



COVERSHEET

Minister	Hon Dr David Clark	Portfolio	Commerce and Consumer Affairs
Title of Cabinet Paper	Financial Markets (Conduct of Institutions) Amendment Bill: Supplementary Order Paper	Date to be published	9 November 2022

List of documents that have been proactively released		
Date	Title	Author
21 September 2022	DEV-22-MIN-0221: Financial Markets (Conduct of Institutions) Amendment Act 2022: Release of Consultation Document on Proposed Regulations	Cabinet Office
September 2022	Financial Markets (Conduct of Institutions) Amendment Act 2022: Consultation on regulations	Office of the Minister of Commerce and Consumer Affairs

Information redacted

NO

Any information redacted in this document is redacted in accordance with MBIE's and MFAT's policy on Proactive Release and is labelled with the reason for redaction. This may include information that would be redacted if this information was requested under Official Information Act 1982. Where this is the case, the reasons for withholding information are listed below.

Where information has been withheld, no public interest has been identified that would outweigh the reasons for withholding it.

In Confidence

Office of the Minister of Commerce and Consumer Affairs

Chair, Cabinet Economic Development Committee

Financial Markets (Conduct of Institutions) Amendment Act 2022: Consultation on regulations

Proposal

- 1 This paper seeks policy approval for:
 - 1.1 the release of a discussion document on proposed fees for licensing applications under the Financial Markets (Conduct of Institutions) Amendment Act 2022 (**the Act**); and
 - 1.2 the release of an exposure draft of regulations relating to sales incentives to be made under the Act.

Executive Summary

- 2 The Act creates a new conduct licensing regime for banks, insurers and non-bank deposit takers (together, **financial institutions**). Under the Act, financial institutions will be required to comply with a principle to treat consumers fairly (the **fair conduct principle**), and must establish, implement and maintain effective fair conduct programmes to ensure that they comply with the fair conduct principle. This paper seeks approval to progress work on regulations necessary to support the Act.
- 3 Financial institutions will need a licence in order to provide core banking and insurance products and services to consumers in New Zealand (**financial institution licence**). I am proposing to consult on a flat fee of \$1,024.93 (including GST) for all applicants. I am also proposing that the FMA will be able to recover additional costs charged at an hourly rate when it is considering complex applications that take longer than anticipated.
- 4 I am also seeking authorisation to approve the release of an exposure draft of regulations that will give effect to Cabinet's decision to prohibit financial institutions and intermediaries from offering sales incentives based on volume or value targets to their employees (except senior managers and executives), agents and intermediaries [DEV-22-MIN-0003 refers].
- 5 I intend to return to Cabinet in early 2023, following consultation, to seek final approvals for regulations to be made under the regime. This will give financial institutions advanced notice of the costs of obtaining a licence and time to understand their obligations in relation to sales incentives under the new regime before the FMA opens licensing applications (expected in July 2023).

Background

- 6 The Act amends the Financial Markets Conduct Act 2013 (**FMC Act**) to give effect to previous Cabinet decisions regarding the creation of a new conduct licensing regime for financial institutions [DEV-19-MIN-0237 refers]. Under the Act, financial institutions will be required to comply with a fair conduct principle to treat consumers fairly, and must establish, implement and maintain effective fair conduct programmes to ensure that they comply with the fair conduct principle. Some regulations need to be made to support the Act.
- 7 The Act requires financial institutions to operate under a licence granted by the FMA in order to provide core banking and insurance products and services to consumers in New Zealand (a **financial institution licence**). I am seeking approval to release a discussion document, *Financial institution licensing fees under the new conduct regime*, which seeks feedback on the proposed licensing fees for the regime.
- 8 I am also seeking authorisation to approve the release of an exposure draft of regulations that will give effect to Cabinet's previous decision to prohibit financial institutions and intermediaries from offering sales incentives based on volume or value targets to their employees (except senior managers and executives), agents and intermediaries [DEV-22-MIN-0003 refers].

Licensing fees

Licensing fees enable the FMA to recover the cost of processing licence applications

- 9 Licensing allows the FMA to assess whether a financial institution is able to meet the statutory licensing criteria under the FMC Act, including whether it is capable of effectively performing the licensed service. It also improves the FMA's ability to monitor the conduct of licensed financial institutions towards consumers and take enforcement action where necessary.
- 10 Under the Financial Markets Authority Act 2011, the FMA is able to recover the costs incurred in considering a licence application. It is appropriate that these costs are recovered from an applicant for a financial institution licence as it receives the private benefit of acquiring a licence and being able to operate under the regime. The discussion document seeks feedback on proposed licensing fees that will be charged to applicants to recover these costs.

The discussion document seeks feedback on a flat fee for financial institution licence applications with an additional hourly rate for more complex applications

- 11 The cost involved with processing an application will vary based on the complexity and time involved. I propose to seek feedback on a flat licence application fee of \$1,024.93 (including GST) for all applicants (based on an estimated average 5.75 hours to process an application).
- 12 As with many other types of licensed providers (e.g. fund managers, financial advice providers) it is proposed that the FMA will be able to recover additional

costs when it is considering complex applications that take longer than anticipated. The FMA will notify an applicant before it charges the hourly rate.

- 13 Additional fees will apply in situations where a licence covers an authorised body (a related body corporate that sits under the licence of the financial institution), and when there is an application to vary the conditions of a licence. This is consistent with how the fees for other market service licence applications are charged.
- 14 The Financial Markets Conduct (Fees) Regulations 2014 make provision for a reduced licensing fee to apply where a person applies for a licence under the FMC Act at the same time, or within six months of, another licence application. I do not propose that this existing discount (that applies to some other market services licences) would apply to financial institution licences.
- 15 The purpose of the discount is to recognise lower costs for the FMA because information provided in the application forms part of another licence application. The system for financial institution licences will be designed to assess applications in the first instance through an automated process (compared to detailed staff assessment in the case of other existing FMC Act licences to which this discount regulation applies) and it is unlikely there will be lower costs for the FMA resulting from multiple applications.
- 16 As with the fees for financial advice providers set in 2019, the proposed licensing fees have been calculated taking the benefits of the automated licensing system into account.
- 17 The proposed licensing fees are as follows:

Financial institution licensing fees (all costs inclusive of GST)	
Basic licensing fee for all applicants (based on an estimated time to assess a standard application of 5.75 hours)	\$1,024.93
+ Hourly rate charges that may apply for applications where the FMA's time to assess exceeds 6.75 hours	\$178.25/hour , or part-hour pro rata, of work carried out
+ Fee for each authorised body included in the licence (based on an estimated time to assess a standard application of 3.45 hours)	\$614.95
+ Other variations to licence	\$115 plus \$178.25/hour, or part-hour pro rata, of work carried out

- 18 I consider that this proposal is appropriate because:
- 18.1 it should allow the FMA to fully recover, but not over-recover, the anticipated staff cost of assessing financial institution licence applications;

- 18.2 it minimises cross-subsidy between different applicants by allowing additional fees to be charged on an hourly basis for more complex applications;
 - 18.3 using a flat fee combined with an hourly rate above the specified time threshold will provide certainty to most applicants, while allowing the FMA to recover additional costs incurred in assessing more complex applications;
 - 18.4 it will encourage the FMA to deliver licensing services to fee payers in an efficient and effective manner, by setting the base fee at a level that appropriately recovers costs in most cases and by requiring the FMA to notify applicants and explain the reason for charging an additional hourly rate in more complex cases;
 - 18.5 it is simple to administer and aligns with the approach taken to other FMC Act licensing fees.
- 19 Submissions on the discussion document will be open for approximately four weeks commencing late September 2022.

Sales incentives

- 20 In February 2022, Cabinet agreed that regulations will prohibit financial institutions and intermediaries from offering sales incentives based on volume or value targets to their employees (excluding senior managers and executives), agents and intermediaries [DEV-22-MIN-0003 refers]. Officials are currently working with Parliamentary Counsel to draft these regulations.
- 21 I propose that Cabinet authorises me to release exposure draft regulations on sales incentives and related commentary for consultation. I consider that releasing an exposure draft of these regulations, for stakeholder and public feedback, is appropriate at this stage, because it would:
- 21.1 provide an opportunity to obtain specialist input in an efficient manner;
 - 21.2 provide an effective means of helping to ensure that the decisions taken by Cabinet are accurately reflected in the regulations;
 - 21.3 minimise any risk of unintended consequences from the proposed changes.
- 22 I am also aware that these regulations are of significant interest to industry as they will impact on the remuneration of financial institutions' employees, agents and intermediaries. Stakeholders will have a reasonable expectation that they are consulted on the detail of these regulations.
- 23 I note that I had previously proposed there would be an exclusion of senior managers and executives from the scope of the prohibition. This is because the greatest conflict of interest is likely to occur at the mid-to-lower levels of an organisation where individuals are more directly involved in the chain of distribution. It is uncommon for senior managers to receive sales incentives

based on volume or value targets (although they may receive incentives designed to grow the business, such as incentives based on increase in market share).

- 24 While working with Parliamentary Counsel to draft the provisions, officials have identified that an explicit exclusion would be unnecessary because incentives regulations only apply where the recipient of the incentive is “involved” in the provision of products and services to consumers. “Involved” has a specific definition in the Act and means either arranging the contract or giving regulated financial advice. I therefore consider that senior managers and executives are unlikely to be caught by the scope of the prohibition as they are not likely to be “involved” in the provision of products and services to consumers as defined by the Act. In the event that they are “involved” then it is appropriate that the prohibition applies to them.
- 25 Submissions on the exposure draft will be open for approximately six weeks commencing late September 2022.

Next steps

- 26 I intend to return to Cabinet in early 2023, following consultation, to seek final approvals for regulations to be made under the regime. This will give financial institutions advanced notice of the costs of obtaining a licence and time to understand their obligations in relation to sales incentives under the new regime before the FMA opens licensing applications (expected in July 2023).
- 27 At that time, I also intend to seek Cabinet authorisation of an Order in Council to bring the regime into force in early 2025.

Financial Implications

- 28 There are no financial implications from releasing the discussion document or exposure draft for public consultation.

Legislative Implications

- 29 The consultation is likely to result in recommendations to Cabinet to make regulations to give effect to the proposals in the licensing fees discussion document and the exposure draft sales incentives regulations.

Impact Analysis

- 30 A Regulatory Impact Statement in relation to the prohibition on sales incentives based on volume or value targets was submitted at the time Cabinet made policy decisions in relation to the Act [DEV-19-MIN-0237].
- 31 The Ministry of Business, Innovation and Employment’s (MBIE) Quality Assurance panel has reviewed the discussion document (*Financial institution licensing fees under the new conduct regime*) and confirms that it substitutes as an interim Regulatory Impact Statement. The discussion document is likely

to lead to effective consultation and support the delivery of Cost Recovery Impact Analysis to inform subsequent decisions.

Population Implications

- 32 There are not expected to be significant implications for specific population groups as a result of the recommendations in this paper.

Human Rights

- 33 The proposals in this paper are consistent with the New Zealand Bill of Rights Act 1990 and the Human Rights Act 1993.

Consultation

- 34 The Treasury, the FMA, RBNZ and Commerce Commission have been consulted on this paper. The Department of the Prime Minister and Cabinet (Policy Advisory Group) has been informed.

Communications

- 35 MBIE will make the licensing fees discussion document and exposure draft sales incentives regulations publicly available on its website, inform key stakeholders of their release and proactively engage with industry to seek feedback on the proposals. MBIE will consider feedback received during consultation and make adjustments to the proposals as necessary.
- 36 There may be some adverse reaction to the proposed licensing fee given that this represents an additional cost for financial markets participants. However, the proposed fee is relatively low, with a flat fee of \$1,024.93 including GST expected to be charged for most applications. This is lower than the fees charged for most other licensed services under the FMC Act (for example the fees for acting as a manager of a registered scheme or a provider of a discretionary investment management service).
- 37 Some financial markets participants may also question why different licence classes with different fees have not been set (e.g. three separate licence classes for banks, insurers and non-bank deposit takers). As explained in the discussion document, this approach is unlikely to meet the objective of charging licensing fees in an efficient manner and there is no clear basis for distinguishing between the types of financial institutions. The same licensing application form and questions will apply to all types of financial institutions.
- 38 The relatively low fees may raise questions about the robustness of the FMA's licensing process. For example, the standard fee has been calculated assuming 5.75 hours of FMA staff time. Some could raise concerns that 5.75 hours may seem low for checking the processes of (for example) a large bank. However, risk assessment will be undertaken in the first instance by the licensing system, and the FMA anticipates that the majority of applications will come within the standard assessment time of 5.75 hours. Where the FMA

does take longer to assess some applications it can consider recovering its costs through the hourly charging mechanism.

Proactive Release

- 39 This paper will be published on MBIE's website within 30 business days of decisions being confirmed by Cabinet, subject to withholdings as appropriate and consistent with the Official Information Act 1982.

Recommendations

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

- 1 **note** that the Financial Markets (Conduct of Institutions) Amendment Act 2022 introduces a new regulatory regime for the conduct of financial institutions;

Licensing fees

- 2 **note** that financial institutions will need to obtain a licence granted by the Financial Markets Authority that covers the service of 'acting as a financial institution' in order to offer certain banking and insurance products and services to consumers once the new conduct regime is in force;
- 3 **note** that under the Financial Markets Authority Act 2011, the Financial Markets Authority is able to recover the costs of licensing from applicants;
- 4 **note** that the attached discussion document *Financial institution licensing fees under the new conduct regime* requests feedback on proposed licensing fees that will apply when financial institutions apply for a licence under the new conduct regime;
- 5 **agree** to release the attached discussion document *Financial institution licensing fees under the new conduct regime* for public consultation;
- 6 **authorise** the Minister of Commerce and Consumer Affairs to make minor and technical changes to the discussion document that may be required;

Sales incentives

- 7 **note** that Cabinet previously [DEV-22-MIN-0003 refers]:
- 7.1 agreed that financial institutions and intermediaries be prohibited from offering sales incentives based on volume or value targets to their employees (except senior managers and executives), agents and intermediaries;
- 7.2 authorised the Minister of Commerce and Consumer Affairs to issue drafting instructions to the Parliamentary Counsel Office to give effect to this recommendation;
- 8 **note** that it is not necessary to explicitly exclude senior managers and executives from the scope of the prohibition (because the prohibition will only

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apply to persons who are involved in the provision of products and services to consumers through arranging the contract or giving regulated financial advice);

- 9 **authorise** the Minister of Commerce and Consumer Affairs to release the attached exposure draft of regulations relating to sales incentives for consultation with the public and stakeholders;
- 10 **authorise** the Minister of Commerce and Consumer Affairs to make any minor or technical changes to the exposure draft that may be required prior to consultation;
- 11 **authorise** the Minister of Commerce and Consumer Affairs to approve and release commentary material related to the exposure draft of regulations, for consultation with the public and stakeholders;
- 12 **invite** the Minister of Commerce and Consumer Affairs to report back to Cabinet on the outcome of consultation on the above matters and submit final recommendations on regulations for Cabinet authorisation in early 2023.

Authorised for lodgement

Hon Dr David Clark
Minister of Commerce and Consumer Affairs