Submission template

Treatment of intermediaries under the new regime for the conduct of financial institutions

Your name and organisation

Name	Privacy of natural persons Head of Risk & Compliance – New Zealand
Email	Privacy of natural persons
Organisation/Iwi	FNZ Limited and FNZ Custodians Limited (together **FNZ**)

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Option 1: Amend definition of intermediary to focus on sales and distribution	
	Do you have any comments on Option 1: 'Amend definition of intermediary to focus on sales and distribution'?
1	First, and by way of introduction, FNZ is a provider of online investment platforms, custodial and investment administration services in New Zealand. FNZ provides custodial services[1] to institutional wholesale clients, including clients who will be financial institutions under the new COFI regime. Via contractual obligations FNZ's wholesale client agrees with its retail (and wholesale) customers that the wholesale client will hold client money or property in custody, and subcontracts that obligation to FNZ. FNZ interacts only with the wholesale client and its authorised representatives. FNZ is not customer-facing and has no direct contractual relationship with retail customers/end investors. FNZ's interactions are with its wholesale clients or their advisers and not with the retail customer directly. Accordingly, FNZ **agrees** with the proposal to amend the definition of intermediary to focus on sales and distribution: • Sales and distribution service providers promote financial goods and services to retail customers – their conduct can have a direct effect on a retail customer; • Persons involved in the after-sales administration and performance of a service offered by a financial institution, as FNZ is, ought not to be considered intermediaries. This is particularly so in the case of a custodial services, where the custodian has no direct relationship with retail customers.
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 gaps and risks of arbitrage?
	N/A
Option 2: Refine scope of who is covered as an agent	
3	Do you have any comments on Option 2?

[1] FNZ's custodial services provided under the Financial Markets Conduct Act 2013 include services 1) as a client money or property service provider under section 431W; and 2) as a scheme custodian under sections 157-159.

	FNZ submits that the legislation must allow service providers to financial institutions (and the financial institutions themselves) to know with certainty who is subject to the financial institution's fair conduct programme. FNZ is not, by contract, the agent of the financial institution. FNZ and the financial institution ought not to have to determine whether the individual circumstances between it and each of FNZ's clients indicate that authority ought to be implied. This would also have the effect of creating legal uncertainty with respect to existing relationships as well as future relationships. FNZ's view is that it would be an unintended consequence of the legislation if obligations excluded as an intermediary are then re-caught by implied rather than explicit agency. FNZ submits that only agents with express contractual agency authority should be subject to the legislation.
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 institution's relevant service or associated products to consumers?
	Yes – but FNZ submits that Option 2 should go further, to ensure that any service provider to the financial institution who is not directly involved in providing services or products to consumers is not an intermediary or an agent.
5	Do you think any explicit exclusions are needed for particular occupations or activities? If so, which ones, and why?

	FNZ considers that an explicit exclusion is needed (either in the amendments to the Act, or in the proposed regulations to be made under section 446E) in relation to the provision of a custodial service. FNZ's reasons are: • custodians are already (and have for many years been) subject to statutory regulation and compliance under the new FSLAA and its precursors, including conduct obligations; • the inclusion of FNZ within the regime as intermediary could result in duplication of conduct obligations and in addition to its own obligations, FNZ could find itself in the position of having to apply the Fair Conduct requirements of multiple financial institution clients; • FNZ's ability to provide a standardised and streamlined commercial service to its wholesale clients would be compromised by the application of bespoke conduct programme requirements of each financial institution; • FNZ's customers are wholesale financial institutions who do not need the protection of consumer legislation, and who can and do contract with FNZ for it to provide its custodial service to a high standard; • the objectives of the intermediaries' obligations include ensuring that consumers are being treated fairly. Imposing intermediary obligations on FNZ will not achieve this end, as it does not deal directly with consumers. The risk that FNZ might keep a consumer at arm's length from the relevant financial institution (para 21 of MBIE's discussion paper) simply does not arise. FNZ is, in fact, kept at arm's length from the consumer by its wholesale customers.
Objectives	
	Do you have any comments on the objectives regarding the treatment of intermediaries?
6	FNZ agrees with the objectives regarding the treatment of intermediaries – but notes that addressing the treatment of intermediaries is not useful if a person that would now not be an intermediary is instead captured by the broad reference to agents.
Option 3: Minimal changes to intermediaries obligations (remove 446M(1)(b) only)	
	Do you have any comments on Option 3: 'Minimal changes to intermediaries obligations'?
7	FNZ considers that Option 3 does not go far enough. It agrees that section 446M(1)(b) should be deleted, but submits that (if a custodial service will continue to be captured either by the definition of intermediary or as an agent) then, at a minimum, section 446M(1A)(e) should be amended to read "the types of intermediaries or agents that are involved".
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?

	In FNZ's case, where it is in the business of, and has expertise in, providing custodial services to wholesale clients and is not customer-facing, there will be no tangible benefit in requiring: • FNZ and its personnel to undergo initial and regular ongoing training in the financial institution's services and products and to confirm that it and its personnel have completed that training (sections 446M(1)(bb) and (bc); • the financial institution to monitor whether FNZ has treated consumers in a manner consistent with the fair conduct principle – as FNZ is not customer-facing (section 446M(1)(bd)).
Option 4: More significant changes to intermediaries obligations	
	Do you have any comments on Option 4: 'More significant changes to intermediaries obligations'?
9	FNZ considers Option 4 to be preferable to Option 3, but it still does not go far enough in the circumstance where a business that provides a custodial service is caught as either an intermediary or an agent. The issues noted in paragraph 9 above regarding training, for example, continue to exist.
	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 intermediary is supporting the financial institution's compliance with the fair conduct principle", or something else?
10	FNZ submits that the financial institution ought only to be required to "monitor" an intermediary (having regard to the type of intermediary and the level of risk that an action by the intermediary could be contrary to the fair conduct principle). The key issue should be risk – is the intermediary or agent capable of causing the financial institution to fail to comply with the fair conduct principle? If not, then the need for that intermediary or agent to (a) be classified as such and (b) if so classified, to be subject to additional monitoring and compliance, is low.
11	What standard do you think financial institutions should have to oversee their intermediaries to?
	A lower standard where the intermediary or agent is FSLAA-regulated.
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'?

FNZ strongly supports the proposal to distinguish between FSLAA and non-FSLAA intermediaries.

However, that distinction will not be sufficient if an entity (such as FNZ) is an FSLAA intermediary, but separately caught by the legislation as an agent. This could be addressed:

- by defining agent as being limited to agents that have express authority from the financial institution (this is FNZ's preference)
- by providing that an entity that is an agent with implied authority and that is an FSLAA entity will be treated in the same way as an FSLAA intermediary.

13	How far do you think financial institutions' oversight of FSLAA intermediaries under Option 5 should extend? For example, should it cover the general conduct of the intermediaries, or more narrowly on product performance and related consumer outcomes (or something else)?

FNZ submits that a financial institution's oversight of an FSLAA intermediary (or agent) should be limited to "monitoring product performance and related outcomes for consumers, rather than general monitoring of the overall conduct of the intermediary" (paragraph 71 of MBIE's discussion paper).

Obligations in relation to employees and agents

14	Do you have any comments on the proposals regarding obligations in relation to employees and agents?

FNZ agrees that an agent acting with the express authority of the financial institution is effectively acting as the financial institution itself, and so the financial institution should be responsible for the agent's conduct.

However, where a service provider contracts to provide custodial services to a financial institution as an independent contractor and specifically **not** as an agent, the actions of the entity are not the actions of the financial institution. FNZ is not acting as the financial institution. The legislation must provide certainty – not leave room for an argument in hindsight about whether two entities were in an independent contractor relationship or an agency relationship. Only agents acting with express authority should be agents for the purposes of this legislation.

15	Do you think there should be a distinction drawn between employees and agents? Why/why not?

N/A

16	Do you think any amendments should be made to the obligations in section 446M(1) that would apply to employees and agents?

N/A

	Do you have any other comments or viable proposals?
17	FNZ agrees that the other options considered (paragraphs 78-88 of MBIE's discussion paper) are not workable.

Other comments

Nil.