NEW ZEALAND
BANKERS ASSOCIATION

Submission

to the

Ministry of Business, Innovation and Employment

on the

Conduct of Financial Institutions – Discussion Documents

18 June 2021

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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 seventeen 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.
   - Kiwibank Limited
   - MUFG Bank Ltd
   - Rabobank New Zealand Limited
   - SBS Bank
   - TSB Bank Limited
   - Westpac New Zealand Limited

Introduction

3. NZBA welcomes the opportunity to provide feedback to the Ministry of Business, Innovation and Employment (**MBIE**) on regulations to support the new legislation regulating the conduct of financial institutions and how intermediaries should be treated under that regime. This submission comprises our response to both discussion documents: *Regulations to support the new regime for the conduct of financial institutions* paper (**Regulations Paper**) and *Treatment of intermediaries under the new regime for the treatment of financial institutions* paper (**Intermediaries Paper**). NZBA commends the work that has gone into developing both the Regulations Paper and the Intermediaries Paper.

Contact details

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

Antony Buick-Constable
Deputy Chief Executive & General Counsel
Privacy of natural persons

Privacy of natural persons

Executive summary

NZBA strongly supports the policy goals underpinning the Financial Markets (Conduct of Institutions) Amendment Bill (**Bill**) and we are grateful for this opportunity to further engage on the details of the regime so that it achieves its objectives. The customer should be at the heart of everything financial institutions do, and we expect that the Bill and supporting regulations, with the changes proposed in this submission, will help to put a framework around what this means in practice.

Good conduct is front of mind for banks, particularly since the RBNZ and FMA's Conduct and Culture Review in 2017. Since the Conduct and Culture Review banks have taken a number of steps to improve outcomes for customers and to demonstrate their social licence to operate, for example:

- Banks have put in place comprehensive conduct programmes to strengthen processes and ensure fair treatment of customers, including providing regular updates to key regulators.
- Banks have worked with the Banking Ombudsman Scheme in the development of its banking sector complaints dashboard to improve transparency and learn from customer complaints.
- In 2018, banks proactively committed to removing volume and value-based targets for frontline staff and their immediate managers.
- In 2020, NZBA released its guidelines to help banks serve customer needs. The guidelines explain what it means to treat customers fairly and deliver good customer outcomes. They include commitments to recognise and prioritise customer interests, give customers clear, concise and effective information, design and provide products that meet customer needs, provide good customer care, and identify, fix and learn from their mistakes.
- Banks worked in partnership with Government and key regulators to support customers financially affected by COVID-19. That included setting up the mortgage repayment deferral scheme and the Business Finance Guarantee Scheme.

The overarching theme of NZBA's submission is that a less prescriptive regime is preferable, with regulation-making powers only being exercised in a few appropriate instances (for example in relation to sales incentives). In our view, financial institutions should be encouraged to demonstrate leadership and innovation in the delivery of good customer outcomes, and the legislative framework needs to be flexible in order to accommodate this. A principles-based regime will support that, while also delivering benefits of scalability and future-proofing. Where further detail is considered necessary to support the interpretation of statutory requirements, we consider that regulator guidance is preferable. Notwithstanding NZBA's preference, drafts of any regulations or guidance should be subject to further consultation with the industry, and prepared well in advance of the new regime coming into force.

NZBA's detailed responses to MBIE's questions from the papers are set out at Appendices 1 and 2 of this submission. A high-level summary of our key comments is set out below. We are happy to meet with MBIE to further discuss our comments.

Regulations Paper

Requirements for fair conduct programme: NZBA does not consider that regulations are needed at this stage to further prescribe the requirements of financial institutions' fair conduct programmes. Similarly, many of the other areas where regulations have been proposed are, in our view, already well embedded within the existing regulatory framework or our members' policies, procedures, and controls (e.g., remediation of issues, complaints handling, customer vulnerability). Introducing regulations in these areas would be duplicative and unlikely to deliver benefits to customers. We instead think that regulatory guidance on this topic (where guidance does not already exist) would be helpful to establish best practice in complying with the Bill while retaining flexibility to accommodate financial institutions of differing size, scale and complexity. We flag specifically our response to questions 6 and 10 of the Regulations Paper, that prescriptive requirements in relation to remediation and consumer complaints handling would give rise to a number of potential issues, and that guidance is preferable in these instances.

Sales incentives: NZBA supports MBIE's preferred option of prohibiting sales incentives based on volume or value-based targets, provided these targets are appropriately defined and regulations do not go further than the policy decisions announced in 2019. The banking industry has already implemented significant changes in relation to sales incentives since the Conduct and Culture Review, and we think these changes form a strong basis for the regime to build on. We are strongly opposed to a principles-based prohibition on sales incentives, as we consider this is too broad, is likely to have unintended consequences and would create uncertainty for financial institutions, as well as likely capturing incentives that can be used to reward good customer outcomes. Additionally, as we have previously submitted, principles-based regulations could create substantial and unintended change in the broker industry. NZBA considers that prohibitions on sales incentives should only apply to frontline staff and their immediate managers, reflecting the policy decisions behind the prohibition. We consider that any regulatory prohibition would still need to be carefully drafted and the draft regulations subject to further industry consultation, to ensure that it will function as intended and issues of an uneven playing field between financial institutions and other financial sector participants not caught by the regime are minimised.

Requirement to publish information about fair conduct programmes: NZBA supports MBIE not prescribing any further detail in regulations on the requirement to publish information about fair conduct programmes. We understand the expectation is that the published information would be able to be contained in a relatively short document, an example given being the NZBA Code of Banking Practice.

Intermediaries Paper

NZBA supports a narrowing of the definition and scope of both “intermediary” and “agent”, which are too broad as currently drafted. We also support further amendments to the Bill to remove a greater number of the current obligations in section 446M(1) that apply to financial institutions in relation to intermediaries.

Intermediaries: NZBA agrees that the definition of “intermediary” should be narrowed to focus on sales and distribution. Intermediaries that are not involved in sales and distribution have minimal ability to influence customer outcomes. This definition will still capture financial institutions’ main intermediary relationships.

Agents: NZBA considers that the scope of who is considered an agent should be narrowed to capture only those acting under *actual* authority and who have the ability to bind the relevant financial institution (i.e. the common law principle of agency). A broader definition of agency risks giving rise to unintended consequences such as capturing third parties that are providing services that could not have an impact on the treatment of customers. NZBA considers that an amendment should be made to ensure that agents involved in the provision of relevant services and associated products in a generalised way are not captured.

Changes to intermediaries’ obligations: NZBA supports option 4, whereby MBIE would remove a greater number of the current obligations in section 446M(1) that apply to financial institutions in relation to intermediaries. Whilst financial institutions can train their intermediaries (should the definition of “intermediaries” be narrowed as we suggest) and obtain reporting from them in respect of certain of their obligations (i.e. monitoring), we think that the language of “managing” and “supervising” intermediaries (as broad, overarching concepts) would not be able to be achieved in practice by financial institutions given the nature of their relationships with intermediaries. Financial institutions are in contractual relationships with intermediaries; intermediaries are not their employees or contractors, and financial institutions do not have the ability to “manage” or “supervise” intermediaries outside of what is contractually agreed on a case-by-case basis. We support the standard of “monitoring”, rather than “managing” and “supervising”, as this more accurately captures the limits of the relationship between financial institutions and intermediaries. Financial institutions’ obligations in respect of employees should be decoupled from those in respect of intermediaries and agents, as they differ. An example of where such a change is needed is section 446M of the Bill.

Appendix 1: Regulations Paper - responses to questions

#	Question	NZBA Response
		Requirements for fair conduct programmes
1	Do you have any comments on the status quo i.e. no further regulations to support the minimum requirements for fair conduct programmes in the Bill?	NZBA supports retaining the status quo, that being, no further regulations are needed to support the minimum requirements for fair conduct programmes. We consider that the building blocks of fair treatment, good conduct and culture, and consumer protection exist within the current regulatory framework, particularly the Credit Contracts and Consumer Finance Act 2003 (**CCCFA**) and the Financial Markets Conduct Act 2012 (**FMCA**) as amended by the Financial Services Legislation Amendment Act 2019 (**FSLAA**), internal and Banking Ombudsman dispute resolution processes and internal audit measures. These principles are already well embedded in our members' policies, procedures, and controls, which differ based on each member's particular customer base, business and circumstances. We anticipate this would be similar for the other financial institutions which will be subject to the new regime. The status quo also provides financial institutions with flexibility when developing and operationalising their fair conduct programmes in a manner that is fit for purpose for their business and customers. That will enable financial institutions to tailor their fair conduct programmes to the size, scale, complexity, maturity and risk appetite of their business. We consider that the preferable approach, given the principles-based nature of the regime, would be for the FMA to issue guidance around its expectations and best practice, following consultation with stakeholders, prior to the regime coming into effect.
2	Do you have any comments on MBIE's proposal position that no regulations are needed at this time to support section 446M(1)(a)?	NZBA supports this proposal and, as discussed further below, considers that guidance is more appropriate than regulations in this context. Any guidance should: • Clarify that the role of the fair conduct programme is to describe broadly how the financial institution uses policies, processes, systems and controls to ensure it meets its legal obligations to consumers, rather than requiring detail. • Be clear that the prescriptive requirements of the CCCFA (and the other regimes listed in section 446M(1)(a)) take precedence over the principles-based conduct regime. For example, affordability decision outcomes under the CCCFA may not always be perceived by customers as "fair" but are required under the CCCFA.
3	Do you have any comments on the proposals regarding distribution of relevant services and associated products? We are particularly interested in how these proposals may be implemented.	NZBA considers that these proposed regulations are unnecessary, as they appear to set out a range of actions banks would clearly need to undertake to meet the requirements of the Bill. Specifically, we do not believe that a financial institution could comply with the obligation in section 446M(1)(ab)(ii) to "regularly review the relevant services or associated products that are provided to consumers on an ongoing basis to determine whether they are likely to continue to meet the requirements and objectives of those consumers" without having identified the existing and/or target customer base and understood their needs. Similarly, the selling of products or services to customers for which the products or services are not suitable will be a key risk that financial institutions will need to have processes to monitor and manage under section 446M(1)(ac). For that reason, we do not believe that explicit requirements to have processes for ensuring products are

#	Question	NZBA Response
		only sold to customers within their target market provides any additional protection for customers. We consider that regulations would not provide anything further, but may reduce flexibility. NZBA would support guidance on this topic rather than regulations, as this would allow the industry to share best practice whilst retaining flexibility to distribute services and products in a way that meets the requirements in the Bill.
4	Do you have any comments on MBIE's position that no regulations are needed at this time to support section 446M(1)(ac)?	We support MBIE's position that no regulations are needed at this time to support section 446M(1)(ac).
5	Do you have any comments on MBIE's position that no regulations are needed at this time to support section 446M(1)(bb) to (bd)?	We support MBIE's position that no regulations are needed at this time to support section 446M(1)(bb) to (bd). Guidance would be useful to clarify what is meant by "monitoring" agents and intermediaries in the context of a contractual relationship as opposed to an employment relationship. For example, it is unclear whether contractual reporting obligations would cover "monitoring". We believe that amendments to the Bill are required, including in order to clarify the scope of "agent" and "intermediary" and to change from an obligation to "manage" and "supervise" intermediaries and agents to an obligation to "monitor" please see our further discussion on intermediaries in Appendix 2.
6	Do you have any comments on the proposal to specify further minimum requirements regarding remediation of issues? Are there any further specific remediation principles that should be specified in regulations?	NZBA appreciates MBIE's concerns regarding uncertainty in respect of remediation under section 446M(1)(ad) of the Bill. However, the approach a financial institution takes to its remediations should be flexible, to reflect the size of the entity and the varying scales and complexity of the remediations being undertaken. We consider that any concerns about the approach financial institutions are taking to remediations are more appropriately addressed through regulatory guidance and expectations of best practice as opposed to specifying minimum requirements regarding remediation of issues by introducing further regulations. Our view is that imposing prescriptive requirements such as those proposed in paragraph 66(a)-(g) will give rise to a number of potential issues, some of which are set out below. In particular, we are concerned that the threshold of "all reasonable steps" proposed in paragraph 66(a)-(g) is overly onerous and does not align with the Bill itself (section 446M(1)(ad) refers only to "reasonable steps"). In the event that any requirements are captured in regulations, we strongly support that the threshold be "reasonable steps" rather than "all reasonable steps". **a) Review and remediation processes must be comprehensive, efficient, timely and transparent.**

#	Question	NZBA Response
		• We support the obligation for financial institutions to be transparent, comprehensive, timely and efficient. However, the complex and wide-ranging nature of remediation may present challenges if this requirement is prescribed by regulations, given the subjectivity inherent in the proposed language. • It may not always be possible to communicate with customers about the progress and outcome of the review and remediation processes in a timely manner (for example, when customers are no longer contactable). • Transparency may also be difficult to demonstrate. For example, is transparency required in relation to the calculation of the sum remediated (where relevant) or the process followed to remediate the issue, or is it connected to the requirements to communicate with customers? Further clarity would need to be provided to assist in interpreting how these requirements can be met. **b) Review and remediation processes must be fair, equitable and transparent taking into account consumer's interests and needs, and financial institutions must take all reasonable steps to remediate all affected customers.** • In principle we support the requirements of "fair" and "equitable". As above, "transparency" would be difficult to operationalise in this context. • In relation to these proposed requirements, we also note the importance of materiality in compensation - remediation involves the application of sensible de minimis thresholds and different customer engagement approaches depending on the nature of the remediation, the characteristics of the customer, and the number of customers affected. • As discussed above, we consider that "reasonable steps" is more appropriate than "all reasonable steps", and think that guidance would be useful in this instance to clarify expectations on what taking "reasonable steps" would involve. **c) Once conduct that fails to comply with the fair conduct principle has been identified, financial institutions should take all reasonable steps to ensure that the misconduct ceases and that consumers are not continuing to be adversely affected.** • While we support the intention of this requirement, there may be instances when it is challenging to put into practice – for example, when a system issue is identified, if the cause of that issue is not immediately apparent it can take time to resolve the issue. In those instances, the customer will be compensated for any loss over that longer period. We are concerned that in those situations the bank's efforts would not be viewed as "all reasonable steps".

#	Question	NZBA Response
		d) Review and remediation processes must be adequately resourced. • We support the intention of this requirement but consider that it is addressed by (a) above (that review and remediation processes must be comprehensive, timely and transparent). The efficiency of the remediation process should be the focus, rather than the resourcing of the exercise. Each remediation is unique and will require different skills and expertise from different areas of a financial institution's business. **e) Adequate records must be kept of review and remediation processes.** • NZBA supports this requirement in principle but considers it would be more appropriately dealt with through guidance. **f) Communicating with customers about the progress and outcome of review and remediation processes in a clear, concise, timely and effective manner.** • We do not support this requirement being prescribed in regulations. NZBA agrees that it is important to communicate clearly with customers in regards to review and remediation exercises. However, standardising requirements for communications to customers impacted by review and remediation activities may not lead to better outcomes for customers: o Communications with customers impacted by review and remediation activity must be appropriate and proportionate to the remediation, i.e. large or complex issues are more likely to require regular updates, whereas simple issues may be resolved by a single communication to the customer. o Flexibility to communicate with customers in a manner commensurate with the review or remediation activity underway results in communications that are appropriate in the circumstances. There are a number of instances where ongoing communication about the progress of a remediation process with a customer will not be appropriate. In some circumstances, contacting customers about the progress of a review could cause more harm, stress or uncertainty than waiting for the outcome to be sent to customers. • Further, in some situations it may be challenging for financial institutions to communicate with customers about the progress and outcome of the review and remediation processes in a timely manner, such as where customers have not provided updated contact details to the financial institution.

#	Question	NZBA Response
		g) Review of remediation processes to ensure conduct risks and issues are being adequately managed. • NZBA supports this requirement in principle but considers it would be more appropriately dealt with through guidance. NZBA would support regulatory guidance on this topic rather than regulations, and would welcome the opportunity to work with regulators to develop any guidance. If guidance is created, NZBA considers that it should be released before the implementation of the Act so that financial institutions have sufficient time to review their remediation processes in light of the guidance.
7	Do you have any comments on MBIE's position that no regulations are needed at this time to support section 446M(1)(be)?	We support MBIE's position that no regulations are needed at this time.
8	Do you have any comments on MBIE's position that no regulations are needed at this time to support section 446M(1)(bf)?	We support MBIE's position that no regulations are needed at this time.
9	Do you have any comments on MBIE's position that no regulations are needed at this time to support section 446M(1)(d)?	We support MBIE's position that no regulations are needed at this time. We agree that a fair conduct programme should be a living document and that setting a requirement for review in regulations would be unworkable, and would potentially make review a compliance-driven event, rather than a response to changes to the bank's product and service offering and risk profile, etc.
10	Do you have any comments on the proposal to specify further minimum requirements regarding consumer complaints handling?	NZBA does not support MBIE's proposal to specify further minimum requirements regarding consumer complaints handling. Legislation, regulations and guidance already set out a number of obligations in respect of consumer complaints handling (e.g. Code of Banking Practice, CCCFA, FSLAA). Regulations which duplicate existing obligations would create a significant compliance burden on financial institutions with very little or no corresponding benefit for consumers. If there are concerns with the complaints handling in some parts of the sector, it would be more appropriate to approach that directly with the sector and relevant dispute resolution provider.

#	Question	NZBA Response
		These regulations may also duplicate sector-led initiatives that emanated from the Conduct and Culture review – especially work by the Banking Ombudsman to uplift banks' complaints handling through the creation of the Complaints Dashboard. The Dashboard has improved the Banking Ombudsman visibility of banks' internal dispute resolution management meaning that she is able to monitor complaints trends at an individual bank level and industry level. The Banking Ombudsman is also able to work with individual banks if further uplift/improvements are required. Additionally, MBIE has recently consulted on options for standardising dispute resolution scheme rules which we believe will have a positive impact on consumers ability to access timely redress.
11	Do you have any comments on the proposals to specify further minimum requirements regarding claims handling and settlement?	In principle we agree with the proposed elements set out at paragraph 99 of the Regulations Paper. However, we do not believe that they necessitate the introduction of regulations; guidance would be more suitable, allowing flexibility in the claims handling process and the type of insurance. This flexibility also allows for innovation in the sector.
12	Do you have any comments on the proposed definition of 'handling and settling a claim under an insurance contract' means? If so, why?	We are broadly supportive of a definition being introduced for 'handling a claim under an insurance contract' (if regulations are introduced). Any definition would need to be carefully drafted and comprehensively consulted on given the potential implications for different types of insurance. We suggest that a definition of "handling and settling a claim" should focus on when a decision to pay, decline or settle an insurance claim is made and capture the process in making those decisions. Therefore, under such a test, simply providing information, opinion or professional service to an insurer which it uses in the course of assessing, handling or managing a claim would not fit under this definition.
13	Do you have any comments on the discussion regarding customer vulnerability?	NZBA agrees with MBIE's view that it is not necessary to progress any specific regulations regarding customer vulnerability. Customer vulnerability is an issue that is front of mind for banks, and we consider that there are already a number of tools available to help banks meet the needs of vulnerable customers (e.g. the Bill itself, the financial advice regime under the FMCA as updated by FSLAA, the CCCFA and new Responsible Lending Code, Council of Financial Regulators' (**COFR**) Consumer Vulnerability Framework, the Code of Banking Practice, the Guidelines to help Banks meet the needs of older and disabled customers and Guidelines to help banks serve customer needs). We understand the FMA also proposes to update the Conduct Guide to reflect customer vulnerability issues in early 2022. NZBA was pleased to see that the Regulations Paper specifically calls out the situational nature of vulnerability, for example, paragraph 108 notes that "[a]ll consumers can become vulnerable at any given time". This acknowledges that

#	Question	NZBA Response
		people can move both in and out of vulnerable circumstances over time, and that vulnerability is a not static. This reflects our member banks' approaches to vulnerability, where the focus is on recognising that circumstances create vulnerability, rather than people being "intrinsically vulnerable". NZBA has set up a vulnerability working group comprised of subject matter experts in banks to provide a forum for members to discuss customer vulnerability issues from an industry perspective.
14	Do you have comments regarding the option of including vulnerable consumers in section 446M(1A)?	We do not consider that it is necessary to specifically mention "potential customer vulnerability" in the list of factors to consider as we think that is sufficiently captured under section 446M(1A). Additionally, we expect that this will become clearer when the FMA updates the Conduct Guide to reflect customer vulnerability issues, and when read alongside COFR's Consumer Vulnerability Framework.
15	Do you think any further factors should be added by regulations to the list under section 446M(1A)?	We cannot think of any further factors that should be added to the list under section 446M(1A).
16	Do you think any other regulations that could be made under new section 546(1)(oa) are necessary or desirable? Please provide reasons for your comments.	We do not consider that further regulations are necessary or desirable.
	Sales incentives	
17	Do you have any comments on the status quo (no regulations)?	NZBA acknowledges MBIE's view that the overarching obligation around design and management of incentives (new section 446M(1)(be)) does not go far enough, and that the status quo would be inconsistent with Cabinet's decision to prohibit volume and value based incentives. We agree that the status quo would undermine the objectives of the Bill. NZBA supports regulations that target volume and value-based incentives for frontline staff and their managers, as discussed in more detail below.
18	Do you have any comments on the option to prohibit sales incentives based on volume or value targets?	NZBA supports MBIE's preferred option, to prohibit sales incentives based on volume or value targets provided they are appropriately defined. We consider that this option is preferable to the alternative "principles-based" approach, which will likely create uncertainty, may have unintended consequences, and could capture incentives which are not problematic (this is discussed further in response to question 20).

#	Question	NZBA Response
		This option has the following benefits: • It is targeted, proportionate and would guard against incentives to sell inappropriately. As the Regulations Paper explains, not all incentives create conflict and incentives are not inherently bad. • It is consistent with the policy decision announced by Minister Faafoi on 25 September 2019 which describes "a ban on incentives which are based on meeting sales targets". • It will ensure a level playing field among those firms subject to the regulations, and will allow for consistency in the way in which employees are remunerated. • It strikes the right balance between a financial institution's obligations to its customers to deliver good customer outcomes, and its obligations to staff to remunerate them for the work they do and reward them for exceptional performance. • It is consistent with changes the banking industry has already made to remuneration practices following the Conduct and Culture Review (as noted in the Regulations Paper). • It would ensure a consistent approach across a broader range of financial service providers. If this option is adopted, we consider that volume and value targets should be defined to make clear that incentives for senior staff linked to financial metrics are not captured. As the Bill stands currently and from the Regulations Paper, it is unclear how broad the definition of incentive is intended to be, particularly the reference to incentives "calculated in any way by reference (directly or indirectly) to the volume or value of products". That could capture incentives used in balanced scorecards for more senior employees linked to financial metrics (such as Net Profit After Tax and Profit After Capital Charge) and metrics tied to market share, which we do not understand to be MBIE's intention.
19	What would the likely impacts be for financial institutions, intermediaries and/or consumers of prohibiting sales incentives based on volume or value based targets?	If MBIE's preferred option is adopted and applies incentive regulations only to frontline employees and their immediate managers, there should be positive impact on banks and their customers. Customers would continue to be protected from the risks of sales incentives based on volume or value targets. This option would also benefit financial institutions through continuity and certainty – that is because NZBA's members have already reviewed their incentives structures to ensure that they align with the recommendations made by the RBNZ and FMA's expectations, which are reflected in this option. Customers will also benefit from other parts of the sector removing volume or value-based targets. As noted in NZBA's 30 April 2020 submission on the Bill, care should be taken when drafting regulations as there is a risk of creating substantial (and unintended) change in the broker industry. We would welcome the opportunity to work with MBIE on the drafting of the regulations to ensure that there are no unintended consequences for brokers or other intermediaries.
20	Do you have any feedback on a more	We do not support this option. We are concerned that this option is too broad and would potentially capture sales incentives that are not likely to cause poor customer outcomes, and are a valuable component of a financial institution's

#	Question	NZBA Response
	principle-based approach to prohibiting some incentives?	overall remuneration structure. Principles-based regulation would also likely result in a range of unintended consequences, including regulatory over-reach, and may exacerbate the “unlevel playing field” caused by not all financial sector participants being caught by the Bill e.g. non-bank non-deposit taking lenders (**NBNDTLs**). We are concerned that the language of this option is very unclear and could be interpreted in different ways by different financial institutions. There is a risk that principles-based regulation would create a risk of regulatory arbitrage – it creates ambiguity that some financial institutions could manipulate and use to their advantage in order to continue offering volume and value-based incentives. We believe that prohibiting any incentive that “could reasonably be expected to influence the choice, volume or value of relevant services or associated products that are offered or provided to a consumer … or the financial advice given…” would potentially capture all incentives that are connected to the financial institution’s strategic goals. For example, banks may have strategic priorities in relation to particular customer segments, or parts of the market. This option would effectively prevent banks from offering incentives connected to those objectives because they could be said to “influence the choice, volume or value” of the products and services offered to customers. We also believe this option goes beyond the policy decision announced by Minister Faafoi on 25 September 2019 which describes “a ban on incentives which are based on meeting sales targets”.
21	How could a more principles-based approach to prohibiting some incentives be made workable?	We do not consider that a principles-based approach to prohibiting sales incentives is appropriate. A principles-based approach (by definition) is not capable of giving financial institutions certainty about the scope of the prohibition. It creates an unacceptable risk of regulatory arbitrage, which would undermine the objectives of the regime and could potentially lead to consumer harm.
22	If a more principles-based option was chosen, should there be some incentives specifically excluded?	At a minimum, a principles-based approach would need to clearly carve-out any incentives linked to the organisation’s strategic goals and priorities. The answer to this question will also depend on the scope of the regulations – if the prohibition applies beyond frontline staff and their managers, a broader range of incentives may need to be excluded.
23	Do you think there are any other viable options other than what has been put forward by this discussion document? Please explain in detail.	Any alternative approach should be based on evidence of harm caused by current practices, rather than based on the concerns expressed by RBNZ/FMA in 2017 (before banks restructured their incentives). We are not aware of any concerns about poor customer outcomes or harm that is being caused by banks’ current practices in relation to incentives.

#	Question	NZBA Response
24	Are there sales incentives based on volume or value targets that should be excluded from the regulations (i.e. allowed to be offered/given)?	The answer to this question will depend on the scope of the regulations – if the regulations apply beyond frontline staff and their immediate managers, a broader range of incentives may need to be excluded.
25	Do you think there are any other types of incentives that should be excluded from the regulations? Please provide reasons for your comments.	NZBA agrees that salary-based remuneration, performance benefits, linear sales incentives and disincentives should be expressly excluded from regulations relating to incentives.
26	Do you think that the scope of who can be covered by the regulations poses a risk of unintentionally capturing other intermediaries that are paid incentives but should not be covered?	We think that this depends on the changes made to the Bill in the Supplementary Order Paper. If the definition of intermediaries is appropriately narrowed to focus only on sales and distribution, we agree that the regulations should apply to all intermediaries.
27	Do you agree/disagree that within financial institutions and intermediaries sales incentives regulations should apply to all staff? Why/why not?	NZBA disagrees that sales incentives regulations should apply to all staff, especially under a principles-based prohibition. A principles-based prohibition which applies further than front line staff and their immediate managers would also significantly overreach the policy decisions made by Government, would be unlikely to create substantially better outcomes for customers, and would be very difficult to operationalise. We need to be mindful of the reason for the prohibition – preventing mis-selling and poor treatment of consumers. This option does not reflect the reality that there is only a small subset of people in a bank who have the ability to directly influence the behaviour of frontline staff and their managers. As explained in response to question 20 above, some incentives are positive and reinforce good behaviour. We have observed that an unintended consequence of the removal of sales incentives has been a drop off in the volume of sales of insurance and retirement savings products (e.g. Kiwisaver). Banks are working to re-educate their people on the importance of financial protection and retirement savings and are monitoring whether this increases the number of conversations about these important matters.

#	Question	NZBA Response
28	Do you agree/disagree that within financial institutions and intermediaries sales incentives regulations should only apply to frontline staff and their managers? Why/why not?	NZBA considers that sales incentives regulations should only apply to frontline staff and their immediate managers, otherwise, the proposals in the Regulations Paper will have a much greater impact than appears to have been envisaged by the 2019 policy decisions. We understand from further guidance provided by MBIE that there is little differentiation between the two options presented in the discussion paper. MBIE's guidance is that Option 2 ("frontline employees, agents and intermediaries and their managers only") applies to all staff other than senior managers and directors (as defined by the Financial Markets Conduct Act). Such a broad application of Option 2 appears inconsistent with the intention of this Option, which is to "[lessen] conflicts of interest at the point of interaction with consumers (frontline), which is where the conflict of interest operates." The discussion paper also notes that "For staff who are more removed from the sales and advice process…their ability to influence the consumer is far lower and therefore less problematic." For banks, there are many people between frontline staff and senior managers that are far removed from the sales and advice process. We understand that the rationale for the scope of application is due to the relative difficulty in defining 'immediate managers' compared to 'senior managers' (which is defined in the Financial Markets Conduct Act). However, we do not consider this should drive a wider scope of application of incentive regulations and would be happy to engage on a workable definition of 'immediate manager.'
29	Do you think that external incentives should apply to any incentive paid to an agent, contractor or intermediary? Why/why not?	We support an environment that creates a level playing field and focuses the attention on needs, suitability and the delivery of good customer outcomes.
30	Do you agree that both individual and collective incentives should be covered? Why/why not?	This will depend on how the regulations are framed (i.e. whether the prohibition is confined to volume/value-based incentives, or a principles-based prohibition is adopted) and how 'collective incentives' is defined. We would be unlikely to support a prohibition on collective incentives if a principles-based regulation of sales incentives is enacted. That is because it could potentially capture incentives connected to an organisation's strategic goals. As discussed at question 20, we believe that some incentives, for example, those connected to an organisation's strategic objectives, are positive and likely to have a positive impact on customers and NZ Inc. Collective incentives, if appropriately designed, can create an environment where collaboration benefits customers. However, if inappropriately designed, they can create a culture where sales are prioritised over good customer outcomes.

#	Question	NZBA Response
		For example, a review found staff 'hoarded' referrals even though other staff could have managed them and helped avoid delays to customers. However, we think our members' recent restructuring of incentives has ensured that collective targets/incentives are appropriate and geared toward good customer outcomes.
31	Do you have any other comments on the discussion related to incentives?	NZBA does not have any other comments on the discussion related to incentives at this stage.
		Requirement to publish information about fair conduct programmes
32	Is more detail needed to outline what information should be published regarding financial institutions' fair conduct programmes to assist financial institutions to meet this requirement, or to assist consumers in their interactions with financial institutions?	NZBA prefers Option 1 – prescribe no further detail. MBIE has said that its expectation is that financial institutions only need to publish a summary that is easy for the customer to read and understand. It does not expect financial institutions to publish detailed information. To this end, section 446HA should be sufficient for a financial institution to know what to publish. NZBA considers that Option 2, prescribing further detail, could remove the ability for financial institutions to be innovative in how they might describe their fair conduct programmes, show individuality, and produce something that is customer-focused and relevant to the particular organisation. It may also result in a product that is not relevant or confusing to the end consumer. For example, the suggestion around publishing expected timelines and outcomes of complaints as part of the complaints process does not convey the complexity and variability that can arise, and may cause confusion.
33	Do you have any comments on the options outlined above? What do you think the costs and benefits would be to financial institutions and consumers of the two options?	Please refer to our answer above.
34	This discussion document outlines two options regarding the requirement to publish information about the fair conduct	NZBA considers that Option 1 is the most viable option, and does not think that MBIE should consider alternatives at this stage.

#	Question	NZBA Response
	programmes. Do you have any other viable options?	
	Calling in contracts of insurance as financial products under Part 2	
35	Do you have any comments on the proposal to declare contracts of insurance as financial products under Part 2?	NZBA does not have any comments on this proposal at this stage.
	Exclusions of certain occupations or activities from the definition of intermediary	
36	Do you think it would be appropriate to exclude people who are subject to professional regulation from the definition of an intermediary (e.g. lawyers, accountants, engineers)?	Please refer to our discussion in response to questions 3 – 5 of the Intermediaries Paper.
37	Do you think that any other occupations or activities should be excluded from the new proposed definition of an "intermediary"? If so, why?	Please refer to our discussion in response to questions 3 – 5 of the Intermediaries Paper.

Appendix 2: Intermediaries Paper - responses to questions

#	Question	NZBA Response
		Option 1: amend definition of intermediary to focus on sales and distribution
1	Do you have any comments on Option 1: 'Amend definition of intermediary to focus on sales and distribution'?	NZBA supports a narrowing of the definition of intermediary. In our view, the current definition is too broad and uncertain. We consider that can be achieved by limiting what it means to be 'involved' in the provision of a relevant service or associated product, as proposed by MBIE. We agree that the removal of cl 446E(3)(b) (carries out other services that are preparatory to that contract being entered into) assists to narrow the scope. We think cl 446E(3)(d) (assists in administering or performing the service or the terms or conditions of the associated product) should also be removed to narrow the scope further and ensure a variety of arrangements that banks enter into which do not seem to be connected to the Bill's objectives are not captured. We consider the preparation of disclosure documents and standard form agreements should be expressly excluded under clause 446E(4) to clarify that this is not captured within a broad reading of "negotiates… a contract for the service" under clause 446E(3)(a). An example of an arrangement that could be captured by the current wording is a mail house that sends out the welcome brochure and terms and conditions for a product. It cannot be the intention of the legislation to capture this kind of third party as an intermediary. Intermediaries that are not involved in the sales and distribution of products and services should not be captured as they have little ability to influence outcomes for customers. The financial institution holds the main obligation to treat the customer fairly – as the holder of the primary obligation, they are responsible for work undertaken by third parties that is tangentially or indirectly connected to the development, distribution, etc of the product/service. However, we think that there is a risk that the words "sales" and "distribution" may not accurately cover the intended scope of the services provided by intermediaries. For example, mortgage advisors can provide advice with no corresponding sale. Additionally, the provision should include ongoing servicing by financial advisers. This needs to cover circumstances where a financial adviser might be involved in ongoing servicing, but not involved in the original sale (e.g. following the sale of a book). Further consideration or associated guidance is required to clarify the scope in this context.
2	Do you think the scope of the proposed definition of an intermediary is comprehensive enough to capture the variety of sales and distribution methods and to avoid	Yes, we think that the scope of the definition will still be comprehensive enough (subject to our comments in response to question 1 regarding the provision of advice where there is no "sale" etc.). It will continue to capture banks' main intermediary relationships, e.g. broker relationships and online retail investment platforms. We think the real risk of arbitrage arises from the fact that the obligations under this Bill which would relate to CCCFA products only apply to banks and non-bank deposit takers, despite the fact that there is a much broader range of entities which offer CCCFA products. This means that a large group of consumers will not benefit from the protections created by this Bill, which will undermine its objectives. For example, many finance companies and Managed Investment Scheme

#	Question	NZBA Response
	gaps and risks of arbitrage?	managers offer products that are the same as, or substantially similar to, products offered by banks, including motor vehicle finance, personal loans and KiwiSaver.
	Option 2: refine scope of who is covered as an agent	
3	Do you have any comments on Option 2?	With reference to paragraphs 34 – 36 of the Intermediaries Paper, NZBA's view is that only those acting on behalf of the financial institution and with actual authority should be captured by the definition of agent; people acting under apparent authority should not be captured. Consider the scope of what the proposed regulations require financial institutions to do in relation to their agents: initial and ongoing training, checking that training has been completed and that processes and procedures are being followed. These are highly systems-focused obligations which are only likely to be workable with financial institutions' established intermediaries subject to contractual relationships. Importing the concept of apparent authority would create a risk that a person is brought within the definition of an agent where the principal merely does nothing to dissuade the third party from believing that the agent has the authority to bind the principal – these are complex concepts which are difficult to relay to front line staff. A broader definition of agent risks unintended consequences. For example, it could capture third parties that are only involved in a generalised way and not directly involved in providing any part of the financial institution's relevant service or associated products to consumers, or third parties that are providing services that could not have an impact on the treatment of customers. For these reasons, NZBA supports the further option set out at paragraph 40 of the Intermediaries Paper, excluding those agents who are only involved in a very generalised way in the provision of relevant services or associated products. However, we are concerned this does not go far enough to exclude those agents who would not have an impact on the treatment of customers. An example could be the external provider of terminals for merchants, they are involved in the provision of a specific relevant service to individual customers, but they provide only terminals and would not impact on whether a customer receives fair treatment.
4	Do you think Option 2 would adequately exclude advisory services (e.g. lawyers, accountants) and other service providers to the financial institution who are not involved, directly or indirectly, in providing any part of the financial	We think there is a risk that option 2 would not exclude advisory services. A potential option would be to say in 446M(1)(b)(i) that it is only agents involved in the provision of the financial institution's relevant services or associated products and define what "involved" means in this context. Alternatively, MBIE's proposed further option at paragraph 40 may resolve this concern (excluding persons who are only involved in a very generalised way in the provision of relevant services or associated products). However, footnote 1 creates confusion – we are not sure whether MBIE is suggesting that these lawyers used by banks in conveyancing transactions would be carved out or kept in.

#	Question	NZBA Response
	institution's relevant service or associated products to consumers?	
5	Do you think any explicit exclusions are needed for particular occupations or activities? If so, which ones, and why?	We're concerned that carving out particular activities or professions could have the unintended consequence of suggesting a wider meaning is intended. We think the better approach is to treat agent narrowly (i.e. those with actual authority), removing the need for specific carve outs. If carve outs are applied, we prefer principles-based carve outs over specifying particular professions.
		Objectives
6	Do you have any comments on the objectives regarding the treatment of intermediaries?	One concern is that intermediaries who act on behalf of multiple financial institutions may face consequences of having to comply with/be trained on multiple conduct programmes. This could result in intermediaries being more selective with the financial institutions they work with or choosing not to work with financial institutions at all (e.g. boutique fund managers and KiwiSaver providers), which would mean less choice for consumers. Financial institutions that utilise wider group entities to perform functions that support the provision of products and services to customers will find the group entity captured as an intermediary in some instances. Oversight of intermediary arrangements within a group context does not appear to be a scenario envisaged by the Intermediaries Paper. Care will need to be taken when drafting regulations to minimise the risk of potentially conflicting or overlapping compliance requirements where a financial institution ("A") is acting as an intermediary for another financial institution ("B") and B has monitoring, training and expectation-setting responsibilities in respect of A, and A has a fair conduct programme that could cover its activities as an intermediary. We also think that this should include obligations under other legislation such as FSLAA i.e. if an intermediary is subject to training under FSLAA it should not have to undertake further duplicative training under the Bill.
		Option 3: Minimal changes to intermediaries obligations (remove 446M(1)(b) only)
7	Do you have any comments on Option 3: 'Minimal changes to intermediaries obligations'?	NZBA does not support this option. This option would be very burdensome on intermediaries. They could be required to complete numerous different training sessions that could differ between the different financial institutions, and comply with different processes in relation to misconduct, etc.

#	Question	NZBA Response
		Financial institutions do not “manage” and “supervise” intermediaries. Financial institutions can place contractual obligations on intermediaries and monitor compliance with these, but they do not have the ability to be in charge of the intermediaries and supervise all of their conduct.
8	If Option 3 were pursued, do you think any other obligations in section 446M(1)(bb), (bc), (bd) or (bf) would need clarifying or amending? Why/why not?	If the obligation on financial institutions to set procedures and processes is removed, the training obligation around the fair conduct program and procedures and processes should also be correspondingly pared back.
		Option 4: more significant changes to intermediaries obligations
9	Do you have any comments on Option 4: ‘More significant changes to intermediaries obligations’?	NZBA considers that option 4 has a number of benefits. This option is more reflective of what a financial institution can require an intermediary to do via the contractual arrangement between the parties. It also allows an intermediary to put in place one set of procedures and processes that allow it to comply with the conduct expectations of all of the financial intermediaries it deals with. We think the comments in paragraph 65 that option 4 “may set too low a standard of oversight in respect of non-FSLAA intermediaries” are inconsistent with the earlier statement in paragraph 63 that “financial institutions are not in a relationship of influence or control over independent third party intermediaries”. We do not think this is a valid reason to not implement option 4.
10	What do you think the level of responsibility should be for financial institutions’ oversight of intermediaries? For example, “*managing or supervising* the intermediary to ensure they support the financial institutions compliance with the fair conduct principle”, or “*monitoring* whether the	We consider “monitoring” is a better requirement than “managing” and “supervising”. As noted above, financial institutions do not “manage” and “supervise” intermediaries. Financial institutions can place contractual obligations on intermediaries and monitor compliance with these, but they do not have the ability to be in charge of the intermediaries and supervise all of their conduct. It is important that financial institutions are only responsible for their conduct and the distribution of/customer outcomes from their products – not other aspects of their intermediaries’ conduct. It also addresses the concerns about training intermediaries on the financial institution’s entire fair conduct program and policies and processes, which were too broad and onerous. We do query how under this option financial institutions are to “establish robust and transparent processes for dealing with misconduct” by intermediaries. Intermediaries are not employees, so financial institutions’ scope to discipline (outside of contractual remedies) is limited.

#	Question	NZBA Response
	intermediary is supporting the financial institution's compliance with the fair conduct principle", or something else?	
11	What standard do you think financial institutions should have to oversee their intermediaries to?	We think the standard should be set at financial institutions "setting conduct expectations" and "monitoring to ensure the intermediary is supporting the financial institution's compliance with the fair conduct principle". We don't believe a definition of "monitoring" in legislation is appropriate, but would support FMA providing guidance on the level of monitoring that would be adequate. It is important that any guidance is provided early and prior to the commencement of the new regime, as there is a significant risk FMA guidance will impact on the terms financial institutions need to negotiate into contracts with intermediaries.
		Option 5: Distinguish between FSLAA and non-FSLAA intermediaries
12	Do you have any comments on Option 5: 'Distinguish between FSLAA and non-FSLAA intermediaries'?	NZBA considers that there are some benefits to option 5, including the certainty provided to a significant group of intermediaries, and the recognition of some obvious overlaps between FSLAA and obligations under the Bill. Based on the proposed areas of distinction, we think the consistency provided by option 4 is preferable. We would likely be more supportive of option 5 if there was further reduction in the oversight of FSLAA intermediaries. However, in the key area of monitoring providers, we think it might be better to simply set one standard of "monitoring" and allow different approaches, including risk-based monitoring approaches, depending on the financial institution, intermediary and product involved (which already seems to be contemplated by section 446M(1A)). If a distinction is made, care needs to be taken to ensure that entities are treated correctly – with complicated structures, a company may be an intermediary because it employs financial advisers who advise on a financial institution's product and receives commissions for sales, but may not be a FAP because the financial advisers are 'engaged' by another entity that is a FAP for the purposes of FSLAA.
13	How far do you think financial institutions' oversight of FSLAA intermediaries under Option 5 should extend? For example, should it cover the general	If this option was taken, we believe a financial institution's oversight should only extend so far as to ensure that the intermediary has undertaken the training required by the financial institution, that it has complied with the conduct expectations set by the financial institution, and that misconduct is dealt with in accordance with the contractual arrangement between the financial institution and the intermediary.

#	Question	NZBA Response
	conduct of the intermediaries, or more narrowly on product performance and related consumer outcomes (or something else)?	
		Obligations in relation to employees and agents
14	Do you have any comments on the proposals regarding obligations in relation to employees and agents?	We agree that financial institutions should have requirements in place in respect of agents (noting that this assumes a narrower definition of "agent" than is currently in the Bill) but that these requirements shouldn't extend to "managing" or "supervising" agents. Financial institutions are constrained by their contractual relationships and are not in a position to "manage or supervise" third parties' adherence to obligations. Rather, financial institutions will usually only be able to set conduct expectations and other obligations through their contracts with intermediaries, and monitor and enforce compliance with those contractual obligations using the mechanisms provided for in their contracts. We also note that training obligations should be more limited for agents. Training in relation to products and fair conduct obligations should be clearly limited to matters relevant to the agent's involvement in the provision of the relevant service. Additionally, as we propose that the obligation for financial institutions to set processes and procedures is removed for agents, the obligation to train in policies and procedures should also be removed.
15	Do you think there should be a distinction drawn between employees and agents? Why/why not?	Yes, employees are managed and supervised by a financial institution but agents are not. An example is a debt collection agency. Their relationship with a financial institution is contractual and therefore the financial institution should monitor compliance with conduct expectations etc, rather than manage or supervise. Additionally, a financial institution's obligations in relation to agents should be expressly limited in relation to the functions they perform as an agent of that financial institution. Entities that act as an agent of a financial institution could separately provide other advisory services to that institution, provide similar services to other financial services businesses, or provide services to other types of customers. To ensure efficiency and workability, it is important that the obligation to monitor an agent is limited to the functions they perform as an agent of the relevant financial institution and not a broader obligation to supervise the conduct of that entity.
16	Do you think any amendments should be made to the obligations in section 446M(1) that would apply to employees and agents?	In our view, the only necessary changes are those as proposed above to 446M(1)(b)(i), 446M(1)(bb)(ii) and 446M(1)(bd), and that generally the obligations described in section 446M in respect of employees should be decoupled from those in respect of intermediaries and agents as described in the Executive Summary in relation to these sections.

#	Question	NZBA Response
17	Do you have any other comments or viable proposals?	We are also concerned by the removal of cl 446J of the Bill, which provided that 'the fair conduct programme does not apply to other financial institutions acting as intermediaries". There may be some circumstances where one financial institution is the intermediary of another small financial institution, and we do not think it is necessary or realistic that one financial institution should be required to comply with another organisation's fair conduct programme. We were unable to find any explanation for this deletion in the Select Committee's report. We note that the Bill currently requires financial institutions to obtain reasonable assurance that the employee, agent or intermediary is "competent and otherwise a fit and proper person". We think that the reference to "fit and proper" should be removed. "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. Competent is an appropriate level to set the baseline requirement, while allowing for financial institutions to scale this up if appropriate for the role. It also allows for the overlay of other regulatory regimes e.g. Code of Professional Conduct for Financial Advice Providers, which outlines competency requirements for roles of that nature. If MBIE considers that this should go beyond competency, we would welcome clarity that any good character assessment needs to require a diligent but not excessive check proportionate to the level of the role. NZBA also considers that amendments should be made to the Bill to clarify that any misconduct by an agent or intermediary will be dealt with through the contractual arrangements between the financial institution and the agent/intermediary. That is, the Bill should be clear that misconduct procedures set out in the contract are sufficient, and financial institutions are not required to have additional procedures in place if the contract deals with situations of misconduct.