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MINISTRY OF BUSINESS INNOVATION AND EMPLOYMENT

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Institute of Internal Auditors (IIA) NZ Feedback on the Options Paper – Conduct of Financial Institutions

The Institute welcomes the opportunity to provide feedback on the options paper.

Background to our interest in this submission

IIA NZ is a member-led organisation that draws on the skills and knowledge of our members in the private and public sectors across the country.

We're affiliated with and draw on the professional practice Code of Ethics and standards, and extensive guidance and resources of the Institute of Internal Auditors Global and Institutes of Internal Auditors around the world.

Internal audit professionals are widely recognised, respected, trusted and valued as the leading providers of assurance and advice on risk management, internal control and governance for the benefit of organisations and their stakeholders.

Our primary stakeholder focus includes management and governors and we provide an independent, objective assurance and consulting function designed to add value and improve an organisation's operations.

We are the 'third line of defence' in an organisation and assist the achievement of the organisation's objectives through sound control framework analysis and insights into areas of improvement for the organisation's operations.

We do not specifically comment on each of the options included in the paper – although we have noted our input to specific sections.

1. 3.1 Initial preferred package of options – Sections 113 to 116

(a) Summary of the below for Questions 1-3 in your paper: Options 1, 3 and 4 should be included (Customer's interest, Customer information and communication and Good conduct). Conflict of interest is a responsibility of every company and remuneration conflicts (although as noted by the examples in your report and the Hayne Commission report have not been handled well) are part of conflicts that all financial institutions must resolve satisfactorily. Management and governors have ultimate responsibility for conflicts resolution. Codes of practice for overarching principles is ultimately helpful – and gives an opportunity for regulators to have meaningful dialogue with financial institutions. More importantly, financial institutions will have information

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that allows them to critically evaluate what is required and how they put systems and controls in place to ensure that these duties are appropriately exercised.

(b) We support the general approach to a 'principles-based set of duties' as outlined in section 113. As noted, "A regime like this requires a proactive regulator that engages with the industry, sets clear expectations and holds institutions to account". A principle-based regime must embrace and support the key concepts of self-discipline and self-assurance. Management and governors must be assisted in this through control mechanisms including third line of defence assurance. This is a positive setting that reinforces the need for organisational accountability with monitoring and supervision required due to the fact that financial institutions are a critical part of a well-functioning society.

(c) The proposal in section 114 to apply this package only to banks and insurers seems odd – given the principles-based approach advocated, then in our view it could apply to **all** financial institutions that offer similar services to banks and insurers.

(d) Overarching duties to govern conduct – S115 – While we agree with the need for overarching duties that are aligned with principles-based frameworks, the six items included in this section are in our view not specifically targeted to areas where there are currently gaps. Concerns reflected in the paper relate largely to a lack of customer focus noted in the Hayne report – profits and remuneration priorities over ensuring that the customer's interests are protected. Accordingly, in our view, the first, third and sixth principle are specifically aligned to the issues identified by Hayne. While the others listed here are critical principles too – they are already covered by other legislation. For example, "a duty to act with due care, skill and diligence" is incorporated in the Companies Act in New Zealand.

(e) In our view it is important to specify and focus on those duty of care principles that are specifically aimed at the issues identified as being important to respond to issues identified in paragraph #1. Conduct and customer interest and customer information needs are the three areas that are specifically not covered by current legislation adequately.

2. TWO: Options to improve product design

(a) Option 1, 2 and 3: Principles based guidance is then overruled in this next section – through the suggestion of banning distribution and products. In our view, these will be difficult for the regulator (capacity and capability) and it reduces the financial institutions responsibility for acting appropriately in the first instance. As noted above, management and governors, assisted through control mechanisms including third line of defence assurance, must be responsible for product design.

Generally, product design concerns can be monitored by regulators requesting either consultation prior to initiation of products or by the request for significant assurance expectations that financial institutions have a process for ensuring that products and their distribution meet the principles outlined. Depending on the risk assessed for each product, this could be used to determine what involvement regulators would need to have to ensure appropriate oversight of product design and distribution.

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3. THREE: Options to improve product distribution

(a) Options 1 and 5 – lend themselves to appropriate behaviours in product distribution, specifically financial institutions taking responsibility for customer outcomes in a way in which they may not do now. Appropriate assurance can be gained from systems and processes that relate to this area that will be required by management and governors. Regulators in their oversight role will be able to gain assurance from the process that financial institutions follow in order to get required comfort.

(b) Options 2, 3, 4 – While it may be easy to specifically ban certain structures and incentives, given its specificity, it is likely that financial institutions will find ways to circumvent the rules. For example, remuneration increases based on good performance could be expanded. As noted earlier, banning is prescriptive and while you may be able to ensure that "rules" are not broken – the intent you are trying to stop may not be altered as there will be other ways to achieve the same end.

4. FOUR: Options relating specifically to insurance claims

(a) Option 1 - This duty already exists as noted in paragraph #179. It's not clear to us why adding a 'duty' "provides a way for the regulator to monitor" – as this is currently possible. As noted in question #9, the option to "clarify what fair, timely and transparent mean" would be of assistance to insurance companies – their boards and management and the regulator in supervising claims handling.

(b) Option 2 – This is already included – as noted above ("timely"). It's not clear that requiring a settlement of claims in a specified period is possible and if it were, it might force insurance companies to deliver poor customer outcomes.

Thank you for the opportunity to comment. The Institute is more than happy to meet to discuss the content included if that would be helpful.

Yours Sincerely

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