

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

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## 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 have significant concerns with the words 'or other thresholds' being added to the regulations which we believe widens significantly the scope of the regulations well beyond what the intent of the cabinet paper identified. We believe this is a drafting issue which needs to be rectified. Without change there could be significant unintended consequences to the sector. The draft regulations as they are written are too wide with the inclusion of 'or other thresholds' and goes beyond the intent of the cabinet decision. We believe the inclusion of these words will have significant unintended consequences to the sector and may limit the availability of advice to the consumer. The cabinet paper has a very narrow view on the restriction for incentives which are limited value and volume targets and soft incentives. The drafting of the regulations has widened the intent of the cabinet paper. We believe adding the words 'or other thresholds' has significantly changed the intent of the cabinet paper and widened the meaning which will have significant unintended consequences on the sector.*

PLEASE PROVIDE AN EXAMPLE OF WHERE "OR OTHER THRESHOLD" IN A REMUNERATION STRUCTURE WOULD BE CAUGHT UP AND PROHIBITED.(WHICH IS NOT LINEAR) EG PERSISTENCY RATES

*Below is how the cabinet paper, legislation and regulations have been implemented and drafted 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 significantly.*

*Cabinet Paper 16 March 2022*

*Regulation 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) 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 5 rates which for some providers is a key component of a scorecard.*

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

*'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 widens the interruption significantly.

**We recommend the removal of the words 'or other thresholds' in the regulation as they go beyond the intent of the cabinet paper.**

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

*CCCFA has shown how examples do not reverse poorly drafted regulations.*

*We believe the wording in the regulations is much wider than the examples provided and the words 'or other thresholds have to be removed'.*

*The examples provided are clear and make sense. However, we believe that the wording of the regulation is incorrect.*

*The CCCFA is a perfect example of poorly worded legislation and regulation even with the use of good examples – the examples did not override the legal interruption of the regulations by 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?**

*S237(D) – We have concerns regarding this section. The cabinet paper, legislation and drafting of the regulations have unintended consequences which will significantly impact on the growth of the sector and the ability of New Zealanders to obtain expert financial advice. Sector growth needs to be able to develop new innovative remuneration structures which are not solely based on commissions. The introduction of S237(D) we believe could significantly impact on the growth of the sector based on the way it is presently drafted.*

PLEASE PROVIDE AN EXAMPLE WHERE AN INTERMEDIARY WILL NOT BE ABLE TO PAY ANOTHER INTERMEDIARY OR FINANCIAL ADVISER A COMMISSION OR FEE (excluding linear payments) AND HOW THIS WOULD IMPACT ON BUSINESS MODELS.

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

*S237D states the 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 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; 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.*

In addition to this, 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 struggle to understand why S237D has been included and what harm it is trying to resolve?*

*We strongly recommend that S237(D) should be removed and reviewed in 2 years to see if there is any evidence of harm.*

*If S237(D) remains 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?**

We believe 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. Therefore they should not be excluded.

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 and inconsistent!

Imagine the illogic of a CEO having sales targets in their KPIs to achieve financial budgets but having no ability to reward their sales/distribution function (internal/external) for KPI achievement.

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 the words 'or other thresholds' should be removed.

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 not the least the lack of access to financial advice by the public.

The draft regulations ignore the existing FSLAA Code of Professional Conduct which require financial advisers to place their clients' interest first. They are a legislative double up and as such are therefore unnecessary.