HEARTLAND BANK

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Financial Markets Policy
Commerce, Consumers and Communications
Ministry of Business, Innovation and Employment
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New regime for conduct of financial institutions – MBIE discussion documents - Submission of Heartland Bank Limited

Introduction

Heartland Bank Limited (**Heartland**) welcomes the opportunity to submit on the following discussion documents published by the Ministry of Business, Innovation and Employment (**MBIE**) in April 2021:

- Regulations to support the new regime for conduct of financial institutions (**Regulations Discussion Document**); and
- Treatment of intermediaries under the new regime for the conduct of financial institutions (**Intermediaries Discussion Document**),

(together, the **Discussion Documents**).

Heartland supports the New Zealand Banker's Association (**NZBA**) submission on the Discussion Documents, to which it has contributed. The NZBA submission includes detailed comments on both Discussion Documents.

However, there are some points in the NZBA submission that Heartland wishes to reiterate and some additional submissions Heartland wishes to make which are set out in more detail in our submissions below.

Ongoing industry engagement vital to ensure fit for purpose conduct regime

Heartland commends MBIE's continuing engagement with the banking industry in respect of the new conduct regime, and welcomes the opportunity to engage further with MBIE and the Financial Markets Authority (**FMA**) in respect of any amendments to the Financial Markets (Conduct of Institutions) Amendment Bill (**Bill**), any draft regulations and any guidance prepared to support the new conduct regime.

Heartland considers, as stated in the NZBA submission, that drafts of any regulations or regulator guidance should be subject to further industry consultation, and prepared well in advance of the coming into force of the new conduct regime. This is to ensure:

- that any regulations or guidance are fit for purpose and do not result in any unintended consequences; and
- financial institutions (**FIs**) have sufficient time to consider the impact of any final regulatory requirements or guidance, and embed any applicable requirements in their fair conduct programmes or contractual arrangements with intermediaries and agents, the development, operationalisation and amendment of which (as applicable) will be a significant undertaking for FIs.

Regulations Discussion Document

Heartland supports NZBA's submissions on the Regulations Discussion Document, and also wishes to particularly submit on the topics below.

Requirements for fair conduct programmes – status quo preferred

Heartland particularly submits in favour of maintaining the status quo, i.e. no further regulations are needed to support the minimum requirements for fair conduct programmes. The status quo provides FIs with the flexibility to develop and operationalise their fair conduct programmes in a manner that is fit for purpose for their business and customers, tailored to the size, scale, complexity, maturity and risk appetite of their business (as section 446M(1A) of the Bill intends).

A 'one size fits all' approach via overly detailed regulatory prescription would in Heartland's view be challenging to implement within the banking sector (where banks' businesses and circumstances vary considerably) and across the different categories of FIs (banks, insurers and NBDTs).

The status quo approach is consistent with a principles-based regime. Heartland's preference (which aligns with that of the NZBA and its other members) is for the FMA to issue guidance around its expectations and best practice, following consultation with stakeholders, prior to the new conduct regime coming into force where considered necessary.

In addition to the above, in many cases:

- there are already existing regulations or guidance on a number of the topics raised in the Regulations Discussion Document which banks such as Heartland are subject to (e.g. complaints handling, customer vulnerability, etc.); or

- there soon will be, with the coming into force of new legislative regimes (e.g. CCCFA requirements in relation to remediation).

This obviates the need for additional regulations and guidance particular to conduct (at least in respect of the banking sector). Regulatory overlap (particularly the possibility of conflict between different statutory regimes) should be minimised as far as possible.

Removal of concepts of "managing" and "supervising" intermediaries and agents from s446M(1)(bd) of the Bill necessary given nature of FI relationships with these persons

As discussed in the NZBA submission, Heartland (as is the case with other banks) has only contractual relationships with its intermediaries and agents. FIs are not in employment relationships with these persons who are independent third parties which FIs do not control and cannot manage, supervise or direct outside of what is contractually agreed.

Heartland can, and already does, provide initial and regular ongoing training to its intermediaries and agents on the products and services they will be involved in providing, and monitors its intermediaries and agents via contractual reporting obligations and customer complaints review, with contractual remedies being applicable in the case of contractual breaches or other misconduct. The concepts of "training" and "monitoring" remain appropriate in the context of the new conduct regime in relation to intermediaries and agents (noting regulator guidance on what is intended by "monitoring" would likely be helpful).

Heartland submits that it is not appropriate for the Bill to require FIs to "manage" and "supervise" their intermediaries and agents in the context of limited contractual relationships and these concepts should be removed from the Bill in this respect. More detailed discussion in this respect is set out in NZBA's submission.

Reference to "fit and proper person" should be removed from s446(M)(1)(bd)(i) of the Bill

Heartland particularly supports NZBA's submission that the reference to "fit and proper person" should be removed from the above section of the Bill, and submits in favour of the removal of this requirement for the reasons below.

It is unclear how fitness and propriety would be assessed or assurances obtained across the range of different intermediaries and agents who will be within the scope of the Bill (even with the definitions of "intermediary" and "agent" amended as proposed above and in the NZBA submission).

"Fit and proper" has a particular meaning in the financial services sector and is usually associated with a high level of vetting and regulator approval, or requirements in relation to licensed intermediaries (e.g. Financial Advice Providers). Intermediated distribution of financial products is undertaken in a whole manner of ways in the New Zealand banking sector, and commonly does not involve financial advice or intermediaries that are themselves financial markets licensees. Many intermediaries are sales people. For example, Heartland distributes its motor vehicle loan products via car dealers on an unadvised basis.

Accordingly, requiring a FI to seek reasonable assurance that an intermediary or agent is "competent" to carry out the range of work for which they will be engaged is an appropriate level to set the baseline requirement, while allowing for FIs to scale this up if appropriate for the particular intermediary or agent.

Regulation of sales incentives – MBIE's preferred option should be adopted

Heartland support's NZBA's submissions in relation to the approach to implementing Cabinet's 2019 policy decision to "*prohibit sales incentives based on volume or value-based targets, e.g. soft commissions such as overseas trips, bonuses for selling a certain number of products or leader boards*" by way of regulation.

In particular, Heartland supports MBIE's preferred option, to prohibit only those sales incentives based on volume or value targets (provided these incentives are appropriately defined). Heartland considers that this option is preferable to the alternative "principles-based" approach (which Heartland does not support) as it is unclear, would go beyond the 2019 policy decisions, cause issues of uncertainty and may have unintended consequences and capture incentives which are not problematic (it being widely acknowledged that incentives are not inherently bad).

As stated in the Regulations Discussion Document, "*the intention for the proposed regulations discussed in this section is to address the incentives that are particularly problematic (sales target-based incentives)*". Regulation of incentives beyond the preferred approach identified in this discussion document would go further than the 2019 policy decisions, and risk exacerbating the "unlevel playing field" caused by not all financial sector participants distributing similar products (and their employees, intermediaries and agents) being caught by the Bill.

As discussed in the NZBA submission, any regulations prohibiting incentives will need to be carefully drafted, and industry engagement will be vital to ensure regulations are fit for purpose and do not cause any unintended consequences. Heartland would be glad to engage further in this respect.

Intermediaries Discussion Document

Heartland supports NZBA's submissions on the Intermediaries Discussion Document, and also wishes to particularly submit on the topics below.

In general, Heartland:

- echoes the concerns regarding the requirements that apply in respect of intermediaries and agents set out in the Intermediaries Discussion Document. In particular, those set out in paragraphs 16a., b., d. and e., 17, 18 and 19;

- submits that if changes are not made, not only could intermediaries reduce the number of financial institutions they work with, they could also choose not to work with financial institutions at all (instead choosing financial sector participants not within the scope of the Bill, such as non-deposit taking finance companies); and

- submits that to ensure the Bill is workable with respect to the obligations it (indirectly) places on intermediaries and agents and FIs with respect to these persons, the opportunity must now be taken to amend the Bill in the manner discussed below (and more broadly in the NZBA Submission) via a Supplementary Order Paper prior to the Bill being passed.

Each of the proposals in Options 1, 2 and 4 should be adopted, and the Bill amended accordingly

As discussed in detail in the NZBA submission, Heartland submits that:

- the definition of intermediary should be amended to capture only sales and distribution activities, the current definition being too broad (Option 1);

- only those agents acting on behalf of a FI who have actual authority should be captured by the definition of agent; people acting under apparent authority should not be captured. Whether or not a person has apparent authority to act for an FI would in many cases be inherently unclear, and the new conduct regime should provide FI's with clarity (Option 2). Heartland submits that similar amendments need to be made both in respect of intermediaries and agents for the reasons discussed in this submission and does not agree with the proposal in Part 3 of the Intermediaries Discussion Paper in respect of agents (i.e. no major amendments are proposed to the Bill); and

- Option 4 has a number of benefits, and should be preferred as this option is more reflective of what FIs can require an intermediary to do via the contractual arrangements between the parties (noting also Heartland's submission above on the need for the removal of the concepts of "manage" and "supervise" in relation to intermediaries and agents). Heartland does not consider that this option would set too low a standard of oversight in relation to non-FSLAA intermediaries, who are not independently regulated. These intermediaries are not independently regulated as they are distributing products on an unadvised basis, and will still be subject to initial and ongoing training and monitoring by FIs which, as discussed above, is all that is practically possible in the context of an arms-length contractual relationship with an independent third party.

Questions

If you would like to discuss any aspect of this submission further, please do not hesitate to contact me via the sender of this submission.

Kind regards

Privacy of natural persons

Bruce Irvine
Chairman of Heartland Bank