Your Name
David Ireland
Your organisation
Kensington Swan
Which overarching duties should and should not be included in the regime? Are there other duties that should be considered?
We are generally supportive of the concept of an overarching set of conduct duties applying to entities that are licensed to provide financial services. We believe that this is an efficient way to ensure that customers engaging with New Zealand financial institutions can have confidence that the failings identified in the Australian Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (ARC) are unlikely to be present in New Zealand. We have the following specific comments in respect of the proposed duties: Option 1: A duty to consider and prioritise the customer's interest, to the extent reasonably practicable We submit that Option 1 is problematic in its current form, as it lacks sufficient specificity to allow it to be readily implemented and complied with in practice. In our view, a more appropriate opening overarching conduct duty would be a duty to treat customers fairly and act with integrity, similar to the opening two Code Standards of the Code of Professional Conduct for Financial Advice Services (Financial Advice Code). Many of the other duties included in MBIE's initial preferred package of options are simply manifestations of such a duty. Replicating as far as possible duties that are already in existence, such as Code Standards 1 and 2 of the Financial Advice Code, without creating new alternatives to address similar issues, promotes compliance efficiency and is likely to lead to a more consistent approach across the sector. Option 2: A duty to act with due care, skill and diligence We agree with the substance of this duty. However, we do not see a reason for drafting it in a way that departs from the referenced formulation used for financial advisers under the Financial Advisers Act 2008 (section 33), and for managers and investment managers under the Financial Markets Conduct Act 2013 (FMC Act) (section 144), which is familiar to the market and already has a body of guidance built-up around its meaning. Accordingly, we submit that Option 2 should be redrafted to read as follows: Option 2: A duty to exercise the care, diligence and skill that a reasonable financial institution of its type would exercise in the same circumstances. Option 3: A duty to pay due regard to the information needs of customers and to communicate in a way which is clear and timely. The commentary in respect of this proposed duty notes that the intention is to ensure that customers have the necessary information to help them make informed decisions and to set and manage expectations, which may include taking the circumstances of particular customers into account. This is likely to be difficult for financial institutions to comply with in practice in the absence of further guidance about matters such as the situations in which particular customers interests will need to be considered, and what happens if such circumstances are not known to the financial institution. Is investigation required or do such circumstances need to be reasonably apparent? In our view it is asking too much of all financial institutions to pay due regard to the information needs of customers, given the range of business models that may be subject to the proposed conduct duties. Instead, a simple duty to communicate in a way that is clear, concise, and effective would be an adequate and more appropriate formulation for such a duty, that allows greater flexibility in practice. This has the advantage of replicating a duty that already appears in other contexts in the financial services sector. Option 4: A requirement to have the systems and controls in place that support good conduct and address poor conduct. We do not believe that imposing such a requirement is necessary. This is a mechanical compliance assurance step that is not an additional conduct duty as such, but a sensible approach for financial

institutions to take to ensure the duties are observed.
Option 5: A duty to manage conflicts of interest fairly and transparently.
We believe such a duty is too broadly cast and high level to be appropriate for a package of entity-level conduct duties. The extent of the compliance burden placed on entities to demonstrate compliance with such a duty would be extensive. Instead, we believe that duties to manage conflicts of interest are best addressed at the activity level where the specific conflicts of concern can be identified with tailored responses applied – see, for example, the related person provisions of the FMC Act.
The recommended duty to treat customers fairly and transparently, and to communicate in a way that is clear, concise, and effective, will go a long way toward addressing the mischief this duty is intended to cover.
Option 6: A duty to ensure complaints handling is fair, timely and transparent.
We support such a duty being included. It reflects good business practice.

Do you think the overarching duty for managing conflicts of interest should be general (as it is currently worded) or focus on conflicts of interest that arise through remuneration?

If the overarching duty for managing conflicts of interest contained in Option 5 is retained, contrary to our submission, we believe it should be kept general. A focus on remuneration practices would be unduly narrow.

Is a code of practice required to provide greater certainty about what each overarching duty means in practice?

It would be sensible for a code of practice to be created to supplement the overarching duties and provide guidance on their meaning and scope.
That said, given the status of the proposed duties as legislative duties (as distinct from guidance or commentary) we submit that care should be taken to ensure they are drafted in a manner that is clear, concise and effective on theirface (with any key words or phrases defined) rather than leaving it to a code of practice to explain their meaning.
One option would be to include express legislative power for the regulator to issue guidance or codes of practice, of similar weight to the FMA frameworks and methodologies able to be issued under the FMC Act. Amongst other things, that would enable safe harbours to be established that will provide much needed certainty for market participants.

Which options for improving product design do you prefer and why?

Option 1: Give the regulator the power to ban or stop the distribution of specific products.
Generally, we do not support a proposal to ban or prevent the distribution of specific products. In our view the better legislative or regulatory response is to impose a positive requirement on providers to design products with a focus on customer outcomes. However, if banning or prevention of the distribution of specific products is considered necessary we prefer the option of providing for a regulator discretion, as opposed to an outright ban as suggested by option 2. Option 1 provides for a degree of flexibility and interaction between the provider and the regulator to ensure that any consequences for the customer can be considered in the regulator's response, and that any ban is appropriately tailored to the product of concern.
Option 2: Ban certain products.
We do not support a proposal to ban certain products. In our view it is unlikely to be practical to sufficiently identify a product and/or product features to ensure the ban affects the intended product or audience, and goes no further. The difficulty in identifying any banned product in sufficient detail in legislation is that if the net is cast too wide it may prevent access to products that customers want – alternatively, if too narrow the ban may not serve any useful purpose.
Option 3: Requirement for manufacturers to identify intended audience AND a requirement for distributors to have regard to the intended audience when placing the product.
We prefer Option 3 over Option 1 or 2. However, we submit that only the first portion of the

requirement “to identify intended audience” should be implemented. We agree that product manufacturers should have an intended audience in mind when designing a product, and be able to identify the benefits and risks of any product, and demonstrate the likelihood that customers will actually benefit from the product. However, we are concerned that requiring distributors to have regard to the intended audience when placing the product could result in all sales of financial products needing to become or being deemed to be financial advice.

If a design and distribution requirement like option 3 were chosen, are there particular products for which this is more necessary than others? If so, please explain what and why

Which options to improve product distribution do you prefer and why?

Kensington Swan broadly supports the adoption of a duty along the lines of Option 1. In principle, a duty to design remuneration and incentive structures in a manner that is likely to promote good customer outcomes should go a long way towards addressing many of the failings that came to light through the ARC.

We like the relative simplicity of Option 1. However, we do not support its apparent universal application. While it appears in the chapter on options to improve product distribution, the proposed duty as articulated is not limited to distribution or sales force remuneration and incentive structures, but appears to be of universal application to all aspects of an entity’s operation. We do not believe this is appropriate, and should not apply where those remunerated may have no customer-facing function.

We strongly support a focus on the outcomes of remuneration and incentive structures, rather than the form that those structures might take which more readily lends itself to gaming and unintended consequences.

Our principal reservation with Option 1 is the con identified of such a duty creating uncertainty for financial institutions. To be effective, any such duty would need to be accompanied by very clear guidance as to the regulatory expectations. This would minimise the additional compliance cost that such a duty will inevitably impose upon financial institutions.

While it will be important for participants to be able to effectively explain why they believe their approach to remuneration and incentives is aligned to good customer outcomes, it is important that the threshold for evidencing the reasonableness of that belief is not set too high. Otherwise, there is an additional con of this option in that it may stifle innovation in remuneration and incentive structures that of themselves would not encourage bad behaviours, but which may prove challenging for entities to evidence that they will lead to good customer outcomes.

It is also important that participants have confidence that they can adopt a balanced score card in the way they structure reward packages. In particular, financial institutions should be able to include components of remuneration and incentive structures that are not related to promoting good customer outcomes – provided they do not incentivise bad conduct. In other words, the focus should be on the overall remuneration and incentive structure, and not each individual remuneration and incentive component.

A key additional con for Option 2 is the risk that banning target-based remuneration and incentives may result in suppressing such incentives that might promote good customer outcomes. We believe this is a fatal flaw to the inclusion of this option. If it is to be retained as part of the final package of duties, it will be important to clearly define the targets that are of concern, and ensure the ban is limited to those targets. Otherwise there is a significant risk of unintended consequences of suppressing arrangements that may promote good customer outcomes.

In our view, the imposition of a duty along the lines of Option 1 should be sufficient, without requiring anything further. As an alternative, a corresponding ban on remuneration and incentives that are intended to encourage, or are likely to have the effect of encouraging, anyone to engage in conduct that contravenes any of the overarching duties might be workable. See section 431R(4) of the FMC Act, to be introduced under the Financial Services Legislation Amendment Act 2019.

For completeness, we confirm that we do not support Options 3 or 4. We believe that these measures are too blunt to be effective, and may lead to a suppression of innovations that would otherwise promote good customer outcomes. We also do not support the introduction of a duty on manufacturers to take reasonable steps to ensure the sale of their products are likely to lead to good customer outcomes, as per Option 5. Imposing such a duty would bring into question the effectiveness of our current disclosure regime, and place an undue burden on product manufacturers who may have minimal direct customer interaction. The overarching duties proposed to be imposed on financial institutions should be sufficient in this regard, without adding a duty which may require product manufacturers to develop completely new lines of compliance assurance processes at considerable cost, with those costs inevitably borne by the consumers of their products. A further duty we feel warrants further debate would be a duty, for those providing remuneration or incentives to the distributors of their products, to ensure that those distributors are actually carrying out services for customers to earn that remuneration or reward. The objective of such a duty would be to squarely address the 'fee for no service' issue identified as part of the ARC. We do not have a strong view as to whether such a duty will actually need to be imposed, as that will depend upon the overall package of duties that end up being developed. However, the eventual bundle of conduct duties proposed should be assessed for their effectiveness in managing the risk of fees being paid for no service being provided. A positive duty along the lines of the above would address any gap in the package in that regard.
To assist us in comparing the pros and cons of various options, please provide information about remuneration and commission structures currently in use
What is your feedback on imposing a duty to ensure claims handling is fair, timely and transparent?
We submit that imposing a duty to ensure claims handling is 'fair, timely, and transparent' is an appropriate overarching duty, as previously noted. This principle-based duty does not introduce new obligations on insurers, rather this duty is aligned with insurers' good business practice The key issue is that the meaning of 'fair, timely, and transparent' is not entirely clear in this context given that the duty is principle-based. This could be addressed through codes of practice or guidance empowered by the legislation, as recommended in response to earlier questions.
If a duty to ensure claims handling is fair, timely and transparent were to be adopted, should an attempt be made to clarify what fair, timely and transparent mean?
We submit that the regulator should be charged with releasing a guidance note to ensure that insurers understand the regulators expectations of what is required to comply with this principle-based duty. As discussed earlier, the guidance note should be of a practical nature to provide greater certainty for insurers, including safe harbour relief where appropriate.
What is your feedback on requiring the settlement of claims within a set time?
We believe that imposing a statutory timeframe to settle insurance claims is problematic and will not deliver good outcomes for all customers. The two-year period (or any other period) is too rigid to be appropriate for every type of claim, given the variety of insurance covers available. We agree with the all the cons in the options paper. A one-size fits all approach is inappropriate, and is unnecessary given the package of overarching duties proposed.
Do you agree with the option to empower and resource the FMA to monitor and enforce compliance?
We support the adequate resourcing and appropriate empowerment of the FMA to monitor and enforce compliance. A key failing identified in the ARC was the lack of visible enforcement. For the new duties to be effective, the regulator must have sufficient resources to be able to undertake a sufficient range of activities to have confidence that the new duties are being observed.
What is your feedback on the option to require banks and insurers to obtain a conduct licence?

We do not support the introduction of standalone conduct licensing for banks and insurers, or for any financial institutions. In our view, this will add unnecessary cost, inefficiency, and complexity to the regulatory regime, with those costs likely to be passed on to consumers.

In terms of the stated pros of conduct licensing, our view is that they are overstated. In terms of the cons, there is an additional con worth noting, which is the risk of tilting the playing field against entities that provide banking and insurance services, if conduct licensing is to be limited to such entities. The value in creating an even playing field between financial service providers is recognised in a different context on page 58 of the consultation paper. We agree that this is an important factor and that it should be reflected in the final conduct regime. In our view, requiring entities that provide banking and insurance services to obtain a specific conduct licence would put them at a disadvantage when compared to financial service providers that do not provide those services, and would create confusion for consumers and undermine the integrity of our regulatory regime.

Instead of standalone conduct licensing, our view is that conduct duties should apply to licensed entities generally, and in a complementary fashion so that they simply come as part of the territory for those in the business of undertaking licensed activities. In particular, the conduct duties should be designed to complement those entities' specific licensee duties, with clear rules to address any overlap or inconsistencies. Please refer to our response to question 19.

What is your feedback on the option which discusses a broad range of regulatory tools?

We support the inclusion of a broad range of regulatory tools to address any conduct issues. However, given the principles-based nature of the duties contemplated, it is important that those tools are required to be wielded in a balanced fashion.

Do you think that the maximum pecuniary penalties available for breaches of any conduct duties should be the same as the existing FMC Act penalties?

We do not believe the penalties imposed should be any higher than those imposed under the FMC Act. Indeed, given the principles-based nature of the duties contemplated, there is an argument for them being lighter to reflect the greater level of uncertainty as to what is required to comply, with the highest penalties reserved for the most egregious conduct. We also believe it is imperative that robust safe harbour defences are available for entities who demonstrate they took reasonable steps to ensure their conduct duties were not contravened – see, for example, section 431U(1) of the FMC Act, to be introduced under the Financial Services Amendment Act 2019.

What is your feedback on the option of executive accountability?

We strongly oppose the proposed option of executive accountability. In particular, exposing managers to personal liability for contraventions carries a high risk of stifling innovation and creating a risk averse culture that is unlikely to best serve the long term interests of consumers. The cons identified in the Options Paper in relation to this option are significant, and in our view significantly outweigh any pro. We do not believe such an incentive to comply is required, with the current FMC Act test for employee liability where involved in a contravention, as per section 533 of the FMC Act, all that is required

What is your feedback on the whistleblowing option?

We support the inclusion of effective whistleblowing provisions, and measures to encourage their use.

What is your feedback on the option of regular reporting on the industry?

We do not support regular regulatory reporting as proposed, in the absence of clearly identified consumer benefits from doing so. Gathering date for the sake of generating statistics imposes an unreasonable cost and resource burden on market participants. With limited resources available to both licensees and regulator, we believe that imposing extensive regulatory reporting obligations should not be viewed as a high priority.

What is your feedback on the role of industry bodies?

What is your feedback on the options regarding who the conduct regime should apply to?
As noted in our response to question 12, it is important that a new conduct regime does not unduly tilt the playing field against bank and insurance providers. For this reason, we submit that the conduct regime should apply to all licensed entities, rather than to retail banks and insurers only. We therefore prefer option 2 over option 1. We have no strong view on whether the preferred package of options should apply in parallel with existing regulation or whether it should instead be carved out from existing regulation. Regardless of which approach is taken, it will be critical for the drafting to be clear so that providers understand what they must do, and that new conduct duties imposed are complementary to other duties to enable providers to take a streamlined approach to ensuring compliance. Where a provider is already subject to a specific licensee obligation, we would expect that obligation to have priority in the event of any conflict, although the drafting should be undertaken and new duties imposed to ensure there is no conflict of duties.
Your email address
Privacy of natural persons
In what capacity are you making this submission?
business
Can we include your name or other personal information in any information about submissions that we may publish?
yes
We intend to upload submissions to our website Can we include your submission on the website?
yes
You may ask us to keep your submission, or parts of your submission, confidential If so, you'll need to attach reasons and grounds under the Official Information Act 1982 for consideration
no