

9 November 2022

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Consultation Paper – Exposure draft regulations on sales incentives under new conduct regime: Insurance Brokers Association of New Zealand Inc submissions

1. Please find attached the submissions of the Insurance Brokers Association of New Zealand Inc (IBANZ) on the Exposure draft regulations on sales incentives under new conduct regime.
2. IBANZ has over 100 member firms operating in the general (non-life) insurance market. IBANZ members employ approximately 5,000 staff of which approximately 2,500 staff are currently financial advisers.
3. IBANZ members place general insurance cover equating to approximately 50% of all general insurance premiums (\$3.7 billion) for approximately 1 million New Zealand customers and for approximately 14 of the 30 general insurers operating in New Zealand. The total New Zealand gross written general insurance premiums in the 12 months to 30 September 2021 were more than \$7.4 billion.<sup>1</sup>
4. Please let us know if you would like us to expand on any of the submissions made by IBANZ.
5. Our detailed submissions are below.

#### General submissions

6. IBANZ supports the draft regulations on sales incentives under the new conduct regime, and acknowledges that the exposure draft of the Regulations generally **corresponds to the Cabinet Paper and Minister’s comments.**
7. IBANZ submits that:
  - a. Consumer products only: the Regulations should be amended so the prohibition on volume or value targeted incentives is clearly applicable solely to incentives paid in respect of insurance policies sold to “consumers”. Currently, the Regulations do not specify when the incentive prohibitions apply, and accordingly, when read alone, the Regulations could be interpreted as applying to all forms of insurance.
  - b. **However, the definition of “incentive” in section 446M requires that an incentive is “offered or given** in connection with the person (directly or

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<sup>1</sup> Insurance Council of New Zealand Market Data. An additional approximately \$400 million of cover was placed through Lloyds.

indirectly) being *involved in* the provision of the service or products". "Involved" is defined in section 446P (1) solely by reference to section 446Q (3) and (4). **Section 446Q(3) and (4) define "involved" only in relation to products or services provided to "consumers"**. The better view therefore is that the volume or value target prohibition is intended to be limited solely to insurance products sold to "consumers". No other reasonable meaning could be given to the definitions in the Act. However, this interpretation **follows a tortuous route and would not be "clearly comprehensible" to intermediaries** without the benefit of scholarly or expert legal assistance or clear guidance. This inaccessibility of meaning is undesirable, and accordingly IBANZ encourages MBIE to clarify in the Regulations that the prohibition on volume or value targeted incentives applies only when the **person is "involved in the provision of the service or the products (as defined in subsections 446Q(3) and (4) of the Act),** or better still to expressly state that the restrictions apply only in the context of sales to consumers.

- c. Such an outcome would be consistent with the policy intent. It is commonly recognised that more sophisticated persons (such as wholesale investors in the FMCA context) do not need the same level of protection from legislation as less sophisticated individuals do. A consumer / non consumer distinction should apply in this context under the same principle. Extending the prohibition on volume or value targeted incentives to commercial entities and other non-consumers would not be proportional to their customer needs. Accordingly, applying the incentive restrictions to insurance policies sold to commercial customers would be unnecessary and excessive.
- d. **IBANZ recommends that the words "provided to consumers" are added** to the end of Regulation 237B to save tracing through the definitions in the Act to reach those words, and derive their meaning. Alternatively, an exclusion could be added for clarity, which excludes incentives paid in respect of non-consumer services or products.
- e. **Further clarity required in respect of "consumer" definition:** **Currently, the definition of "consumer" under sections 446P(1)(a), (b) and (c),** differs depending on the underlying financial institution or relevant service being provided. Section 446P(1)(d) attempts to align the definition of "consumer" for intermediary with the relevant principal financial institution.
- f. **It is unclear, however, how a "consumer" is to be defined for insurance brokers who give financial advice,** because there are different results under sections 446P(1)(a) and (d) on one hand, and (c) on the other:
  - i. section 446P(1)(a) defines a "consumer" for insurance brokers as intermediaries as a policyholder under a consumer insurance contract or contract or insurance that provides for life insurance or health insurance (or both), using the personal, domestic or household purposes definition; whereas
  - ii. section 446P(1)(c) defines a "consumer" for insurance brokers who are financial advisers by reference to section 446F(1)(a)(iii), which then refers to certain financial services under the Financial Service Providers (Registration and Dispute Resolution) Act and includes a

financial advice service for a retail client or a person who is offered the service and who would be a retail client if they receive the service.

- g. IBANZ requests that this inconsistency be addressed by clarifying in the Regulations that a consumer adopts the meaning in section 446P(1)(d) for intermediaries in the context of incentives, or that the Act is amended to include clarity that section 446P(1)(d) prevails over section 446P(1)(c) in the case of intermediaries. That approach would align the application of the requirements for insurers with the approach with insurance brokers, which seems to be the intention of section 446P(1)(d) and seems the most sensible outcome.
- h. Exception for training and advice tools: The prohibition on incentives is cast broadly in the Regulations and applies to any form of benefit, including benefits that should be encouraged, such as training, CPD sessions and advice tools which are designed to assist intermediaries improve their services, qualifications and capabilities for the benefit of their customers, as recognised as a sensible exception in Australia.
- i. With the proposed restrictions as they are written, an insurer or intermediary could not meet or subsidise:
  - i. a broker's Level 5 qualifications;
  - ii. CPD sessions or other training costs;
  - iii. attendance at a conference aimed at helping intermediaries/brokers maintain their knowledge about products, regulations, reinsurance markets and other topics required to comply with Standard 9 of the Financial Advice Code,

if the reimbursement, subsidy or attendance requires a certain level of sales to qualify. There are legitimate commercial reasons why an insurer or intermediary would require a minimum level of distribution and commitment by an adviser before being made eligible for these benefits, as these training benefits could not practically be provided to all-comers – there has to be an attendance criteria for practical reasons of cost. These forms of training would be highly desirable in achieving the purposes of the financial adviser regime and accordingly should be encouraged through an exception for them.

- j. Accordingly, IBANZ submits that the prohibition on volume or value targeted incentives should not apply if the benefits are:
  - i. product training, including conferences, which has genuine education or training purposes (as is the case in Australia – see section 963C(1)(c) of the Corporations Act 2001); or
  - ii. systems assistance, such as information technology or software support, where the system is related to the provision of relevant services or associated products (as is, again, the case in Australia – see section 963C(1)(d) of the Corporations Act 2001),

both of which are worthy and needed to advance the intentions of the financial advice regime.

- k. IBANZ recognises that the Cabinet Paper and political statements have not identified any exceptions. However, that should not prevent the Regulations including suitable exceptions to ensure the proposals can be implemented in a sensible manner. Cabinet deals with concepts generally. There should not **be an expectation that Cabinet covers every exception or that Cabinet's principles be effected without minor modifications to make the policy workable, as these are matters of detail for the draftsman to craft so the Cabinet's principles can be implemented without unexpected** consequences in practice. An example of such a departure is already evidenced by the removal of the senior manager exception Cabinet approved.
- l. Senior Managers need to be clearly excluded from the prohibition in accordance with the Cabinet papers: The Consultation paper **acknowledges, "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."** However the draft Regulations do not exclude senior manager expressly. The Consultation Paper observes that senior managers **who are not "involved in" the provision of the service or the products, would not be captured by the prohibition. However, if senior managers are "involved in" the provision of the service or the products, they should be caught.**
- m. In section 446M, to be an incentive, the benefit needs to be offered or given to the person in connection with the person (directly or indirectly) being involved in the provision of the service or the products. Section 446Q(3) **defines "involved in" as either arranging a contract for the service or for the acquisition of the product, or giving regulated financial advice in relation to the product.**
- n. IBANZ accepts **MBIE's interpretation, but believes it is a tortuous route to reach this conclusion, and therefore the drafting lacks clarity and fails to meet the standards of statutory drafting.** Lord Simon of Glaisdale wrote:
- "It is important to remember why our statutes should be framed in such a way as to be clearly comprehensible to those affected by them. It is an aspect of the Rule of Law. People who live under the Rule of Law are entitled to claim that the law should be intelligible. A society whose regulations are incomprehensible lives with the Rule of Lottery, not the Rule of Law."<sup>2</sup>*
- o. IBANZ therefore submits that the Regulations should include a clear exclusion for senior managers who do not arrange for a contract for service or for the acquisition of a product or give regulated financial advice in relation to a product to consumers. IBANZ has deliberately removed in these proposed words **the reference to "(directly or indirectly)" as IBANZ**

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<sup>2</sup> Lord Simon of Glaisdale, *The Renton Report-Ten Years On*, 1985 Stat. Law Rev. 133

believes these words add confusion as to how indirect the behaviours can be for the prohibitions to apply.

Responses to consultation paper questions

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>Yes, however clarification is required to ensure it is clear that the prohibition applies only in respect of incentives relating to services or products provided <i>to consumers</i>, and that senior managers are excluded as the Cabinet Paper specifically indicated would happen.</p> <p><b>Also the implementation of Cabinet’s decision should include drafting suitable exceptions, like in Australia, to make the Cabinet’s principle decision workable in practice. This has not been done adequately and is expected to lead to criticism and unexpected consequences. The draftsman has assumed flexibility to override Cabinet’s “senior manager” exception, but not sought to include much needed exceptions, so it could not be suggested that MBIE does not have the flexibility to implement Cabinet’s objective with suitable exceptions as a matter of detail.</b></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>It would be helpful to adopt an example that illustrates that the prohibitions apply solely <i>to consumers</i>, including an example that shows that a consumer in the insurance broker context has a personal, domestic or household purpose.</p>
3	<p><i>Do you have any other comments on the way the draft regulations define prohibited incentives?</i></p>
	<p>Yes, clarification is required to ensure it is clear that the prohibition applies only in respect of incentives relating to services or products provided <i>to consumers</i>, and that senior managers are expressly excluded in an exception as the Cabinet Paper indicated would happen.</p> <p>The proposed definition is too broad, for example the phrases <b>“in any way”</b> and <b>“directly or indirectly”</b> are too broad, unnecessary, uncertain and potentially capture unintended situations. They <b>will capture targets and thresholds that are not “sales incentives”</b> and are outside the intent of Cabinet. Accordingly, they should be removed.</p> <p>As an example, the proposed definition could be read to include incentives payable where a certain net profit level has been achieved (as sales will indirectly affect the level of net profit). However, many factors will be involved in calculating net profit such as revenues generated from non-relevant services and cutting down on costs. These are not activities that the Cabinet intended to regulate. In fact, the senior manager exclusion was partly to <b>ensure that senior manager profit based bonuses were unaffected. Cabinet’s intention has not been implemented in this respect.</b></p> <p>Further, the proposed definition could capture, and prohibit, targets that have been designed to help facilitate and ensure good customer outcomes. For example, financial advice providers incentivising financial advisers to meet with a certain percentage of their existing clients each year. This is to ensure financial advisers are regularly ensuring a high proportion <b>of their client’s needs</b> are being met. The proposed definition would prohibit these types of targets as being a target determined by reference to the volume of the services provided. These types of rewards cannot practically be implemented by a linear award system.</p> <p>The proposed definition would also capture disincentives which are designed to encourage good customer outcomes, like poor retentions rates which is a sign of selling unsuitable</p>

products and poor follow-up customer servicing. IBANZ suggests that disincentives be expressly excluded.

*Suggested wording:*

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 entitlement** (but not disentitlement) to the incentive, or the nature or value of the incentive, is determined or calculated ~~in any way by reference (directly or indirectly) to~~ using a target or other threshold that relates to the volume or value of the services or products provided to consumers.

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

Yes, clarification is required to ensure it is clear that the prohibition does not apply to senior managers as the Cabinet Paper indicated would happen, rather than relying on a tortuous route of statutory interpretation to reach that conclusion.

The proposed definition is too broad and appears to capture intermediary staff who are not involved in the provision of the **intermediary's** relevant services or associated products, if their reward is determined or calculated in any way (directly or indirectly) by reference to a target (etc). The prohibition would therefore go further than it needs to in order to remove incentives for salespeople, and potentially interferes with legitimate bonuses for backroom and claims staff which may incentivize good customer outcomes or legitimate business activities.

Also it would be more transparent if the definition of involved is repeated in this section **(the Act's definition states it is applicable only to the subpart of the Act.**

Suitable drafting is provided below (which includes removal of "in connection with" which is too expansive). **It ensures relevant persons are providing the intermediary's relevant services:**

*Suggested wording:*

237D Intermediary must not offer or give 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~~ for 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 who is involved in the intermediary's relevant service or associated products; or
  - (b) another intermediary that is involved in the provision of the intermediary's relevant services or associated products; or
  - (c) an agent of the intermediary that is involved in the provision of the intermediary's relevant services or associated products.

237E Meaning of involved

- (1) In sections 237B to 237D, a person is involved in the provision of a relevant service or an associated product to a consumer if the person does either or both of the following:
  - (a) arranges a contract for the service or for the acquisition of the product:

	(b) gives regulated financial advice in relation to the product.
5	<p><i>Do you have any comments on the application of the draft regulations to senior managers and executives?</i></p> <p>Yes, clarification is required to ensure it is clear that the prohibition does not apply to senior managers as the Cabinet Paper indicated would happen, rather than relying on a tortuous route of statutory interpretation to reach that conclusion.</p>
6	<p><i>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?</i></p> <p>Yes, IBANZ submits that the prohibition on volume or value targeted incentives should not apply if the benefits are product training, including conferences, with has genuine education or training purposes (as is the case in Australia – see section 963C(1)(c) of the Corporations Act 2001) and systems assistance, such as information technology or software support, where the system is related to the provision of relevant services or associated products (financial or otherwise - see section 963C(1)(d) of the Corporations Act 2001), both of which are worthy and needed to advance the intentions of the financial advice regime.</p>

Yours sincerely,



Melanie Gorham  
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