not, “indirectly” involved in the provision of the service/product is not clear at all.

We are therefore concerned there is significant uncertainty as to the application of the prohibited incentives regulations given the combination of the wide definition of “incentive” in section 446M of the FMCA (particularly the use of “indirectly”) and the



inclusion of any “employee” of a financial institution regulation 237C(a) of the proposed regulations. This creates uncertainty generally as to the application of the regulations in relation to employees not necessarily involved in sales (for example underwriters), and in particular in relation to achieving the policy intent of excluding senior managers and executives from the incentive prohibition (as agreed to by Cabinet), which is discussed further in response to Question 5 below.

The clearest and most straightforward approach we have identified for ensuring the policy intent is achieved would be to make the treatment of employees under regulation 237C consistent with that of agents and intermediaries. As summarised above in response to Question 1, this could be simply achieved by redrafting regulation 237C as follows and by adding examples under it that define its application, particularly to provide clarity in relation to senior managers/executives (refer to response to Question 5 below):

**237C Financial institution must not offer or give prohibited incentives ~~based on volume or value targets~~**

- (1) For the purposes of section 446K of the Act, a financial institution must not offer or give a prohibited incentive to a relevant person.
- (2) In this regulation, relevant person, in relation to a financial institution, means—
  - (a) an employee of the financial institution that is involved in the provision of the financial institution’s relevant services or associated products; or
  - (b) an intermediary that is involved in the provision of the financial institution’s relevant services or associated products; or
  - (c) an agent of the financial institution that is involved in the provision of the financial institution’s relevant services or associated products.

The equivalent change should equally be made to regulation 237D(2)(a).

It is also recommended that the headings of regulations 237C and 237D are modified to explicitly reference “prohibited incentive”, rather than including what is essentially an abbreviated description of what the prohibited incentive is. This avoids any risks of the headings unduly impacting the interpretation of the prohibition and future proofs the regulations should that definition ever be amended. This is also shown in the drafting above.

### 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 regulations need to be revised to achieve the intended policy intent in relation to senior managers and executives. We recommend this is achieved through the change we have proposed above in response to Question 4 and through the provision of relevant examples below regulation 237C.

We note that the agreed policy intent of Cabinet is to exclude senior managers and executives from the prohibition on target related sales incentives. This was in recognition of both that:

- the greatest conflict of interest is likely to occur at the lower- to-mid levels of an organisation where individuals are directly involved in distribution of the product/service to customers; and
- to allow for incentives to be offered as part of reasonable remuneration at more senior levels where performance and growth of the business requires a focus on achieving financial metrics that are inherently driven by sales.

The consultation paper makes clear that instead of addressing this directly and explicitly exempting senior executives, the drafting approach is to rely on the interpretation of the FMCA (sections 446M(1) and 446Q(3)) to mean that senior managers and executives are not '(directly or indirectly) 'involved in' the provision of the service or the products to customers. As discussed above in response to Question 4 this does not provide certainty and relies on reading 'indirectly' narrowly so that an immediate manager is (potentially) included (as per the second example under regulation 237B) but their manager or manager plus one is excluded. This inevitably creates uncertainty (i.e., is anybody other than the person interacting with the customer 'indirectly' involved, and if so where and how that line is drawn).

We also note that the examples in section 446M(1) of the FMCA make clear that the person engaging with the consumer, and their manager (if there are team level incentive targets in place), are "involved in" in the provision of the service/product. These examples are useful in other respects and support a definition of "incentive" that is deliberately broad, but they do not make clear the limits of "(directly or indirectly) being involved in" - specifically the second example begs the question of where this stops if there were incentives in place for higher level managers that had correspondingly more broadly scoped target related incentives (i.e. if a general manager's performance is measured by reference to the number of policies sold by their group of distribution teams). It is also noted that in larger financial institutions there could be five or more levels of management.

Building on the changes already proposed it is recommended that new examples are added below regulation 237C that clarify the application of "relevant person" in relation to senior managers and executives. These could usefully expand on how "involved in" should be applied.

In summary, to make the non-application of the draft regulations to senior managers and executives clearer in order to achieve the policy intent, we consider that the regulations need to be revised (as outlined above in response to Question 4) by adding:

- the qualification "that is involved in the provision of the financial institution's relevant services or associated products" to regulation 237C(2)(a); and
- adding examples below regulation 237C that clarify the application of "relevant person" in relation to senior managers and executives for the purposes of these regulations.

---

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

6

*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?*

---

Please refer to our comments in Section 1 of this submission.

## Other Comments

Please refer to our responses to other questions and to the overarching comments in Section 1 of this submission.