

Submission

to the

Ministry of Business, Innovation and
Employment

on the

Consultation paper: Exposure draft
regulations on sales incentives
under new conduct regime

9 November 2022

About NZBA

1. The New Zealand Bankers' Association (**NZBA**) is the voice of the banking industry. We work with our member banks on non-competitive issues to tell the industry's story and develop and promote policy outcomes that deliver for New Zealanders.
2. The following eighteen registered banks in New Zealand are members of NZBA:
 - ANZ Bank New Zealand Limited
 - ASB Bank Limited
 - Bank of China (NZ) Limited
 - Bank of New Zealand
 - China Construction Bank
 - Citibank N.A.
 - The Co-operative Bank Limited
 - Heartland Bank Limited
 - The Hongkong and Shanghai Banking Corporation Limited
 - Industrial and Commercial Bank of China (New Zealand) Limited
 - JPMorgan Chase Bank N.A.
 - KB Kookmin Bank Auckland Branch
 - Kiwibank Limited
 - MUFG Bank Ltd
 - Rabobank New Zealand Limited
 - SBS Bank
 - TSB Bank Limited
 - Westpac New Zealand Limited

Introduction

NZBA welcomes the opportunity to provide feedback to the Ministry of Business, Innovation and Employment on the Consultation Paper: Exposure draft regulations on sales incentives under new conduct regime (**Consultation Paper**). NZBA commends the work that has gone into developing the Consultation Paper.

Contact details

3. If you would like to discuss any aspect of this submission, please contact:

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Executive Summary

We are grateful for MBIE's continued engagement on the Financial Markets (Conduct of Financial Institutions) Act 2022 Act (**Act**) and relevant regulations. We have three recommendations that we consider will assist in ensuring the regulations are understood, function as intended in alignment with Cabinet's articulated policy position and do not exacerbate the issue of an uneven playing field which already exists between financial institutions caught by the regime and those who are not (including, non-bank non-deposit taking lenders). These recommendations are set out below.

1. The current drafting of 'prohibited incentive' (at Regulation 237B) is difficult to reconcile with the Act's definition of 'incentive'. We are concerned that this will potentially cause interpretive challenges going forward, and further work is needed to ensure that these definitions work together. We recommend industry and MBIE meet to come up with a workable definition.
2. The prohibition on certain incentives at Regulation 237C should expressly apply only to frontline staff and their immediate managers and supervisors. We have proposed some drafting in the body of this submission, which we consider would achieve Cabinet's policy intention to "expressly prohibit financial institutions and intermediaries from offering sales incentives based on volumes or value targets to their frontline employees" and "exclude senior managers and executives from the scope [of the prohibition]."
3. We have two recommendations relating to the examples contained in regulation 237B. First, we consider that linear based incentives should not be included only as an example of a non-prohibited incentive, rather, these should expressly be excluded in the regulations. Second, the examples proposed do not reflect the reality of how banks structure incentives in 2022. We would welcome some further examples that capture behavioural incentives etc.

We expand on these points below and would welcome a meeting with MBIE to discuss our submission, particularly the definition of 'prohibited incentive'.

The 'prohibited incentive' definition needs to be refined

We consider that the current drafting of the 'prohibited incentive' definition needs to be refined so it better works with the definition of 'incentive' in the Act.

As noted above, the current definition is difficult to reconcile when read together with the 'incentive' definition in the Act. We are concerned that this will potentially cause interpretive challenges going forward. In addition, if terms such as 'indirectly involved', 'by reference (directly or indirectly)' and 'other threshold' are to be incorporated into the definition, guidance on interpretation would be desirable.

We appreciate that this is complex and we suggest that MBIE and industry work together to come up with an appropriate definition of 'prohibited incentives'. We are available at your convenience to meet and workshop a definition.

The prohibition at Regulation 237C should only capture frontline staff and their immediate managers and supervisors

The proposed definition of 'relevant person' at Regulation 237C(2)(a) is drafted widely. We understand Cabinet's intention is to "expressly prohibit financial institutions and intermediaries from offering sales incentives based on volumes or value targets to their frontline employees" and "exclude senior managers and executives from the scope [of the prohibition]."

We are concerned the current wide drafting will not achieve Cabinet's intention to only capture frontline staff and their immediate managers and supervisors. As currently drafted, there is a risk that senior managers and executives would be caught by Regulation 237(2)(a).

To achieve clarity, the regulations could expressly provide that the incentives prohibition only applies to frontline sales staff (i.e. those persons directly involved in the provision of the relevant services and products) and their immediate managers and supervisors. This would have the advantage of consistency with the approach industry has taken following the FMA's Review of Bank Incentive Structures, while also clearly excluding higher-level executives and managers

If this was not accepted, we propose some alternative drafting below which would, in our view, assist in achieving Cabinet's intention. We recommend Regulation 237(a) provide as follows (our additions highlighted in bold italics):

"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 service or associated products.***"

This would make the drafting of Regulation 237C(2)(a) consistent with 237C(2)(b) and (c). It would also help make it clearer that executives and senior managers are not caught by the prohibition.

Clarity is also needed as to how the incentive prohibition is intended to apply to the retail bond market. We would be happy to meet with MBIE and the FMA to discuss this further.

The examples included at Regulation 237B would benefit from revision

We have two recommendations relating to the examples included at Regulation 237B. First, we consider that linear incentives need to be expressly excluded as a 'prohibited incentive' in the final definition of 'prohibited incentive'.

Incentives determined on a "linear basis" (a per product or per service basis) are included in section 446M(3)(g) of the Act as an example of determining or calculating a matter by reference to the volume or value of the services or products. This is difficult to reconcile with the current drafting of the Regulations. The Act cannot be easily changed, so the Regulations need to be very clear that incentives calculated on a linear basis are excluded

from the prohibition (which we understand is the policy intention). We believe this needs to be more overt than inclusion only in an example as is currently the case.

We would also welcome explicit exclusion of salary based remuneration and disincentives.

Second, the examples do not reflect the reality of how banks structure incentives in 2022. Banks have refined incentives practices since the 2018 Conduct and Culture Review, and the focus is now often on “soft” behavioural targets which in many instances will benefit consumers (e.g. contacting current customers to ensure they are informed and comfortable with their service/product). Additionally, incentives are often measured through “balanced scorecards” which are read in the whole, and are comprised of non-financial and financial measures, including revenue, costs, profit, quality of lending book and growth measures. As a result, there may be financial metrics as part of a number of metrics on a balanced scorecard that influence an employee’s variable remuneration.

We would welcome examples that illustrate behavioural targets are not prohibited incentives, and clarify that balanced scorecard assessments may contain financial measures that cannot be converted to sales targets.