MINISTRY OF BUSINESS, INNOVATION & EMPLOYMENT
HĪKINA WHAKATUTUKI

COVERSHEET

Minister	Hon Dr David Clark	**Portfolio**	Commerce and Consumer Affairs
Title of Cabinet paper	Financial Markets (Conduct of Financial Institutions) Amendment Bill: Further Policy decisions and regulations	**Date to be published**	16 March 2022

List of documents that have been proactively released		
Date	**Title**	**Author**
9/2/2022	*Financial Markets (Conduct of Financial Institutions) Amendment Bill: Further Policy decisions and regulations*	*Office of the Minister of Commerce and Consumer Affairs*
9/2/2022	*Cabinet Economic Development Committee – Minute of Decisions [DEV-22-MIN-003]*	*Cabinet Office*
9/2/2022	*Regulatory Impact Statement: Financial Markets (Conduct of Institutions) Amendment Bill – Further policy decisions*	*MBIE*

Information redacted	**NO**

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Regulatory Impact Statement: Financial Markets (Conduct of Institutions) Amendment Bill - Further policy decisions

Coversheet

Purpose of Document	
Decision sought:	Agree further policy decisions for amendments to the Financial Markets (Conduct of Institutions) Amendment Bill (**the Bill**) and regulations to be made under the Bill
Advising agencies:	The Ministry of Business, Innovation and Employment (**MBIE**)
Proposing Ministers:	Minister of Commerce and Consumer Affairs
Date finalised:	1 February 2022

Problem Definition

The Bill introduces a new conduct licensing regime for banks, insurers and non-bank deposit takers (**financial institutions**), and aims to ensure that these financial institutions treat consumers fairly. This RIS supplements MBIE's Regulatory Impact Assessment of 5 December 2019, which contains analysis of the general problem definition that the Bill is seeking to address and which was developed at the time that the policy approvals underlying the Bill were sought.

The Bill was reported back from the Finance and Expenditure Committee on 7 August 2020 and is awaiting completion of its second reading. Following select committee feedback and further consultation with stakeholders, we have identified two areas where the Bill's current requirements need adjustment to ensure the regime operates effectively and delivers on the objectives of the regime. The issues are:

1. The Bill's requirements for financial institutions in relation to third parties involved in the sale and distribution of their products and services (**intermediaries**) are too prescriptive and may not be workable across the different types of financial institutions to which the Bill will apply and their differing business models.
2. The Bill does not apply appropriately to the Lloyd's insurance market which has a unique structure.

Executive Summary

This RIS analyses two areas of the Bill where the current provisions need adjustment to ensure the regime operates effectively and delivers on the objectives of the regime. Part A relates to financial institutions' obligations in respect of their intermediaries. Part B relates to how the Bill's substantive conduct obligations apply to the Lloyd's insurance market.

Part A: Intermediaries

Stakeholders have raised concerns about the provisions in the Bill that set out financial institutions' obligations in relation to their intermediaries. For example, stakeholders have said:

- The current requirements for financial institutions to train and manage or supervise their intermediaries are unworkable given that intermediaries are independent third parties over whom financial institutions may have little or no control.

- The fact that some intermediaries are already regulated, licensed and subject to statutory duties (eg duties under the Financial Services Legislation Amendment Act 2019 (**FSLAA**)) means that requiring financial institutions to have obligations in respect of those intermediaries under the Bill is unnecessary, duplicative and costly.

The options we have considered include providing more flexible and less prescriptive obligations in relation to intermediaries, amending the scope of intermediaries captured by the Bill and distinguishing between licensed and non-licensed intermediaries.

The preferred options are:

- Limiting the scope of the Bill's provisions relating to intermediaries to third parties involved in the sales and distribution of financial products and services.
- Removing the prescriptive obligations on financial institutions in respect of intermediaries and replacing them with higher-level principles-based obligations.

Part B: Lloyd's

Lloyd's is an international market for the provision of wholesale and retail insurance. It has a unique structure whereby many market participants with different functions are involved in the provision of insurance to customers, rather than a single insurer.

Under Part B we consider options in relation to the Lloyd's insurance market and the application of the Bill to the various Lloyd's market participants. The key issue is whether conduct obligations are placed on either Lloyd's underwriting members or its managing agents. The objective is to ensure the fair treatment and adequate protection of consumers and to ensure that the Financial Markets Authority (**FMA**) has effective supervisory and enforcement powers to enforce conduct standards in the Lloyd's insurance market.

The preferred options are:

- The Bill's conduct obligations will apply to Lloyd's managing agents and not to underwriting members.
- Lloyd's underwriting members will be exempted from the requirement to be licensed, and the terms and conditions of the exemption will prescribe the conduct programme requirements and obligations to be placed on the managing agents.

Overall impact

The overall impact of these preferred options under both Parts A and B is that they will provide the flexibility required to accommodate the range of businesses, products and methods of distributions that come within the conduct regime. These options will also avoid any unnecessary duplication of regulation and disproportionate compliance costs, whilst still ensuring the fair treatment of consumers and maintaining the availability of financial products.

Limitations and Constraints on Analysis

We do not have cost estimates or other hard data relating to the costs that the issues with the Bill that we have identified may impose on financial institutions and intermediaries. The analysis is based largely on impacts identified in:

- written submissions received in response to the two discussion documents released in April 2021 (available on the MBIE website here)
- extensive consultation with banks, insurers, non-bank deposit takers, intermediaries, representative industry bodies, consumer representatives and other government agencies (particularly the FMA)
- desk-based research including academic papers, international trends and experiences and the joint reports into banking and insurer conduct and culture.

In some instances, stakeholders shared anecdotal evidence of the anticipated effects of the proposals but did not include quantitative evidence of the problems identified. For

example they made comments about the apparent duplication of conduct obligations under FSLAA and the new conduct regime under the Bill, but did not provide estimates of the unnecessary costs that may be incurred as a result of any duplication. FSLAA comes fully into force in March 2023. If FSLAA was fully implemented prior to the conduct regime being developed, we would have been able to do more analysis of the effectiveness of that regime before developing financial institutions' obligations in relation to their intermediaries.

Some of the options have been consulted on at a relatively high level as Ministers have directed MBIE to develop a high-level regulatory framework governing the conduct of financial institutions. This approach will allow more prescriptive details to be developed over time if necessary through regulations or further legislative changes but may create some uncertainty as the regime is embedded.

Responsible Manager(s) (completed by relevant manager)

Authorised by:

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Building, Resources and Markets

Ministry of Business, Innovation and Employment

1 February 2022

Quality Assurance (completed by QA panel)

Reviewing Agency:	The Ministry of Business, Innovation and Employment
Panel Assessment & Comment:	MBIE's Regulatory Impact Analysis Review Panel has reviewed the attached Impact Statement prepared by MBIE. The Panel considers that the information and analysis summarised in the Impact Summary meets the criteria necessary for Ministers to make informed decisions on the proposals in this paper.

Background - Development of the new conduct regime

Why the new regime is necessary

Banking and insurance services are essential to enable individuals to effectively participate in society – for example, to make transactions, to save or borrow for future purchases or investments (eg housing), to manage financial risks. The purpose of the new regime for the conduct of financial institutions is to ensure that the financial institutions offering these critical products and services have robust systems for delivering them, and treat consumers fairly in all circumstances.

The Bill responds to joint reviews by the FMA and the Reserve Bank of New Zealand (**RBNZ**) into the conduct and culture of banks and life insurers in New Zealand. These reviews identified that these institutions lack focus on good customer outcomes, and had serious weaknesses in their internal systems and controls and governance of conduct risk, creating real risks of widespread harm to consumers if left unchecked.

What the new regime will require

Once implemented, the Bill will require banks, insurers and non-bank deposit takers to obtain a conduct licence from the FMA in order to offer certain products and services to retail customers (**consumers**). They will also be required to implement programmes setting out effective policies, processes, systems and controls in relation to their conduct towards consumers (**fair conduct programmes**). The regime is designed to be principle-based and evolve over time through regulations and guidance from the regulator as standards and societal expectations change.

The new regime will cover effectively three different industries, each with a wide range of products and services, sub-sectors, business models and structures. While there are similarities across each industry, there are also marked differences. These similarities and differences need to be considered when considering how regulatory options impact different parts of the industry.

Purpose of this RIS

The Bill was reported back from the Finance and Expenditure Committee (**FEC**) on 7 August 2020. From April 2021, MBIE undertook further public consultation on outstanding aspects of the new conduct regime. Consultation provided valuable feedback from a wide range of stakeholders. In particular, it confirmed that changes to the Bill are needed to ensure that the Bill's requirements are workable across the different types of financial institutions to which the Bill will apply, and their differing business models, and to deliver the objectives of the regime.

This RIS analyses two areas of the Bill where the current provisions need adjustment to ensure the regime operates effectively and delivers on its objectives. Part A relates to financial institutions' obligations in relation to intermediaries and Part B relates to how conduct obligations apply to the Lloyd's insurance market.

This RIS should be read in conjunction with MBIE's Regulatory Impact Assessment developed when policy approvals underlying the Bill were sought. (Regulatory regime to govern the conduct of financial institutions - 5 December 2019 - Regulatory Impact Assessment - Ministry of Business, Innovation and Employment (treasury.govt.nz)).

PART A: INTERMEDIARIES

Section A1: Diagnosing the policy problem

How is the status quo expected to develop?

The FEC recommended changes to the Bill's requirements as introduced

Financial institutions (particularly in the insurance sector) frequently sell or distribute financial products and services through intermediaries. The conduct and culture reviews carried out by the FMA and RBNZ identified that some financial institutions were not taking adequate responsibility for their customer outcomes that were influenced by the conduct of intermediaries, and made little effort to maintain visibility of customer outcomes where an intermediary was involved. In some cases, it was also found that intermediaries were keeping consumers at arm's length from the financial institutions.

It is therefore an important objective of the regime for financial institutions to take appropriate responsibility and care for whether or not their customers are experiencing fair outcomes from their products and services, including where sales and distribution occurs through an intermediary.

As introduced, the Bill required intermediaries to comply with the fair conduct programmes of financial institutions for whom they act. It also required financial institutions to ensure their intermediaries complied with those conduct programmes. However concerns were raised that this would result in high compliance costs for financial institutions and their intermediaries (who may be required to comply with multiple conduct programmes). This could lead to intermediaries reducing the range of products they offer or tying themselves to only one provider, undermining a key policy objective as it could result in limiting consumer choice.

In its report, the FEC recommended that the Bill's original requirements be changed to remove the requirement for intermediaries to comply with the conduct programmes of financial institutions. Instead, the committee introduced new requirements for financial institutions in respect of their intermediaries that were directed at ensuring those intermediaries would support the financial institution's compliance with the fair conduct principle. These new requirements form the status quo being considered in this RIS.

The Bill now sets specific requirements for financial institutions in respect of their intermediaries, including requirements to train and manage or supervise them

Under the status quo (ie the Bill as reported back by the FEC), financial institutions are required to comply with reasonably prescriptive obligations in relation to their intermediaries. These include having specific policies, processes, systems and controls in their fair conduct programmes in relation to intermediaries, including:

- requiring intermediaries to follow procedures or processes that are necessary or desirable to support the financial institution's compliance with the fair conduct principle
- requiring initial and regular ongoing training for intermediaries on the services and products that they will be involved in providing and on the fair conduct programme
- checking that intermediaries have completed the above training and have a reasonable understanding of it
- managing or supervising intermediaries to ensure that they are supporting the financial institution's compliance with the fair conduct principle.

The Bill further prescribes a list of specific activities that a financial institution must do to manage or supervise its intermediaries, including:

- carrying out competence and "fit and proper" checks
- setting conduct expectations

- monitoring how intermediaries treat consumers
- dealing with misconduct by intermediaries.

The scope of intermediaries covered would be broad. It would include any person who is "involved" in the provision of a financial institution's products and services and is paid or provided commission for their involvement by the financial institution or another intermediary. This captures sales and distribution activities, as well as pre- and post-sale administrative, advisory and fulfilment services that support the provision of the financial institution's products and services (eg claims management companies, lawyers, and panel beaters in relation to motor vehicle insurance).

Intermediaries are not themselves directly subject to the fair conduct principle or statutory obligations related to fair conduct programmes under the Bill. However, they will be required in practice to meet the expectations of financial institutions set through fair conduct programmes to support the financial institution's compliance with the fair conduct principle.

What is the policy problem or opportunity?

The requirements in the Bill relating to intermediaries may be too prescriptive and inflexible for the range of institutions covered

Industry stakeholders (including financial institutions, intermediaries and industry groups) have been concerned about the scope of the Bill's provisions relating to intermediaries since the Bill was introduced and remain concerned following the FEC's report back to the House.

Stakeholders have said that the requirements in the Bill (eg for financial institutions to train and manage or supervise their intermediaries) are unworkable and inappropriate, given that intermediaries are independent third parties over whom they may have little or no control. In some sectors, intermediaries may in fact sometimes have greater market power than financial institutions themselves and can dictate key aspects of products and services to financial institutions eg large insurance brokers who design the terms of insurance products and approach insurers to underwrite them.

However, consumer organisations were concerned about reducing the scope and level of prescription of the obligations in the Bill, considering that this may make it more difficult for the public and the FMA to monitor intermediaries and identify misconduct, cause inconsistency in approach by financial institutions and cause unequal treatment of consumers.

We think the Bill's existing requirements are likely to lead to negative consequences and not achieve the objectives

We consider that it is likely that if financial institutions have the obligations that are currently in the Bill, there will be negative consequences and that the Bill may not achieve its objective of ensuring fair treatment of consumers.

The provisions in the Bill may be interpreted as being too intrusive as they are not flexible enough to accommodate the range of business models to which the Bill applies. They prescribe how financial institutions must achieve the objective instead of setting the objectives. In some cases the training and managing or supervising requirements may be more than is required, for example when the intermediary is highly experienced, where the product is simple and well-understood or where the intermediary has limited involvement with consumers and limited impact on consumer outcomes. Therefore, it is unlikely that there will be significant benefits from this approach.

There will also be significant additional costs, for example:

1. The obligations are likely to require significant resourcing and time commitment from both financial institutions and intermediaries (eg to set up detailed agency agreements that provide for regular training and auditing). Financial institutions would need to develop, deliver, audit and regularly update training specific to their products and services while intermediaries would need to spend time undertaking training and

reporting. Intermediaries that work with multiple financial institutions may have to meet a variety of requirements arising from multiple institutions' conduct programmes. It is likely that these costs would be passed onto consumers.

2. Because of the level of prescription in the Bill, financial institutions may do more than is necessary or appropriate with respect to training, supervising and managing intermediaries in order to ensure strict compliance with the Bill and limit their exposure to statutory liability. This could lead to undesirable structural changes in the market and is not consistent with the proportionate, risk-based approach that is intended. We have already heard some anecdotal reports of financial institutions setting onerous and prescriptive requirements for their intermediaries as a response to the expected requirements of the Bill.
3. Intermediaries could reduce the number of financial institutions they work with (or tie themselves to a single provider) because of the requirement to meet detailed policies and procedures developed by each financial institution. This is likely to reduce product choice for consumers and competition between financial institutions. Where intermediaries are financial advisers, this could also reduce consumer access to financial advice.
4. Financial institutions may also reduce the number of intermediaries they work with and/or bring sales and distribution in-house in order to more easily manage and supervise intermediaries, which is likely to reduce choice and competition in the market.

An inappropriately wide range of third parties may be caught by the current provisions

As noted above, "intermediary" is defined broadly in the Bill. This generally covers any person who is "involved" in the provision of a financial institution's relevant service and is paid or provided commission for their involvement by the financial institution or another intermediary.

Industry stakeholders have been concerned about this scope. This is because financial institutions could potentially have liability for overseeing the conduct of a very wide range of parties over whom they would not normally have this level of oversight, and who have limited interaction with consumers or impact on consumer outcomes. This is therefore likely to result in significant costs similar to those outlined above (eg significant resourcing and time commitment from both financial institutions and intermediaries, reduced competition and consumer choice in the market).

There was limited support for the status quo in submissions, although one consumer organisation did support the status quo on the basis that narrowing the definition could risk weakening protection for consumers.

Some intermediaries are regulated under the new financial advice regime and there may be some duplication of regulation

Another issue that arose during consultation is how to treat intermediaries that are regulated as financial advice providers under the new regime introduced by FSLAA. This regime came into force in March 2021 (but will not be fully implemented until March 2023) and will require anyone providing regulated financial advice to a retail client to be licensed by the FMA and subject to high-level duties and competency and client care obligations.

Industry stakeholders have argued that the fact that financial advice providers are already regulated, licensed and subject to statutory duties (eg to give priority to a client's interests) means that requiring financial institutions to have obligations in respect of them under the Bill to ensure consumers are treated fairly is unnecessary, duplicative and costly.

Our view is that the FSLAA and conduct regimes have different objectives, and that financial institutions are responsible for, and need to have an understanding of, whether consumers are experiencing fair outcomes from their relevant services and products, regardless of the distribution channel used. However, we do agree that it is important that the conduct requirements in the Bill complement rather than duplicate the requirements on financial advice providers under FSLAA.

What objectives are sought in relation to the policy problem?

The overall objectives of the obligations on financial institutions in respect of their intermediaries are:

1. ensuring financial institutions are meeting their responsibilities to consumers under the fair conduct principle in the Bill, regardless of the distribution channel used for their financial products or services
2. minimising unnecessary compliance costs and potential duplication of regulation
3. ensuring consumers continue to have access to suitable financial products and services, and high-quality financial advice.

These objectives take into account the key issues identified in the FMA and RBNZ reviews (described above) as well as the overall objectives for the regime.

Section A2: Deciding upon an option to address the policy problem

What criteria will be used to compare options to the status quo?

We have used the following decision-making criteria to assess the likely impacts of the options:

1. *Achieves fair outcomes:* financial institutions are treating their consumers fairly regardless of the distribution channel used for their financial products or services (goes to achieving Objective 1).
2. *Cost-effectiveness:* unnecessary compliance costs and overlap of obligations with pre-existing regulation (such as FSLAA) are minimised (goes to achieving Objective 2).
3. *Maintaining availability of financial products and services:* consumers continue to have choice from a range of suitable financial products and services, and high-quality financial advice (goes to achieving Objective 3).
4. *Proportionality*: financial institutions are able to take a proportionate risk-based approach when overseeing their distribution arrangements, eg taking into account the type of intermediaries they have engaged (including whether or not they are regulated under FSLAA) and the nature of their involvement.

What scope will options be considered within?

Some options for refining the Bill’s requirements were explored but not considered feasible

Following the FEC’s report back, MBIE sought stakeholder feedback on further options for refining the provisions of the Bill in relation to intermediaries, in order to address stakeholders’ ongoing concerns about the broad scope of these provisions.

A number of options were ruled out through a broad scoping exercise before undertaking consultation and during the consultation itself. These were proposals:

1. for intermediaries to have their own fair conduct programmes
2. for intermediaries to be subject to a duty to cooperate with financial institutions in relation to fair conduct programmes
3. to apply the fair conduct principle to intermediaries
4. to keep the specific obligations applying to financial institutions in respect of intermediaries under the Bill, with amendments.

In respect of points 1 to 3 above, we acknowledge that many intermediaries provide financial services in their own right and there may be merit in the argument that all financial service providers should be subject to conduct obligations under the Bill. However, the focus of the conduct regime is to act swiftly to address conduct issues related to financial institutions as identified in the FMA/RBNZ reviews. The regime could be expanded in the future if appropriate and following a proper policy process, consultation and consideration of the costs and benefits.

Furthermore, the FEC determined that it was inappropriate for the Bill to include direct requirements for intermediaries to comply with fair conduct programmes of financial institutions for whom they sell or distribute products and services, due to the high compliance costs this would impose and the likely negative impact on consumer choice if intermediaries responded by reducing the number of institutions they work with. We therefore did not consider it appropriate to pursue options that would likely result in similar outcomes.

In respect of point 4 above, the discussion document proposed two options to narrow the obligations that the Bill imposes on financial institutions in respect of intermediaries. One option made minimal changes (limited to removing the obligation on financial intermediaries to require intermediaries to comply with their fair conduct programmes) while the other option made more significant changes by removing or amending more obligations (eg replacing the obligation to “manage or supervise” intermediaries with an obligation to “monitor” them).

It was clear from consultation feedback that industry remained concerned that these proposed options still had significant issues and potentially introduced more confusion about what obligations applied to financial institutions (eg submitters were unclear as to what “monitor” would require that would be different to “manage or supervise”). They would likely still require financial institutions to exert a strong degree of control over their intermediaries in order to comply with the specific activities set out in the Bill. They were therefore not effective to achieve the desired objectives.

Following consultation, MBIE identified a revised package of potential options

Taking into account feedback from consultation, MBIE considered further whether there were any approaches that would better ensure that the Bill worked across the different types of financial institutions to which the Bill will apply, and their differing business models. These options are considered in more detail in the next section.

What options are being considered?

Option 1: Status quo (prescriptive obligations and wide definition of intermediary)

As explained above, under the status quo, financial institutions would be required to include specific policies, processes, systems and controls in their fair conduct programmes in relation to intermediaries, including detailed training requirements and managing or supervising intermediaries to ensure that they are supporting the financial institution’s compliance with the fair conduct principle. The Bill further prescribes a list of specific activities that an institution must do to manage or supervise its intermediaries, including carrying out competence and “fit and proper” checks, setting conduct expectations, monitoring how they treat consumers, and dealing with their misconduct.

The scope of intermediaries covered would include any person who is “involved” in the provision of a financial institution’s relevant service and is paid or provided commission for their involvement by the financial institution or another intermediary. This captures sales and distribution activities, as well as pre- or post-sales administrative, advisory and fulfilment services that support the provision of the financial institution’s relevant services (eg claims management companies, lawyers, and panel beaters in relation to motor vehicle insurance).

As identified above, the status quo options may not deliver on the policy objectives. They do not apply flexibly across the range of business models to which the Bill applies. They are likely to result in significant ongoing costs of compliance which may be passed onto consumers as well as reduced consumer choice and competition in the market. They were

opposed by industry stakeholders, although there was a minimal level of support from consumer organisations.

Option 2: More flexible and less prescriptive obligations in relation to intermediaries

Under this option, the status quo obligations on financial institutions that currently require them to train and manage or supervise intermediaries would be removed. The broad obligation for financial institutions to ensure that intermediaries follow procedures or processes to support the financial institution's compliance with the fair conduct principle would also be removed.

Instead, the Bill would take a higher-level approach, and require financial institutions to have effective policies, processes, systems and controls to:

- ensure their distribution arrangements (including the distribution of products and services through intermediaries, and including arrangements for post-sales servicing activities and after-sales care) comply with the fair conduct principle
- monitor whether their distribution arrangements are meeting the fair conduct principle
- regularly review their distribution arrangements, and make enhancements or improvements, or remedy issues, as necessary.

These obligations would be supported by the requirement in the Bill for financial institutions to design their fair conduct programmes with regard to relevant factors, such as the types of intermediaries that are involved in the provision of the services and products. The standard of conduct remains the same (ie financial institutions have an obligation to ensure consumers are treated fairly, regardless of the arrangements used to distribute products and services) but a proportionate approach can be taken to mitigate risks.

For clarity, these obligations would apply in relation to all distribution arrangements, including in-house sales forces and direct sales channels, rather than being limited to intermediated channels (ie where products and services are distributed through intermediaries).

The benefits of this approach are that it would ensure the Bill works across the different types of financial institutions to which the Bill would apply, and their differing business models. It would also be consistent with the approach taken by the Bill in general of setting out high-level principles-based obligations instead of detailed and prescriptive requirements. It should address the concerns raised by industry stakeholders by providing them with some flexibility as to how they meet the compliance obligations while still ensuring that consumers are treated fairly.

Option 3: Amend scope of intermediaries captured by the Bill to focus on sales and distribution

In the Bill as reported back, stakeholders raised concerns about the scope of who was caught as an intermediary. In the discussion document we proposed amending the scope to capture sales and distribution activities only. This approach would capture persons providing non-advised sales (eg travel agents, retailers selling add-on insurance/credit, car dealers, comparison websites) as well as advised sales by financial advice provider intermediaries who are regulated under FSLAA (eg insurance brokers, or mortgage brokers).

We note that Option 3 is not mutually exclusive from Option 2, and could be implemented either on its own (with no changes to the Bill's requirements in respect of intermediaries) or together with Option 2.

The intention of focusing the scope onto intermediaries who undertake sales and distribution activities is to reflect that sales and distribution is a conceptually and practically distinct type of involvement in the provision of a financial institution's services and products. This is because financial institutions would potentially have liability for overseeing the conduct of a wide range of parties over whom they would not normally have this level of oversight, and who have limited interaction with consumers and limited impact on consumer outcomes.

Under this option, people involved in “services that are preparatory to a contract being entered into” and administration and performance of a service or terms and conditions of a product would no longer be within the scope of the provisions relating to intermediaries. This would include the likes of lawyers, plain-English writers, claims management services, and claims fulfilment providers. For completeness, we note that some of these persons may act as agents of the financial institution, and if so financial institutions will have obligations in relation to them under other provisions in the Bill.

There is strong support from industry stakeholders for this approach, and it is likely to result in reduced compliance costs without any material reduction in consumer outcomes.

Option 4: Distinguish between FSLAA and non-FSLAA intermediaries

This option involves distinguishing between intermediaries regulated by FSLAA (ie licensed financial advice providers) and intermediaries not regulated by FSLAA. The purpose of this option would be to recognise that licensed financial advice providers are already subject to direct conduct duties and regulation in the specific context of providing regulated financial advice. Reflecting this, institutions would have a greater degree of responsibility for intermediaries not subject to FSLAA and only a limited degree of oversight of financial advice providers regulated by FSLAA.

We note that Option 4 is not mutually exclusive with Options 2 and 3, and could be implemented either on its own or with any combination of Options 2 and 3.

We note we are not proposing that licensed financial advice providers be removed from the regime by carving them out of the scope of the obligations applying to financial institutions in respect of intermediaries. We consider that some degree of oversight of FSLAA regulated intermediaries is appropriate because financial institutions should understand whether consumers are experiencing fair outcomes from their services and products. This reflects that financial institutions are ultimately responsible for ensuring that consumers are experiencing fair outcomes.

The outcomes of this option would depend on the obligations applying to financial institutions in respect of their intermediaries. The next section of this RIS therefore analyses it in two scenarios: one against the status quo (Option 1 above) and the other against the alternative proposal to introduce more flexible and less prescriptive obligations (Option 2 above).

How do the options compare to the status quo?

	Option 1: Status quo	Option 2: More flexible and less prescriptive obligations	Option 3: Amend scope of intermediary to focus on sales and distribution	Option 4: Distinguish between FSLAA and non-FSLAA intermediaries *If Option 1 is in place*	Option 4: Distinguish between FSLAA and non-FSLAA intermediaries *If Option 2 is in place*
Achieves fair outcomes	0 Financial institutions (**FIs**) will be training and managing or supervising intermediaries to ensure compliance with the fair conduct principle.	0 FIs will still be required to have oversight of their distribution arrangements to ensure compliance with the fair conduct principle – the standard of conduct remains the same.	- Sales and distribution is an area that raises particular conduct risks and conflicts of interest. Intermediaries involved in preparatory or admin services are likely to have more limited impact on consumer outcomes, but there may still be risks.	- FIs will have reduced oversight of whether consumers are experiencing fair outcomes through intermediated channels so it is likely outcomes for consumers will be worse.	- FIs will have reduced oversight of whether consumers are experiencing fair outcomes through intermediated channels so it is likely outcomes for consumers will be worse.
Cost-effectiveness	0 Will not be cost-effective. The status quo is likely to result in some duplication of regulation under FSLAA, and the obligations are likely to require significant compliance costs.	++ Compliance costs should be significantly reduced against the status quo because the obligations are more flexible and proportionate.	++ Compliance costs should be reduced against the status quo because FIs will no longer be responsible for overseeing the conduct of such a wide range of third parties.	+ Compliance costs would be reduced against the status quo because FIs would have reduced obligations in respect of FSLAA intermediaries.	0 Option 2 enables a proportionate risk-based approach to be taken in any case, so there would be no change.
Maintaining availability of financial products	0 Intermediaries are likely to reduce the number of institutions they work with, which could reduce product choice for consumers and competition.	++ This approach should reduce the risk of FIs having to exert a strong degree of control over their intermediaries and should not cause any structural changes in the market.	+ This option has no direct impact on the availability of financial products, but is likely to indirectly improve availability by reducing compliance costs for FIs.	+ This option has no direct impact on the availability of financial products, but is likely to indirectly improve availability by reducing compliance costs for FIs.	0 Option 2 enables a proportionate risk-based approach to be taken in any case so there would be no change.

	Option 1: Status quo	Option 2: More flexible and less prescriptive obligations	Option 3: Amend scope of intermediary to focus on sales and distribution	Option 4: Distinguish between FSLAA and non-FSLAA intermediaries *If Option 1 is in place*	Option 4: Distinguish between FSLAA and non-FSLAA intermediaries *If Option 2 is in place*
Proportionality	0 The provisions in the current Bill are reasonably prescriptive and do not enable a proportionate approach to be taken by FIs.	++ The higher-level principles based approach better supports FIs to take a proportionate risk-based approach towards their distribution arrangements.	+ Focusing on sales and distribution ensures that intermediaries involved in preparatory / admin services are not caught by the Bill's provisions relating to intermediaries, which is more proportionate.	+ Focusing on intermediaries who are not regulated under FSLAA is likely to be more proportionate than the status quo.	0 Option 2 enables a proportionate risk-based approach to be taken in any case so there would be no change.
Overall assessment	0	++	+	0	-

Key for qualitative judgements:

++ much better than status quo
+ better than status quo
0 about the same as the status quo
- worse than the status quo
- - much worse than the status quo

What option is likely to best address the problem, meet the policy objectives, and deliver the highest net benefits?

The status quo option is prescriptive and would have high compliance costs

As discussed above and reflected in submissions, the status quo option is prescriptive and will have high compliance costs. It could potentially lead to undesirable structural changes in the market including intermediaries reducing the number of institutions they work with (in order not to have to comply with requirements stemming from a number of different conduct programmes), which could reduce competition and product choice for consumers.

We therefore do not consider that the status quo should be retained.

We consider that Options 2 and 3 should be implemented together

Options 2 and 3 when implemented together best address the problem, meet the policy objectives and deliver the highest net benefits, because:

1. **Option 2** (more flexible and less prescriptive obligations) will ensure fair outcomes, while minimising unnecessary compliance costs by allowing financial institutions to take a proportionate and flexible approach to oversight of their distribution arrangements. The standard of conduct remains the same as under the status quo (ie financial institutions have an obligation to ensure consumers are treated fairly, regardless of the arrangements used to distribute their products and services), but a proportionate approach can be taken to mitigate risks.

   It provides flexibility to better reflect the different types of financial institutions to which the Bill will apply (banks, insurers and non-bank deposit takers) and their different business models. It also ensures that the responsibility of financial institutions for overseeing third-party distribution arrangements is at a general/collective level (with a focus on systems and controls), not at the level of each individual customer interaction (eg interfering with financial advice).

   The obligations in Option 2 will be supported by the existing provision in the Bill that requires financial institutions to have regard to the types of intermediaries involved and the nature of their involvement when designing their systems and controls.

2. **Option 3** (amend the scope of intermediary to focus on sales and distribution) will avoid the significant compliance costs that would result from financial institutions being required to oversee the conduct of a very wide range of parties over whom they would not normally have this level of oversight, and who have limited interaction with consumers and limited impact on consumer outcomes.

   We acknowledge that there may be some limited increased risks of consumers dealing with other kinds of intermediaries being treated unfairly, but consider these are outweighed by the benefits of Option 3. Intermediaries involved in preparatory or admin services may also otherwise be separately covered under the Bill's provisions relating to agents, which further mitigates risks.

In terms of the costs and benefits of the options as a package, we note that there may be some overlap in the benefits of these options, because Option 2 enables financial institutions to take a proportionate approach having regard to the types of intermediaries involved and the nature of their involvement. We consider however that Option 3 still has benefits in terms of cost-effectiveness and proportionality, because it provides certainty and clarity for financial institutions about the scope of the Bill's provisions in relation to intermediaries.

In our view, Options 2 and 3 complement each other by enabling financial institutions to take a proportionate approach to oversight of intermediaries and to focus on their sales and distribution arrangements where conduct risks and potential conflicts of interest are highest.

We do not consider that Option 4 should be implemented

Option 4 (distinguish between FSLAA and non-FSLAA intermediaries) may be a suitable option if the status quo was otherwise remaining in place. In that situation it would be one mechanism to reduce compliance costs and ensure that obligations under FSLAA are not being duplicated. It would however be likely to have negative impacts on consumers by reducing financial institutions' oversight of intermediated distribution channels and may result in uneven treatment of consumers (depending on how they purchase the products)

However, noting that Option 2 is the preferred option, Option 4 is not a suitable option in conjunction with Option 2. This is because Option 2 will already enable financial institutions to take a proportionate risk-based approach to oversight of their distribution arrangements, and to take into account whether their intermediaries are regulated under FSLAA.

It is important that financial institutions understand (and are responsible for) whether consumers are experiencing good outcomes from their relevant services and products, regardless of the distribution channel used. In our view, the proposed requirements (with Option 2 in place) complement rather than duplicate the requirements on financial advice providers under FSLAA.

What are the marginal costs and benefits of applying Options 2 and 3?

	Summary of *costs* compared to taking no action			Summary of *benefits* compared to taking no action		
Affected parties	**Comment on costs**	**Impact**	**Evidence certainty**	**Comment on benefits**	**Impact**	**Evidence certainty**
Financial institutions	FIs will need to consider how they give effect to the high level obligations and develop their conduct programmes to ensure that they are complying with the fair conduct principle. This may incur slight additional cost as against the status quo which prescribes what FIs must do.	Low	Medium	FIs will face lower overall compliance costs than they would face under the highly prescriptive status quo. FIs can ensure that their approach to their distribution arrangements, including intermediated distribution channels, is tailored and proportionate. This approach will also better reflect the different types of FIs to which the Bill will apply, and their different business models.	Medium	Medium
Intermediaries	Intermediaries may incur slight additional cost of navigating principles-based legislation, as opposed to the more prescriptive legislation under the status quo.	Low	Medium	Some intermediaries will no longer be caught by the regime. Those that are caught are less likely to be subject to overly prescriptive and potentially inappropriate requirements of FIs as to training etc in response to the Bill.	Medium	Medium
Regulators	The FMA may need to develop more guidance for FIs and intermediaries to support compliance with the new regime than it would under a more prescriptive approach.	Low	High	The FMA is likely to find the proposed approach easier to monitor and enforce, given that FIs will be able to take a proportionate approach to compliance.	Low	Medium
Consumers	There may be a potential risk of some consumers being treated unfairly arising out of Option 3 and the more limited scope of intermediaries covered by the Bill.	Low	Medium	Under the proposed approach intermediaries should not reduce the number of FIs they work with (and vice versa) which means competition and product choice should be better than the status quo.	Low	Medium
Total monetised cost/benefits	Without accurate quantifiable evidence, it is difficult to provide an estimate.	Not known	Not known	Without accurate quantifiable evidence, it is difficult to provide an estimate.	Not known	Not known

	Summary of *costs* compared to taking no action			Summary of *benefits* compared to taking no action		
Affected parties	**Comment on costs**	**Impact**	**Evidence certainty**	**Comment on benefits**	**Impact**	**Evidence certainty**
Non monetised costs/benefits	We anticipate a low increase in overall costs. FIs will need to take a more tailored approach to compliance which may result in FIs incurring some additional cost and in the FMA having to produce additional guidance.	Low	Medium	We anticipate a medium level of benefits from reduced compliance costs, ease of monitoring for the regulator and better competition and product choice for consumers.	Medium	Medium

PART B: LLOYD'S

Section B1: Diagnosing the policy problem

Background and status quo

The FEC recommended changes to the Bill's requirements as introduced

Lloyd's is an international market for the provision of wholesale and retail insurance. It has a unique structure whereby many market participants with different functions are involved in the provision of insurance to customers, rather than a single insurer. The Bill does not apply naturally to Lloyd's insurance market given this unique structure.

The FEC recognised market structures for financial institutions can vary and that requiring all participants within certain market structures to gain a conduct licence under the Bill may be an onerous and costly administrative burden. Furthermore, under some arrangements (for example, the Lloyd's insurance market), participants are subject to the oversight of an umbrella organisation that has developed a longstanding governance structure for overseeing conduct and culture risks. The FEC considered that enforcing this regime on those participants in such a market structure may be unnecessary.

To provide the required flexibility, the FEC recommended inserting a regulation-making power into the Bill that would allow regulations to be made to exempt specified types of financial institutions from the requirement to hold a conduct licence. This would be consistent with exemption powers in relation to other market services licences in the Financial Markets Conduct Act 2013 (**FMC Act**). The terms and conditions of this exemption would be specified in regulations.

The Bill captures Lloyd's underwriting members as 'insurers', but with the possibility of exemption from licensing requirements

Currently, the definition of a 'financial institution' in the Bill includes 'licensed insurers', which is defined by reference to the Insurance (Prudential Supervision) Act 2010. By doing so, it captures underwriting members of Lloyd's insurance market as licensed insurers, therefore requiring them to be licensed and comply with the Bill's conduct obligations.

The core role of underwriting members is to underwrite risks by providing capital via 'syndicates' for the purpose of paying claims. Underwriting members only provide capital to back insurance policies and do not perform the functions of a traditional insurer (eg design products or handle claims). 'Managing agents' are the entities responsible for these activities, either directly or through a delegated authority to 'coverholders'.

The Bill does contain the regulation-making power inserted by the FEC that would allow underwriting members to be exempted from the requirement to hold a licence on particular terms and conditions. However, MBIE has continued to consider whether the Bill, as currently drafted, provides sufficient flexibility to accommodate the Lloyd's market structure while meeting the objectives of the Bill.

What is the policy problem or opportunity?

The overall issue is how the provision of insurance by Lloyd's to consumers in New Zealand should be regulated by the Bill. This issue includes:

- how the Lloyd's market and its various participants should be subject to the Bill's duties
- which of the Lloyd's market participants (if any) should be subject to the requirement to obtain a conduct licence.

The obligations in the Bill do not neatly map onto the structure of the Lloyd's market. Under the status quo (without further regulations being made), every underwriting member would need to hold a conduct licence in order to operate in New Zealand. Given the large number of underwriting members and their function in the Lloyd's market, requiring them to be

individually licensed would be impractical and impose unnecessary compliance costs. Additionally, requiring the underwriting members to comply with the conduct obligations in the Bill may not be an appropriate outcome given that underwriting members only provide capital and do not perform the functions of a traditional insurer.

What objectives are sought in relation to the policy problem?

The overall objectives of the provisions are:

1. ensuring the fair treatment and adequate protection of consumers through appropriate conduct regulation and by ensuring that the FMA has effective supervisory and enforcement powers to monitor and enforce conduct standards in the Lloyd's insurance market
2. minimising unnecessary compliance costs
3. ensuring consumers continue to have access to suitable financial products and services.

Section B2: Deciding upon an option to address the policy problem

What criteria will be used to compare options?

The following criteria have been used to assess the likely impacts of the options:

1. *Certainty and efficacy of regulation*: ensuring the FMA has sufficient and adequate oversight over Lloyd's consumer insurance operations in New Zealand.
2. *Avoiding unnecessary compliance costs*: appropriately accommodating Lloyd's structure to assist their participation in the New Zealand consumer insurance market.
3. *Consistency of regulation*: ensuring relatively consistent treatment of Lloyd's insurance market compared to other financial institutions covered under the Bill.
4. *Maintaining availability of financial products*: maintaining availability of insurance cover specialist or niche product lines.

What scope will options be considered within?

We are not considering excluding the Lloyd's insurance market from the scope of the Bill. The Lloyd's insurance market as a provider of retail insurance still presents conduct risks to New Zealand consumers. Although Lloyd's market participants are subject to regulation in other markets, we do not consider this overseas regulation provides the same level of protection to New Zealand consumers or access to redress as provided under the Bill.

Excluding Lloyd's would also create an uneven regulatory landscape for insurers as the Lloyd's insurance market would not be subject to legislative conduct obligations in New Zealand or supervision by the FMA.

Therefore, the options being considered relate, firstly, to which market participants should be subject to the Bill's duties and, secondly, whether or not Lloyd's market participants should be subject to the licensing requirements under the Bill.

What options are being considered?

Options 1 & 2: Conduct obligations

Options 1 and 2 relate to the application of the Bill's conduct obligations and whether these should apply to Lloyd's underwriting members or Lloyd's managing agents.

Option 1: Status quo (underwriting members are subject to the Bill's conduct obligations)

Option 1 (status quo) places the Bill's conduct obligations on underwriting members. There are a large number of Lloyd's underwriting members in the Lloyd's market that could potentially operate in New Zealand, underwriting policies through syndicates. As each one would be a 'financial institution' under the Bill, each underwriting member would be required to meet conduct obligations under the Bill individually, including each having and complying with a fair conduct programme.

As part of the consultation process Lloyd's submitted that placing conduct obligations on each underwriting member individually would create an onerous and costly administrative burden, and would be unnecessary. This is because of the existing conduct obligations placed on the Lloyd's market by overseas regulations and the conduct requirements set by Lloyd's Corporation (the overall market operator) under their contractual minimum standards. MBIE also consider that it would difficult for FMA to effectively supervise the conduct of individual underwriting members, the majority of whom are based outside New Zealand.

Underwriting members do not individually have any involvement in the sale of polices to consumers or influence over the conduct of other market participants or their agents or intermediaries in relation to those activities. As a result it is unlikely that placing these obligations on underwriting members would result in improved outcomes for consumers and the compliance cost would potentially act as a disincentive for Lloyds to continue to offer consumer insurance to the New Zealand market.

Option 2: Make managing agents subject to the Bill's conduct obligations

Option 2 places the Bill's conduct obligations on managing agents. A managing agent is a company set up to manage one or more 'syndicates' of underwriting members for whom it acts as agent and on whose behalf it accepts insurance risks. Functions undertaken by managing agents, on behalf of underwriting members, include determining underwriting contracts of insurance, reinsuring such contracts in whole or in part and agreeing and settling claims on such contracts.

Managing agents are also the entity responsible for implementing the minimum conduct standards for consumers set by the Lloyd's Corporation and have regular reporting requirements to Lloyd's Corporation. Lloyd's managing agents are also regulated (and required to be authorised / licensed) by the Financial Conduct Authority (**FCA**) in the UK and are subject to the FCA's conduct rules.

There are currently 59 managing agents in the Lloyd's insurance market with 47 of them writing consumer business into New Zealand. The insurance business is generally brokered or placed through a registered Lloyd's broker or 'coverholder' authorised by the managing agent under the terms of a binding authority (effectively distributing agents), rather than directly through managing agents themselves.

This option is supported by both Lloyds and FMA and placing the obligations on managing agents more closely aligns with the responsibility for other conduct obligations the market participants are subject to.

Options 3 & 4: Licensing requirements

As stated above the Bill as reported back from FEC allows for financial institutions (such as underwriting members) to be exempt from the requirement to be licensed on terms and conditions. Whether or not Lloyd's underwriting members should be licensed or exempt also determines how the FMA would enforce conduct obligations.

Option 3: License Lloyd's underwriting members

The status quo option would require Lloyd's underwriting members to be licensed under the Bill. The primary advantage of licensing is that this would provide FMA with its full suite of

supervision and enforcement tools against Lloyd's market participants, as well as the ability to impose licence conditions and to suspend or remove licences. If Option 2 above is the preferred option (placing conduct obligations on managing agents), this could be achieved through the terms of the licence.

This option would also nominally ensure an even regulatory playing field across different institutions providing insurance to consumers in New Zealand. Although the Lloyd's insurance market is regulated in the United Kingdom, with a range of internal and external mechanisms to manage the market, this approach would ensure that insurance providers are treated largely consistently by requiring all providers of consumer insurance in New Zealand to hold a conduct licence.

However, this option would not recognise the unique structure of the Lloyd's market and the involvement of many market participants with different functions being involved in the provision of insurance to customers, rather than one insurer.

Lloyd's has indicated that the costs of licensing underwriting members would create a barrier to entry or ongoing participation in the New Zealand market, given the small consumer market presence of Lloyd's. These costs would include the initial licensing application fee and time costs, an industry levy and ongoing costs of complying with the substantive conduct obligations under the Bill, monitoring and supervision.

Option 4: Exempt Lloyd's underwriting members from licensing on appropriate terms and conditions

Under this option Lloyd's underwriting members would be exempted from the requirement to be licensed using the existing exemption power in the Bill. If Option 2 above is the preferred option, conduct obligations could be placed on managing agents through the exemption terms and conditions. These obligations will include matters such as maintaining relevant information on the Lloyd's website and specific reporting requirements.

The requirements in regulations will differ from those that apply to other financial institutions only to the extent necessary to ensure that the requirements are workable given the structure of the Lloyd's market. For example, it may be necessary to change the requirement for conduct programmes to enable financial institutions to meet their legal obligations to consumers, to ensure that it covers the entities in the Lloyd's market that are subject to those obligations. In addition the exemption regulations would specify the consequences of a breach of the terms and conditions and provide the FMA with enforcement and supervision powers.

This option would still result in some costs on Lloyd's such as the costs of complying with the substantive conduct obligations under the Bill, but would not be as costly as requiring underwriting members to be licensed.

How do the options compare to the status quo?

	Options 1 and 2: Conduct obligations		***Options 3 and 4: Licensing requirements***	
	Option 1: Status quo for conduct obligations (place them on underwriting members)	Option 2: Place conduct obligations on managing agents	Option 3: Status quo for licensing (licence Lloyd's underwriting members)	Option 4: Exempt Lloyd's underwriting members from licensing
Certainty and efficacy of regulation	0 This option would place obligations on multiple individual underwriting members who are not best placed to meet them making effective supervision by FMA impractical and ineffective.	++ This option would place obligations on managing agents that act on behalf of underwriting members and reduces the number of entities that FMA will be required to oversee. It places the obligations on those in the best position to meet them.	0 This option would provide that Lloyd's market participants would be subject to the same licensing requirement as other financial institutions and FMA would have its full suite of regulatory tools available.	- This option will provide some level of certainty of regulation as the exemption regulations will specify the consequence of a breach of the terms and conditions and other requirements consistent with those placed on other insurers by the Bill. However, the FMA may have more limited supervisory tools and enforcement powers.
Avoids unnecessary compliance cost	0 This option would create unnecessary compliance costs as obligations would fall on multiple underwriting members that provide capital to back insurance policies and do not perform the functions of a traditional insurer.	++ This option reduces the number of entities subject to conduct obligations under the Bill, avoiding a large number of underwriting members being having to comply with obligations and develop conduct programmes.	0 This option would place significant compliance cost on the Lloyd's insurance market as they would be required to licence multiple market participants providing insurance products to New Zealand.	++ This option will reduce compliance costs as multiple Lloyd's market participants will not be required to apply for a licence.

	Options 1 and 2: Conduct obligations		***Options 3 and 4: Licensing requirements***	
	Option 1: Status quo for conduct obligations (place them on underwriting members)	Option 2: Place conduct obligations on managing agents	Option 3: Status quo for licensing (licence Lloyd's underwriting members)	Option 4: Exempt Lloyd's underwriting members from licensing
Consistency of regulation	0 This option does not align well with the treatment of other financial institutions as obligations would be placed on underwriting members who do not perform traditional functions of insurers.	+ Under the Lloyd's model managing agents are the market participants responsible for conduct towards consumers either directly or through a delegated authority to 'coverholders' and are most closely aligned in their functions with other insurers under the Bill.	0 Requiring Lloyd's underwriting members to be licensed is consistent with other licensed insurers being required to be licensed but does not recognise the unique structure of the Lloyds market	- Exempting Lloyd's underwriting members from licensing does differentiate them from other insurers. However, under this option managing agents can be made subject to conduct obligations similar to those placed on other financial institutions through the Bill and the licensing framework.
Maintains availability of financial products	0 This option would create the risk of conduct obligations deterring ongoing participation in the New Zealand retail insurance market by Lloyd's market participants as compliance cost may outweigh the benefit of remaining in the New Zealand market.	+ This option places conduct obligations on the Lloyd's market participant most appropriate to perform them and may make it more viable for Lloyd's to maintain a presence in the New Zealand retail insurance market.	0 This option would create the risk of licensing obligations deterring ongoing participation in the New Zealand retail insurance market by Lloyd's market participants, as compliance costs may outweigh the benefit of remaining in the New Zealand market.	++ This option mitigates the risk of licensing obligations deterring ongoing participation in the New Zealand retail insurance market.
Overall	0	++	0	+

Key for qualitative judgements:

++ much better than status quo
+ better than status quo
0 about the same as the status quo
- worse than the status quo
- - much worse than the status quo

What options are likely to best address the problem, meet the policy objectives, and deliver the highest net benefits?

Option 2 (place conduct obligations on managing agents) is the preferred option in respect of conduct obligations

Given the respective functions of underwriting members and managing agents, we consider that the role of managing agents more broadly aligns with the role of 'financial institutions' or traditional insurers under the Bill. Accordingly, managing agents are in the best position to meet the conduct obligations and ensure that the Lloyd's insurance market is treated in an equivalent manner to traditional insurers. Option 2 is therefore the preferred option regarding conduct obligations.

This approach will ensure that consumers buying insurance policies from the Lloyd's market (either directly or indirectly) should receive the same outcomes, including being treated fairly, as they would with another insurer, and that the FMA has access to effective supervisory and enforcement powers.

Option 4 (exempt Lloyd's underwriting members from licensing) is the preferred option in respect of licensing

Option 4 is the preferred option in respect of licensing. Lloyd's Corporation, whilst agreeing managing agents are best placed to meet conduct obligations, expressed concern that having a requirement to licence all of their underwriting members would create an unnecessary compliance burden compared to other licensed insurers who will make a single application. MBIE agree that it would be unduly onerous and impractical to licence Lloyd's underwriting members given the large number of them. The preferred option is that that they are exempted from the requirement to be licensed. This approach aligns with the policy intention behind the exemption power added to the Bill by the FEC to provide flexibility for the licensing regime to accommodate unique market structures and avoid onerous and costly administrative burden.

As with other insurers, Lloyd's managing agents will subject to obligations similar to those placed on other financial institutions through the licensing framework where appropriate (eg requiring them to report certain information). In addition FMA will be given supervision and enforcement powers to address any breach of these requirements by a Lloyd's market participant.

What are the marginal costs and benefits of the option?

	Summary of *costs* compared to taking no action			Summary of *benefits* compared to taking no action		
Affected parties	**Comment on costs**	**Impact**	**Evidence certainty**	**Benefits**	**Impact**	**Evidence certainty**
Regulated parties	Lloyd's managing agents (rather than underwriting members) will be required to establish and maintain effective conduct programmes and make other operational changes to meet obligations under the Bill.	Medium	High	Lloyd's market participants will not have to meet costs associated with making multiple licensing applications and conduct obligations will be placed on the member of the Lloyd's market in the best position to most meet them.	Medium	Medium
Regulators	The FMA will monitor and supervise managing agents' compliance with the conduct obligations under the Bill. MBIE will be required to prepare regulations to support this option.	Low	Medium	The FMA will have adequate tools to monitor and enforce the obligations placed on managing agents under the Bill.	Low	Medium
Consumers	Some of the increased costs to regulated parties may be passed on to consumers in the form of higher premiums.	Low	Medium	Consumers will continue to have a broader choice of insurance product through Lloyd's insurance and have confidence they are subject to equivalent conduct regulation as other insurers in the market.	Medium	Medium
Total monetised cost/benefits	Without accurate quantifiable evidence, it is difficult to provide an estimate.	Not known	N/A	Without accurate quantifiable evidence, it is difficult to provide an estimate.	Not known	N/A
Non monetised costs/benefits	We anticipate a low increase in overall costs as this option only impacts the Lloyd's market and its New Zealand retail customers.	Medium	Medium	We anticipate a medium level of benefits as conduct obligations can be more effectively met by Lloyd's, consumer choice of insurance products will be maintained and FMA have sufficient tools to effectively monitor and supervise.	Medium	Medium

PARTS A & B

Section 3: Delivering an option

How will the new arrangements be implemented?

The options analysed in the RIS will be implemented through amendments to the FMC Act and supporting regulations.

To prepare for the new regime and obtain a conduct licence, financial institutions will need to review their businesses and implement systems and controls to ensure good conduct and fair treatment of customers. They will also need to ensure that their products and services are clearly understood by customers and suited to their needs.

The FMA will also need sufficient time to adequately prepare internally for implementation of the new conduct regime (for example, to recruit and train new staff, design the digital licensing process and develop assessment frameworks and guidance).

MBIE and the FMA have recently consulted on funding for the implementation of the regime through the 2021 Review of the Financial Markets Authority Funding and Levy, and are currently considering submissions. The FMA will also take responsibility for enforcement and supervision of the new regime and it will be important to ensure the FMA is adequately resourced to carry out these new functions.

This consultation has also covered implementation time frames for the new conduct regime, including proposing a sufficient period of time between the Bill passing and the licensing window opening before any changes come into force (to allow time for financial institutions to develop and implement their fair conduct programmes). It is also likely that there will be a period between the opening of the licensing window and all obligations in the Bill coming into force. These transition periods will enable regulated parties and the FMA to manage any implementation risks proactively.

How will the new arrangements be monitored, evaluated, and reviewed?

The anticipated impacts will be clearly able to be identified as the proposed approach will require financial institutions to develop conduct programmes that will evidence how they are complying with the fair conduct principle. The FMA as conduct regulator will be able to monitor to what extent entities are complying with the obligations through ongoing monitoring and supervision processes.

The system level impacts will be monitored by MBIE, in close cooperation with the FMA, on an ongoing basis as part of MBIE's ongoing regulatory stewardship obligations. MBIE's role as a member of the New Zealand Council of Financial Regulators is another mechanism by which impacts of the proposed changes will be monitored to ensure the changes made are resulting in a well-functioning financial markets regime.

In addition impacts of the proposals will be monitored by the FMA as part of its role in monitoring and responding to market conduct issues and in enforcing the new conduct obligations. This monitoring and enforcement will also take place within the context of the FSLAA regime, which the FMA regulates.

The FMA also conducts regular market surveys and thematic reviews on various issues as and when it considers relevant. These regulatory tools may be used in respect of the new conduct obligations if appropriate. MBIE will provide support to the FMA as appropriate and necessary and monitor the regulatory settings as part of its wider regulatory stewardship obligations. FMA may also require periodic regulatory returns financial institutions to the FMA when the regime is in force.