



COVERSHEET

Minister	Hon Kris Faafoi	Portfolio	Commerce and Consumer Affairs
Title of Cabinet paper	Financial Markets (Conduct of Institutions) Amendment Bill: Approval for Introduction	Date to be published	TBC

List of documents that have been proactively released

Date	Title	Author
4 December 2019	Financial Markets (Conduct of Institutions) Amendment Bill: Approval for Introduction	<i>Office of the Minister of Commerce and Consumer Affairs</i>
4 December 2019	DEV-19-MIN-0327	<i>Cabinet Office</i>

Information redacted

YES

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In Confidence

Office of the Minister of Commerce and Consumer Affairs

Chair, Cabinet Economic Development Committee

Financial Markets (Conduct of Institutions) Amendment Bill: Approval for Introduction

Proposal

1. This paper seeks approval for the Financial Markets (Conduct of Institutions) Amendment Bill (the Bill) to be introduced into the House. It also seeks policy decisions for three outstanding issues.

Policy

2. The purpose of the Bill is to create a new regime for the conduct of financial institutions in order to improve the conduct of those institutions and reduce the risk of harm to consumers.

Financial institutions, and the products and services they provide, are an essential part of a well-functioning society

3. Financial products and services are typically complex and can be very high-value, and there is often an imbalance of power between financial institutions and the consumers they serve. This creates a particular and acute risk of harm to consumers. When things go wrong with financial products or services, it can be catastrophic at the individual level and cause significant harm at the broader societal and economic level.
4. Recent reviews have identified that banks and life insurers lack focus on good customer outcomes, and have insufficient systems and controls to identify, manage and remedy conduct issues. This creates real risk of misconduct and I have heard New Zealand examples of actual misconduct occurring (for example, consumers being sold insurance products that they are ineligible to ever claim on).

Previous policy decisions

5. In September 2019, the Cabinet Economic Development Committee (DEV) agreed to a requirement that banks, insurers and non-bank deposit takers (NBDTs) be licensed by the Financial Markets Authority in respect of their conduct [DEV-19-MIN-0237 refers]. DEV also agreed that this licensing regime require banks, insurers and NBDTs meet a high-level standard to pay due regard to the needs and interests of customers and treat them fairly. Licensed entities would be required to have and implement effective policies, processes, systems and controls to meet this high level fair treatment standard. DEV also agreed to regulate sales incentives based on volume or value targets.

This Bill gives effect to these decisions and creates a broad conduct regime

6. The Bill requires banks, insurers and NBDTs (together, financial institutions) to obtain a licence from the Financial Markets Authority (FMA) regarding their general conduct. The Bill extends the FMA's existing powers under the Financial Markets Conduct Act 2013 (FMC Act) to monitor market services licensees and enforce their conduct obligations, such as the power to censure, give directions to a licensee or require them to submit an action plan.
7. The core obligation in the Bill is a duty for financial institutions to have and implement effective policies, processes, systems and controls to enable them to meet a high-level principle to treat consumers fairly, including by paying due regard to their interests. These policies etc. will be set out in a "conduct programme". The Bill allows for regulations to prescribe what must be in the conduct programme.
8. The Bill also creates the ability to prescribe regulations relating to incentives, which financial institutions and their intermediaries will be required to comply with. These regulations will be the mechanism through which sales incentives based on volume and value targets will be prohibited.
9. I note that there are some aspects of the Bill likely to be debated at Select Committee, particularly the scope of the Bill (whether or not non-bank KiwiSaver providers and non-bank or non-NBDT lenders should be included in the regime) and whether intermediaries should have to comply with financial institutions' conduct programmes.
10. This regime is targeted at types of institution (i.e. banks, insurers and NBDTs) rather than at particular products or services (e.g. credit, insurance, KiwiSaver etc.). This may place banks in particular at a competitive disadvantage compared to non-bank KiwiSaver providers and lenders. However, I decided to draw the regulatory boundary at banks, insurers and NBDTs in order to move quickly to regulate the areas where there is the most evidence of harm. In addition to this, other parts of the market are already regulated by the financial advice regime, the Credit Contracts and Consumer Finance Act 2003 and the FMC Act.
11. While I believe there are good reasons for drawing the boundary of the regime where we have, the Select Committee process may provide other perspectives.

Outstanding policy issues

12. There are two issues which have arisen through the drafting process which were not anticipated when earlier policy decisions were sought and for which I am now seeking approval. The Bill as drafted incorporates these matters.

Requiring financial advice provider intermediaries to comply with the financial institution's conduct programme

13. When I previously sought policy decisions from DEV on conduct of financial institutions, DEV agreed that financial institutions will be accountable for the activities of their intermediaries that are not financial advice providers. This remains consistent with the Bill as drafted, however I consider that there is also a need to ensure financial advice providers comply with the financial institution's conduct programme.

14. Some financial institutions, particularly insurers, occasionally outsource functions such as claims-handling, underwriting or policy design to other intermediary organisations. Many of these intermediaries are advice providers and will be licensed under the new financial advice regime.
15. I recommend financial advice provider intermediaries be required to comply with the conduct programme of financial institutions in order to ensure outsourced functions continue to be captured regardless of whether they are carried out by a financial advice provider. This will also ensure that the regime treats advice provider and non-advice provider intermediaries the same way in relation to them performing the same activities. If not, there would be a perverse incentive for financial institutions to outsource their functions to advice providers to avoid compliance with the regime.
16. I do not propose to change the previous decisions in relation to financial institutions' responsibility and liability for intermediaries (i.e. the Bill would not make licensed institutions liable for ensuring financial advice providers comply with any obligations). This would risk financial institutions bringing advice in-house and becoming vertically integrated which would not be desirable as I want to ensure that consumers continue to be able to access independent financial advice. Moreover, the conduct programme would not apply when the intermediary is giving financial advice as the giving of financial advice is already regulated by the FMC Act as amended by the Financial Service Legislation Amendment Act 2019.

Increasing penalties for intermediaries

17. The original DEV policy paper sought decisions on civil liability, including possible pecuniary penalties, for contravention of certain obligations under the new regime. For licensed entities, the pecuniary penalties were to be the greatest of the consideration for the relevant transaction, 3 times the amount of the gain made or loss avoided, and \$1 million in the case of an individual or \$5 million in any other case. For other entities captured by the regime (e.g. intermediaries covered by the incentives prohibition), pecuniary penalty levels were set at a maximum of \$600,000. This was based on the assumption that intermediaries distributing a financial product would be smaller than the financial institution manufacturing the product.
18. However, it is not always the case that intermediaries will be smaller than licensed financial institutions. This suggests that the penalties available for institutions not licensed under the regime should mirror those that are available for licensed financial institutions. This is especially true if an intermediary is accountable for delivering on core elements of a conduct programme.
19. With this in mind, I recommend amending the previous DEV decision so pecuniary penalty levels are consistent for any relevant entity that breaches its obligations under the regime.

Providing for the ability to add conditions to financial advice provider licenses

20. There is one outstanding matter which was included in the previous DEV paper but which the paper did not include a recommendation to give effect to. Accordingly, I seek formal policy approval for this matter.

21. The previous DEV paper noted that “the new conduct regime should preserve the possibility of further licence conditions on financial advice providers that align with the new conduct obligations. This would future-proof the regime to address any problems that might arise if financial advice providers do not conduct themselves in a way that is consistent with the high-level conduct standard expected of banks, insurers and NBDTs.” These conditions should be able to relate to advisers’ involvement in the providing of services that goes beyond the provision of financial advice.

Impact analysis

22. The Ministry of Business, Innovation and Employment’s (MBIE) Regulatory Impact Analysis Review Panel has reviewed the attached Impact Statement prepared by MBIE. The Impact Statement is a version of the one that accompanied the previous DEV paper. The Impact Statement has been updated to inform the further policy decisions that are now being made. The Panel considers that the information and analysis summarised in the Impact Statement meets the criteria necessary for Ministers to make informed decisions on the proposals in this paper.

Compliance

23. The Bill complies with:
 - 23.1. the principles of the Treaty of Waitangi;
 - 23.2. the rights and freedoms contained in the New Zealand Bill of Rights Act 1990 and the Human Rights Act 1993;
 - 23.3. the disclosure statement requirements (a disclosure statement has been prepared and is attached to the Bill);
 - 23.4. the principles and guidelines set out in the Privacy Act 1993;
 - 23.5. relevant international standards and obligations;
 - 23.6. the Legislation Guidelines (2018 edition), which are maintained by the Legislation Design and Advisory Committee.

Consultation

24. MBIE released an options paper which explored options to regulate financial institutions and their intermediaries in April 2019 and consulted publicly on the options contained in it. The feedback received was used to inform the development of policy recommendations.
25. MBIE has worked closely with the FMA in developing the Bill. The Treasury, Ministry of Justice, Reserve Bank of New Zealand, and Commerce Commission have also been consulted.
26. Following policy approval, MBIE held workshops with industry stakeholders such as banks, insurers and industry associations to seek feedback on the policy decisions. This feedback has informed the drafting of the Bill.

Binding on the Crown

27. The Bill amends an Act that already binds the Crown.
28. The Bill amends the law relating to the FMA by extending the existing powers that the FMA has under the FMC Act to monitor market services licensees and enforce their conduct obligations, such as powers to censure, give directions to a licensee or require them to submit an action plan.
29. The Bill does not amend the existing coverage of the Ombudsmen Act 1975, the Official Information Act 1982, or the Local Government Official Information and Meetings Act 1987.

Allocation of decision making powers

30. The Bill does not involve the allocation of decision-making powers between the executive, the courts, and tribunals.

Associated regulations

31. Regulations will be required to implement the Bill.
32. The Bill allows for regulations to prescribe the necessary content of a financial institution's conduct programme. This will give control over what licensed entities must turn their minds to and what must be included in the conduct programme.
33. The Bill will also create the ability to prescribe regulations relating to incentives, which financial institutions and their intermediaries will be required to comply with. These regulations will be the mechanism through which sales incentives based on volume and value targets will be prohibited.
34. I consider regulations to be the appropriate vehicle to regulate incentives and prescribe the necessary content of a conduct programme because there is a need for the requirements to be flexible enough to adapt as they evolve over time. I also consider that the prohibition on sales incentives based on volume and value targets will require further policy thinking and consultation with the industry – things which are built into the regulation-making process.
35. The Bill also allows for regulations to be made to adjust the boundaries of some definitions used in the Bill to allow the definitions to be flexible, and for regulations to prescribe the timing of the implementation of the regulations in the Bill.
36. I have included a backstop of 24 months from when the Bill is passed for the Bill to come into force. I expect the regulations to be made in advance of that backstop.

Other instruments

37. The Bill does not include any provision empowering the making of other instruments that are deemed to be legislative instruments or disallowable instruments (or both).

Definition of Minister/department

38. The Bill does not contain a definition of Minister, department (or equivalent government agency), or chief executive of a department (or equivalent position).

Commencement of legislation

39. The Bill provides for a commencement date or dates to be appointed by Orders in Council to provide some flexibility for development of the regulations that are needed to implement the Bill.
40. The Bill enables a phased approach to implementation so that different kinds of financial institution and different requirements can be brought in at different points in time.
41. There is a backstop date for the Bill to come into force 24 months after the Bill is passed if Orders in Council do not bring the Bill into force sooner.

Parliamentary stages

42. I recommend that the Bill be introduced on 11 December 2019. The Bill should be passed by the end of 2020.
43. I propose that the Bill be referred to the Finance and Expenditure Committee for consideration.

Proactive Release

44. I will release this paper proactively in whole, subject to redactions as appropriate under the Official Information Act 1982, within 30 business days. MBIE will publish a copy of this paper on its website.

Recommendations

The Minister of Commerce and Consumer Affairs recommends that the Committee:

1. **note** that a ^{Constitutional conventions} priority on the 2020 Legislation Programme ^{Constitutional conventions} has been sought for the Financial Markets (Conduct of Institutions) Amendment Bill;
2. **note** that the Financial Markets (Conduct of Institutions) Amendment Bill forms the basis of a broad conduct regime which will require certain financial institutions to be licensed in respect of their general conduct under the Financial Markets Conduct Act 2013;
3. **agree**:
 - 3.1. that financial advice providers be required to comply with financial institutions' fair conduct programmes, except in respect of financial advice;
 - 3.2. to increase the maximum level of pecuniary penalties available for contravention of relevant obligations by intermediaries under the regime, so that intermediaries may be liable for pecuniary penalties up to the greatest of:

- 3.2.1. the consideration for any relevant transaction;
 - 3.2.2. three times the amount of the gain made or the loss avoided;
 - 3.2.3. \$1,000,000 for an individual and \$5,000,000 for bodies corporate;
- 3.3. that conditions that relate to involvement in the provision of a financial institution's services and products by financial advice providers can be imposed on the licences of those financial advice providers (regardless of whether their involvement is related to the giving of financial advice) to ensure consumers are treated fairly;
4. if the Committee agrees to the policy proposals in paragraph 3, **approve** the Financial Markets (Conduct of Institutions) Amendment Bill for introduction, subject to the final approval of the Government caucus and sufficient support in the House of Representatives;
5. **agree** that the Bill be introduced on 11 December 2019;
6. **agree** that the Government propose that the Bill be:
 - 6.1. referred to the Finance and Expenditure Committee for consideration in early 2020;
 - 6.2. enacted by the end of 2020.

Authorised for lodgement
Hon Kris Faafoi
Minister of Commerce and Consumer Affairs