Fit for purpose financial services conduct regulation

DISCUSSION DOCUMENT – MAY 2024

MINISTRY OF BUSINESS, INNOVATION & EMPLOYMENT
HĪKINA WHAKATUTUKI

Te Kāwanatanga o Aotearoa
New Zealand Government

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How to have your say

Submissions process

The Ministry of Business, Innovation and Employment (MBIE) seeks written submissions on the issues raised in this document by **5pm on 19 June 2024**.

Your submission may respond to any or all of these issues. Where possible, please include evidence to support your views, for example references to independent research, facts and figures, or relevant examples.

Please use the submission template provided at: *https://www.mbie.govt.nz/have-your-say/fit-for-purpose-financial-services-reform*. This will help us to collate submissions and ensure that your views are fully considered. Please also include your name and (if applicable) the name of your organisation in your submission.

Please include your contact details in the cover letter or e-mail accompanying your submission.

You can make your submission:

- By sending your submission as a Microsoft Word document to *financialmarkets@mbie.govt.nz*
- By mailing your submission to:

  Financial Markets
  Small Business, Commerce and Consumer Policy
  Ministry of Business, Innovation & Employment
  PO Box 1473
  Wellington 6140
  New Zealand

Please direct any questions that you have in relation to the submissions process to *financialmarkets@mbie.govt.nz*.

Use of information

The information provided in submissions will be used to inform MBIE's policy development process and will inform advice to Ministers on potential reforms to financial markets conduct requirements. We may contact submitters directly if we require clarification of any matters in submissions.

Release of information

MBIE will publish the submissions on our website at *www.mbie.govt.nz*.

Submissions may be subject to release under the New Zealand Official Information Act 1982 and requests under the Privacy Act 2020.

Official information

Submissions may be requested under the Official Information Act 1982. If you have any objection to the release of any information in your submission, please set it out clearly in your submission.

Please clearly indicate which parts you consider should be withheld, together with the reasons for withholding the information and the grounds under the Official Information Act 1982 you believe apply. We will take such objections into account and will endeavour to consult with submitters when responding to requests under the Official Information Act 1982.

Private information

The Privacy Act 2020 governs how we manage personal information (e.g., collection, use, holding, disclosure, etc.). Any personal information you supply to us in the process of making a submission for this consultation will only be used for the purpose of assisting in the development of policy advice in relation to this review, to attribute submissions or for contacting you about your submission. We may also use personal information you supply in the course of making a submission for other reasons permitted under the Privacy Act 2020 (e.g. with your consent, for a directly related purpose, or where the law permits or requires it).

Please clearly indicate in the cover letter or email accompanying your submission if you do not wish for your name, or any other personal information, to be disclosed in any summary of submissions or external disclosures. You have rights of access to and correction of your personal information as explained on the MBIE website at *www.mbie.govt.nz*. If you include the personal information of another individual in your submission, they also have the right to access and/or correct of their own information.

Other information

If there is other information that you would like to submit to MBIE for consideration in this consultation but do not want it publicly disclosed, please do clearly set that out in your submission for MBIE to consider.

Glossary

AML/CFT	Anti-Money Laundering and Countering Financing of Terrorism Act 2009
CCCFA	Credit Contracts and Consumer Finance Act 2003
CoFI Act	Financial Markets (Conduct of Institutions) Amendment Act 2022
DTA	Deposit Takers Act 2023
Fair conduct principle	The principle in section 446C of the CoFI Act that a financial institution must treat consumers fairly
Fair conduct programme	A financial institution's policies, processes, systems and controls that are designed to ensure its compliance with the fair conduct principle
Financial institution	Bank, insurer or non-bank deposit taker regulated under the CoFI Act
FMA	Financial Markets Authority
FMA Act	Financial Markets Authority Act 2011
FMC Act	Financial Markets Conduct Act 2013
FMC Regs	Financial Markets Conduct Regulations 2014
FSPR	Financial Service Providers Register
IOSCO	International Organization of Securities Commissions
IPSA	Insurance (Prudential Supervision) Act 2010
MBIE	Ministry of Business, Innovation and Employment
RBNZ	Reserve Bank of New Zealand

Introduction

Context of financial services reforms

1. The Government is reforming the regulatory landscape for financial services in two phases. The objectives of this reform are to:
    a. simplify and streamline regulation of financial services (including reducing duplication)
    b. remove undue compliance costs for financial markets participants
    c. improve outcomes for consumers.

2. Phase One focuses on:
    a. revoking prescriptive affordability requirements and outdated exemptions from regulations made under the Credit Contracts and Consumer Finance Act 2003 (CCCFA)
    b. exempting voluntary targeted rates schemes from being consumer credit contracts and removing duplicative reporting requirements from regulations made under the CCCFA
    c. aligning certain rules for different financial dispute resolution schemes.

3. Phase Two focuses on:
    a. transferring regulatory responsibility for the CCCFA from the Commerce Commission to the Financial Markets Authority (FMA)
    b. reforms to address other known problems with the CCCFA, such as the liability settings for directors and senior managers
    c. examining the effectiveness of the CCCFA's high-cost credit provisions
    d. a targeted review of the Financial Markets (Conduct of Institutions) Amendment Act 2022 (CoFI Act) and other conduct requirements under the Financial Markets Conduct Act 2013 (FMC Act) and Financial Markets Authority Act 2011 (FMA Act)
    e. improving consumer access to and effectiveness of the financial dispute resolution system.

4. To enable consideration of these issues, the Government is releasing a package of discussion papers. You may wish to respond to one or more of the papers. The three papers are titled:
    a. Fit for purpose financial services conduct regulation (this paper)
    b. Fit for purpose consumer credit legislation
    c. Effective financial dispute resolution.

What does this discussion paper do?

5. This discussion document seeks feedback on:
    a. Part 1: Options to streamline and improve provisions of the CoFI Act, including:
        i. amending the minimum requirements for fair conduct programmes
        ii. amending the fair conduct principle.
    b. Part 2: Options to amend the regulatory framework and powers of the FMA in the FMC Act and the FMA Act, including:
        i. requiring the FMA to issue a single conduct licence for market services
        ii. improving the way the FMA and Reserve Bank of New Zealand (RBNZ) work together
        iii. strengthening the FMA's regulatory toolkit.

6. Part 3 provides information about the limitations and constraints on our analysis, and Part 4 provides information about implementation of options.

7. We encourage submitters to raise any issues they may have with the options identified in this document. We also welcome any other suggestions which might improve the function of the CoFI Act or the regulatory framework in line with the Government's stated objectives.

Criteria for review

8. The Government continues to support the need for good conduct by financial institutions and the fair treatment of consumers. Conduct regulation and the CoFI Act are important to deliver this.

9. Considering the Government's objectives discussed in paragraph 1, the options in each Part will be assessed against the following criteria:
   a. whether they make obligations more proportionate to the risks of harm, including by improving the flexibility of the requirements and enabling them to be tailored to account for the size and nature of different businesses
   b. whether they avoid unnecessary compliance costs for market participants, including by making obligations more certain or avoiding duplication of other requirements in financial markets legislation
   c. whether they promote fair treatment of consumers and good conduct.

10. In relation to Part 2 of this discussion document, we note that the Government's objective is also to ensure that the "twin peaks" model of financial regulation (explained at paragraphs 58-60 below) is clear and effective. We therefore assess these options against an additional criterion of whether the option promotes a clear and effective twin peaks model.

1.	Do you agree the proposed criteria are appropriate, given the objectives? Are there other criteria which should be considered?

Process and timeline

11. Submissions on this paper close at 5pm on 19 June 2024. Following this, officials will review the feedback and make recommendations to the Minister of Commerce and Consumer Affairs, with a view to introducing amendment legislation by December 2024. It is expected that legislation will be passed no earlier than Q3 2025.

12. The CoFI regime commences on 31 March 2025. By this date, under the current legislation, financial institutions will need to comply with all obligations in the CoFI Act and to have applied for (and received) a licence from the FMA in order to continue providing banking and insurance services to consumers. Further information about implementation is provided in Part 4 below. There are no plans to change the CoFI regime commencement date.

1: Options for CoFI Act reform

Context

13. Financial markets conduct regulation focuses on behaviour in financial markets. It supports confident and informed participation in financial markets by businesses, investors and consumers, and promotes and facilitates the development of fair, efficient and transparent financial markets.

14. The FMA is the regulator responsible for monitoring and enforcing financial market conduct regulatory requirements, which are primarily found in the FMC Act.

15. The CoFI Act amends the FMC Act to introduce a regime regulating the conduct of banks, insurers and non-bank deposit takers (collectively financial institutions) from 31 March 2025. It was developed in response to reviews by the FMA and the RBNZ which found that New Zealand banks and insurers had weak systems and controls for managing conduct risks, that were affecting outcomes for consumers.[1] Lack of regulatory oversight meant there was a risk of ongoing systemic harm to consumers.

16. To address these issues, the CoFI Act sets conduct obligations for the provision of core retail banking and insurance products and services. Key elements of the regime include:
    a. Financial institutions will need to operate under a conduct licence in order to offer products and services to consumers in New Zealand.
    b. Financial institutions must establish, implement, maintain and comply with effective policies, processes, systems and controls within their businesses (called fair conduct programmes) that are designed to ensure they comply with the principle to treat consumers fairly.
    c. The FMA is responsible for monitoring and enforcing this new conduct regime and for issuing licences. The legislation gives the FMA direct oversight of the 'entity-level' conduct of these financial institutions and provides the FMA with formal supervisory and enforcement tools to support fair treatment of consumers.

Problem/opportunity

17. Most stakeholders agree that the overall intent and framework of the CoFI Act is sound. However, some stakeholders have raised concerns that certain requirements in the CoFI Act are unnecessary or unduly prescriptive given the risks of harm to consumers, and may create unnecessary duplication with other regulatory regimes. They have claimed the regime may impose unnecessary compliance costs which may be passed onto consumers or limit the availability of financial products and services.

18. In light of the issues raised by stakeholders, the review of the CoFI Act is intended to be targeted and focused on particular requirements in the CoFI Act where there may be

[1] See the 2018 Bank Conduct and Culture Review (***https://www.fma.govt.nz/assets/Reports/Bank-Conduct-and-Culture-Review.pdf***), the 2019 Life Insurer Conduct and Culture Review (***https://www.fma.govt.nz/assets/Reports/Life-Insurer-Conduct-and-Culture-2019.pdf***) and the 2021 Fire and general insurers update (***https://www.fma.govt.nz/assets/Reports/Insurance-conduct-and-culture-fire-and-general-insurers-update.pdf***).

stakeholder concern about unnecessary compliance costs, or opportunities to simplify the regime.

A. Options for amending minimum requirements for fair conduct programmes

Background

19. The CoFI Act sets an overarching principle that financial institutions must treat consumers fairly (discussed in more detail in section B below). This principle is operationalised through the duties for financial institutions to establish, implement and maintain a fair conduct programme (in section 446G), and to comply with it (in section 446I). Fair conduct programmes are policies, processes, systems and controls that are designed to ensure the financial institution's compliance with the fair conduct principle.

20. Section 446J sets out high-level categories of minimum requirements that all fair conduct programmes must cover. These minimum requirements that apply to all fair conduct programmes were expanded following select committee consideration of the CoFI Bill to provide additional certainty for financial institutions as to their obligations.

21. These minimum requirements were based on areas where conduct issues and risks were identified through the FMA and RBNZ conduct and culture reviews, and other evidence of consumer harm.

Status quo

22. Section 446J provides a non-exhaustive list of requirements that must be met in relation to fair conduct programmes. These are only <u>minimum</u> requirements, and the overall standard is that a financial institution's fair conduct programme must be designed to ensure the financial institution's compliance with the fair conduct principle.

23. The section has two main parts. Section 446J(1) sets out the minimum level of content the programme must include, for example:
    a. enabling the financial institution to meet all of its legal obligations to consumers, including under the CoFI Act and other financial services and consumer legislation
    b. designing and managing the provision of relevant services and products to consumers
    c. identifying, monitoring and managing risks associated with conduct that fails to comply with the fair conduct principle.

24. Section 446J(2) sets out the factors a financial institution must consider when creating their fair conduct programme, for example, the nature, size and complexity of their business. This is intended to support financial institutions to take a proportionate approach to developing fair conduct programmes and right-size these for the circumstances of their particular businesses.

25. There are regulation-making powers allowing additional requirements to be prescribed for the purposes of sub-sections 446J(1) and (2). No regulations in relation to fair conduct programmes have been made or are proposed at this stage.

Problem/opportunity

26. Some stakeholders have suggested certain minimum requirements in section 446J(1) are too prescriptive. They argue these requirements are overly specific and may not be necessary or appropriate for all fair conduct programmes, depending on the nature of the business conducted by the financial institution. Some of the requirements may create unnecessary or undesirable overlap with other regulatory regimes.

27. Overly prescriptive requirements could create unnecessary compliance costs and limit flexibility in how financial institutions design and maintain fair conduct programmes within their businesses. This could result in reduced provision of products and services, or additional costs being passed along to consumers.

Option A1: Remove/amend some minimum requirements for fair conduct programmes <u>(preferred)</u>

28. This option would involve removing or simplifying certain requirements in section 446J(1). The intent would be to reduce prescription and provide greater flexibility for financial institutions to comply with their obligations, while continuing to provide sufficient certainty and set clear standards of conduct that support fair outcomes for consumers.

29. The intent of this option is not to lower the expected standards of financial institutions' conduct. However, there may be opportunity to remove certain elements of the section that may be unnecessary, repetitive or too detailed to meet the objectives of these reforms.

30. Examples of changes that could be made under this option include (but are not limited to):
    a. <u>Removing paragraph (a) (enabling the institution to meet its legal obligations to consumers).</u> We understand this paragraph has caused some confusion as to its intended scope and effect and has been perceived as introducing unnecessary duplication. Some financial institutions have interpreted it as requiring them to "re-document" processes in other parts of their business (eg their CCCFA processes) into their new fair conduct programme. Removing this paragraph could allow financial institutions to take a more flexible and proportionate approach to areas of their businesses that are subject to requirements under more than one legislative regime.
    b. <u>Removing subparagraphs (i) to (iii) in paragraph (c) (identifying, monitoring and managing conduct risks).</u> These subparagraphs may be too prescriptive. It may be obvious that (for example) an effective risk management programme would include regular reporting of conduct risks to the board. Removing these subparagraphs could increase financial institutions' flexibility for identifying, monitoring and managing risks, although we expect that in most circumstances equivalent requirements will still be needed in fair conduct programmes.
    c. <u>Adjusting or consolidating paragraphs (e) to (h) (setting requirements relating to employees and agents) to reduce the level of prescription.</u> For example, the requirement in paragraph (e) relating to employees could be removed (while retaining paragraph (e) as it relates to agents) as it could be seen as duplicative or unnecessary when read alongside the requirement to manage or supervise employees in paragraph (h). Paragraphs (f) to (h) could be amended to have higher-level and less prescriptive requirements around training,

managing and supervising employees. Alternatively, paragraph (e) could be retained for employees and agents with paragraphs (f) to (h) removed.

d. Removing paragraph (k) (reviewing the effectiveness of the programme). Section 446G(1) already requires that financial institutions "establish, implement and maintain effective fair conduct programmes". While paragraph (k) requires something slightly different (that financial institutions include policies in their fair conduct programmes setting out how they will maintain them), it may not be strictly necessary to include.

31. There is a risk that simplifying and reducing the specificity of fair conduct programme requirements could make it more difficult for financial institutions to understand what the content of their fair conduct programme should look like (particularly for smaller financial institutions). This means that simplifying the requirements could potentially increase compliance costs rather than reducing them.

32. This risk could be mitigated by the broad regulation-making power in the CoFI Act which allows further minimum requirements to be specified in regulations if needed. The FMA also has the ability to issue guidance to financial institutions to communicate expectations and highlight best practice, and will be engaging with industry to understand where guidance and support may be desirable.

33. Our overall assessment is that the kinds of changes we have listed above in paragraph 30 would reduce prescription, provide greater flexibility for financial institutions to comply with their obligations and reduce compliance costs, while continuing to promote fair treatment of consumers and good conduct.

2.	Do you support removing or amending some of the minimum requirements for fair conduct programmes? What are the advantages and disadvantages of this option?
3.	Which requirements should be removed or amended, if any? Please explain what changes you would like to be made.
4.	What would be the impact of removing or amending particular requirements (for example, on compliance costs for businesses)?
5.	Do you have any other comments on the minimum requirements for fair conduct programmes?

Option A2: Potential additions to minimum requirements for fair conduct programmes

34. Option A2 would involve adding new minimum requirements to section 446J(1) relating to:
    a. applying, disclosing and reviewing fees and charges and/or
    b. recording and resolving consumer complaints.

35. Both or either of the proposed additions could be implemented. This option could be implemented together with Option A1 (removing or adjusting some minimum requirements) or

Option A4 below (keeping other minimum requirements the same), but not with Option A3 below (removing all minimum requirements).

36. The two potential additions would address areas where conduct risks can arise. In relation to fees and charges, the FMA and RBNZ conduct and culture reviews found instances of fees and charges materially outweighing benefits to customers, incorrect application of fees and charges, and fees and charges being incorrectly disclosed to consumers. In relation to complaints processes, the reviews found instances of poor processes for recording and resolving consumer complaints.

37. The Minister of Commerce and Consumer Affairs has also stated his expectation that fair conduct programmes should cover, amongst other things:
    a. establishing transparent fee structures and charging arrangements, particularly regarding intermediaries
    b. development of an adequate complaints process.

38. Section 446J(1) does not currently expressly address these matters, so it may not currently be clear as to how and to what extent financial institutions should address these matters in their fair conduct programmes. However, adding specific references to these matters could reduce flexibility in how financial institutions can address them, and result in financial institutions needing to review and amend their fair conduct programmes. This may result in an increase in compliance costs, without necessarily advancing the key objectives of the CoFI regime.

39. Arguably, both matters are already within the broad scope of the fair conduct programme duty (section 446G) and are unlikely not to be addressed in financial institutions' programmes (even without express reference). We note:
    a. In relation to fees, the basis for the relationship between financial institution and customer is the exchange of money for products and services. The fair conduct principle provides that the requirement to treat consumers fairly includes paying due regard to consumers' interests. We expect this would include considering how fees and charges will be correctly applied and disclosed to consumers. In relation to intermediaries, there is also an express requirement in section 446J(1)(i) to address the design and management of incentives.
    b. In relation to complaints processes, paragraphs (c) and (d) of section 446J(1) set requirements around identifying and addressing conduct that may not comply with the fair conduct principle. Complaints are also expressly addressed in section 446D (which gives responding to a complaint as an example of when the fair conduct principle applies) and the duty in section 446H to ensure that information is available to assist consumers to understand how to make complaints.

40. We would be interested in your feedback, including whether these matters are already covered sufficiently or whether including an express reference to them could improve certainty regarding the intention that these matters should be covered in fair conduct programmes. If they were to be included:
    a. drafting would need to be carefully considered to ensure financial institutions retain flexibility to set policies and procedures that are appropriate for their business
    b. there would need to be an appropriate period before commencement of these provisions to ensure sufficient time for amendments and implementation.

6.	What are the advantages and disadvantages of adding an express minimum requirement for fair conduct programmes relating to fees and charges?
7.	What are the advantages and disadvantages of adding an express minimum requirement for fair conduct programmes relating to complaints processes?
8.	Do you consider that financial institutions already need to cover fees and charging arrangements and/or complaints processes in their fair conduct programmes under the current requirements?

Option A3: Remove all minimum requirements for fair conduct programmes

41. One option to address stakeholder concerns would be to remove all of the minimum requirements in section 446J(1). Financial institutions would still be required to have a fair conduct programme including policies, processes, systems and controls designed to ensure the financial institution's compliance with the fair conduct principle, but there would be no minimum requirements set by legislation.

42. This option would maximise flexibility for financial institutions in determining how to establish and maintain effective fair conduct programmes. It would also enable them to make their own decisions about what is necessary to include in the programme to meet the fair conduct principle in a manner that is appropriate for their own business. If any issues arise in the future, further requirements could be introduced through regulations.

43. However, this option would likely decrease clarity and increase uncertainty, which may particularly impact smaller financial institutions. Financial institutions may find it difficult to create their programme without guidance in the legislation about what it is expected to include. This is why the minimum requirements were included at select committee. This option may therefore increase compliance costs rather than reduce them.

44. This option is also less likely to support the core objective of the CoFI regime to ensure fair treatment of consumers. It could lead to more gaps in fair treatment of consumers as a result of the removal of minimum requirements as interpretations and standards vary between financial institutions and may relax over time.

45. To promote fair outcomes for consumers and the objectives of the CoFI regime, under this option the FMA in practice is likely to continue to expect that fair conduct programmes include certain elements. The FMA may issue guidance to help financial institutions understand expectations. However, from a transparency, certainty and accountability perspective, our view is that it is more appropriate that certainty about regulatory standards be provided through primary or secondary legislation, rather than by the FMA.

9.	Do you support removing all of the minimum requirements for fair conduct programmes from the legislation? What are the advantages and disadvantages of this option?

Option A4: Retain minimum requirements for fair conduct programmes without change (status quo)

46. A final option is to retain the minimum requirements as they are, by not making any changes to the existing list of requirements in section 446J(1). This option would prioritise certainty and avoid unnecessary additional compliance costs at this stage. However, it may result in increased compliance costs on an ongoing basis when compared to Option A1 (which is aimed at reducing prescription and increasing flexibility for financial institutions).

10.	Do you support retaining the existing list of minimum requirements for fair conduct programmes without any changes? What are the advantages and disadvantages of this option?

Proposal: proceed with Option A1 (remove/amend some minimum requirements)

47. The preferred option is to proceed with Option A1 only (removing and amending some of the minimum requirements in section 446J(1)). We consider that this option best meets the Government's objectives of this targeted review when compared to the status quo.

11.	Do you support the proposal to remove and amend some of the minimum requirements for fair conduct programmes and not to proceed with the other options? Why/why not?

B. Options for amending fair conduct principle

Background

48. The CoFI Act sets an overarching fair conduct principle (section 446C) that financial institutions must treat consumers fairly. The requirement to treat consumers fairly includes:
    a. paying due regard to consumers' interests
    b. acting ethically, transparently and in good faith
    c. assisting consumers to make informed decisions
    d. ensuring that the relevant services and associated products that the financial institution provides are likely to meet the requirements and objectives of likely consumers (when viewed as a group)
    e. not subjecting consumers to unfair pressure or tactics or undue influence.

49. The fair conduct principle was designed to be a broad and relatively high standard of conduct that applies in a wide range of circumstances. The concept of what is 'fair' will also likely evolve over time as products and services, industry practices and societal norms change.

Status quo

50. The fair conduct principle is open-ended and is not an enforceable duty itself but is a guiding principle or policy objective that informs the specific duties imposed by the regime. Financial institutions' fair conduct programmes must be designed to ensure they comply with the fair conduct principle (section 446G), and financial institutions must then comply with their fair conduct programmes (section 446I).

Problem/opportunity

51. The fair conduct principle relies on a concept of 'fairness' that is deliberately broad and multi-faceted. However, because this concept is not exhaustively defined, financial institutions may be uncertain about what fair treatment of consumers covers and whether this could expose them to unexpected liability (for example if the principle is subsequently interpreted to include something that is not already on the current list).

52. This uncertainty could lead to financial institutions being unnecessarily risk averse, and reducing the provision of financial products and services that might otherwise be appropriate or desirable. In addition, some in the industry are concerned that the open-endedness could result in the FMA providing further expectations via guidance, which may be viewed as mandatory. We note that most industry feedback received at this stage has been around the minimum requirements for fair conduct programmes set out in section 446J rather than the fair conduct principle.

Option B1: Keep the fair conduct principle open-ended (status quo) (preferred)

53. One option is to retain the principle as it is, with an open-ended inclusive list of matters that fair treatment of consumers includes. This is consistent with the original intent of the principle to be broad to provide flexibility for financial institutions and support fair outcomes for consumers, and to reflect that the concept of fair treatment may evolve naturally over time.

Option B2: Make the fair conduct principle definition exhaustive

54. To address the issue above, we have considered amending the definition of the fair conduct principle to make the current list of matters exhaustive. This option would not involve adding any new elements to the list of matters in section 446C. The current list of matters would become a complete list of what treating consumers fairly means.

55. This option could make the obligations imposed by CoFI more certain in one way, as it would mean that financial institutions only need to consider what is listed under the principle and design their conduct programmes in light of these standards. However, it could also unduly limit the application of the principle, which was always intended to apply broadly to support the fair treatment of consumers in a financial institution's provision of relevant services to consumers. We think the impact on compliance costs and flexibility would be minimal, and that it may not promote the fair treatment of consumers over time.

Proposal: retain status quo (Option B1)

56. The preferred option is to retain the status quo, on the basis that having a broader, open-ended definition of fairness would better promote the conduct changes that the CoFI regime is intended to support, and will better allow businesses to determine what is appropriate depending on the context. It will also avoid the need for potential legislative change in future to reflect evolutions in the concept of fair treatment as products and services, industry practices and societal norms change. It is important to note that while the concept of fair treatment of consumers is broad, it is not entirely open-ended and applies only in the circumstances set out in section 446D (when the fair conduct principle applies).

57. However, we are interested to hear your views on whether the current definition could be clarified. We would also be interested in feedback as to whether there are matters that should be included in or removed from the definition of the fair conduct principle (which could be done under either Option B1 or B2). We note:

   a. We have not identified any obvious aspects of fair treatment that are not covered and adding additional matters at this stage could give rise to additional compliance costs.

   b. Paragraph (d) of the definition refers to "ensuring that the relevant services and associated products that the financial institution provides are likely to meet the requirements and objectives of likely consumers (when viewed as a group)". Some concerns have been raised that this paragraph might require institutions to define a particular group of consumers in advance. The intent of this paragraph is to encourage financial institutions to think about the likely suitability of their product design and distribution, and the wording "when viewed as a group" clarifies that this can be considered at a general or collective level rather than requiring individual suitability assessments. We would be grateful for your feedback on this provision.

12.	Do you support the proposal to maintain the status quo in the definition of the fair conduct principle? What are the advantages and disadvantages of this option?
13.	Are there any additional clarifications that could be made to the definition of the fair conduct principle, or matters that you consider should be included or removed? Why or why not?
14.	Do you have any other suggestions or comments in relation to the fair conduct principle?
15.	Do you have any comments in relation to other areas of the CoFI Act that have not been covered in this section?

2: Options for regulatory framework and powers

Context

58. New Zealand has a "twin peaks" model of financial markets regulation, shown in Figure 1 below. The RBNZ is the prudential regulator responsible for the soundness and stability of the market and market participants. The FMA is the conduct regulator responsible for the conduct of market participants.[2]

59. Both regulators have licensing requirements for financial markets participants. Firms that are prudentially regulated hold a licence from the RBNZ.[3] Firms that provide particular market services regulated by the FMA (eg providing financial advice or managing a registered scheme) also need to hold licences for each market service they provide. In some cases, firms may need to hold multiple licences. Licensing imposes compliance and administrative costs on firms.

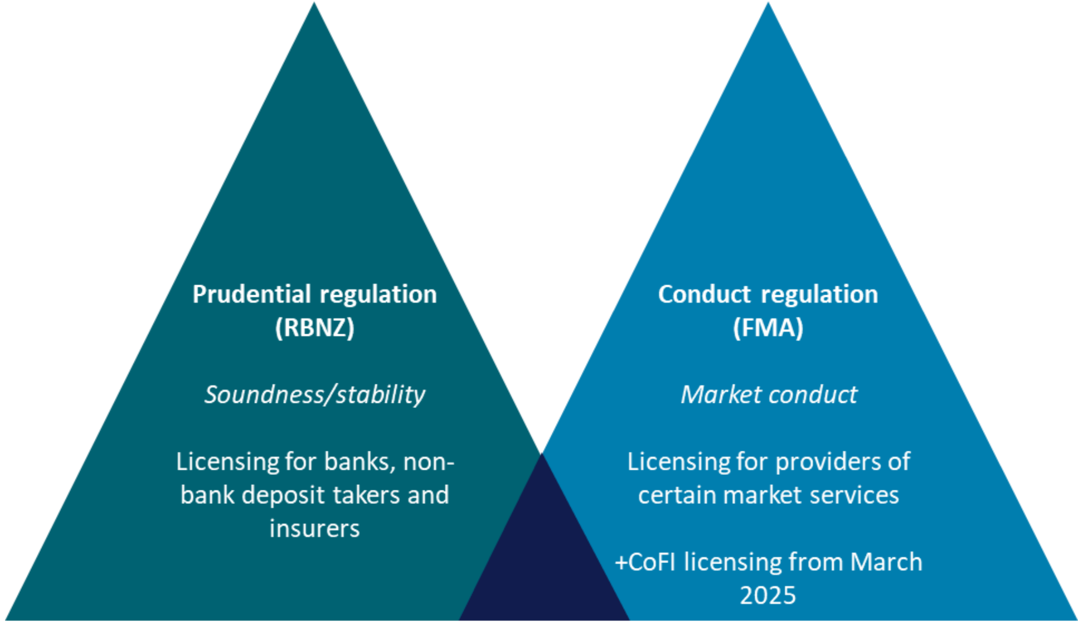

Figure 1: Twin peaks regulatory landscape

60. The RBNZ and the FMA may both have interests in the activities of firms from independent prudential and conduct perspectives, and at times requirements may overlap. For the twin peaks model to work, it is important that both regulators have a clear mandate and equal powers and that neither is secondary to the other. It is equally important that the regulators coordinate with each other to ensure they work together in a coherent way and do not duplicate requirements for industry.

[2] The Commerce Commission currently has regulatory responsibility for consumer credit conduct under the CCCFA. Cabinet has decided to move this responsibility to the FMA – see the discussion document titled *Fit for purpose consumer legislation*.

[3] Prudential licensing is outside the scope of this discussion document.

Problem/opportunity

61. Stakeholders have raised concerns that the complexity of the current model imposes costs on firms, including potential duplication of requirements. For example, both regulators may request and consider similar information from firms around matters like business continuity plans and cyber-security from their different perspectives. There could be opportunities for the regulators to better coordinate and collaborate to reduce burden on industry. In addition, stakeholders have raised concerns about the need for some firms to hold multiple licences from the FMA and the compliance costs associated with this.

62. This review also provides an opportunity to consider whether there are any other improvements that could be made to the way the twin peaks model works, including the need to ensure that the FMA and RBNZ can take regulatory action independently or jointly where appropriate, and addressing any regulatory gaps.

63. As part of this review, we are considering options to streamline and simplify financial service conduct requirements more generally, and to ensure a clearer and more effective twin peaks model for financial regulation. We want to ensure that the FMA is well-equipped to carry out its functions as a conduct regulator in a way that does not unduly increase compliance burden for industry. This includes administering its functions under the CoFI Act and the FMC Act generally, and its proposed new responsibilities under the CCCFA.

C. Consolidating financial market conduct licences

Background

64. Part 6 of the FMC Act requires providers of certain market services (whether they are a financial institution or not) to be licenced by the FMA. Licences are required to be held where the provider is:
    a. acting as a manager of a registered scheme (other than a restricted scheme)
    b. acting as an independent trustee of a restricted scheme
    c. acting as a provider of a financial advice service
    d. acting as a provider of a discretionary investment management service
    e. acting as a derivatives issuer in respect of a regulated offer of derivatives that is made by the derivatives issuer
    f. acting as a financial institution (from 31 March 2025, introduced by the CoFI Act).

65. There are also two opt-in licences for prescribed intermediary services (crowd funding services and peer-to-peer lending services) and financial benchmark administration.

Status quo

66. Under the FMC Act, the FMA may issue different licences for each class or market services, or alternatively a single licence covering multiple classes of licensed services. Currently, the FMA chooses to issue licences for these market services separately. This means that some licensed firms will hold more than one conduct licence, where they provide more than one licensed market service.

67. Under the status quo, dual-regulated firms (particularly banks) are most likely to hold more than one market conduct licence. Of the approximately 84 firms regulated by both the FMA and

the RBNZ once CoFI comes into force, 26 are expected to hold two conduct licences and four firms (all banks) are expected to hold three or more conduct licences. Of the approximately 1,650 firms only regulated by the FMA, fewer than 50 firms hold two conduct licences and fewer than 10 firms hold three or more conduct licences.

68. In the context of the wider financial services regulation reforms to simplify and streamline obligations, including moving regulatory responsibility for the CCCFA to the FMA, the Government has announced its intention to move to a single conduct licence overseen by the FMA.

Problem/opportunity

69. The FMC Act currently permits a siloed approach to licensing that may impose unnecessary costs on some market service providers. While most firms are not affected, we are aware that some stakeholders have raised concerns about the cost of multiple licence applications, and overlaps and misalignment in requirements under separate licences such as standard conditions and regulatory returns.

Option C1: Amend the FMC Act to require the FMA to issue a single licence covering different classes of market service (preferred)

70. Under this option the FMC Act would be amended to make it mandatory for Part 6 licences issued by the FMA to encompass all of the market services that a single legal entity has been approved to provide. For example, a firm that has been approved by the FMA to provide the services of acting as a manager of a registered scheme and acting as a provider of a financial advice service would have those two market services on its conduct licence. If in future the firm applied and was approved to provide an additional market service, this would be added to the same licence.

71. In our view, this approach would provide better clarity and certainty for industry and the FMA than the FMA moving to a single licence approach operationally (which can be done under current legislative provisions). A mandatory move to a single licence could eliminate some of the complexity that exists as a result of the multiplicity of licences and requirements, reducing the duplication of work and costs for some firms.

72. The market services listed in paragraphs 64 and 65 above would be in scope to be covered by the single conduct licence. Licences not issued under Part 6 of the FMC Act (for example, licences issued by the FMA under the Financial Markets Supervisors Act 2011) would be out of scope for inclusion in the single conduct licence. MBIE is separately consulting on whether the market service of "acting as a creditor under a consumer credit contract" should be added as a market service under Part 6 that would be in scope to be covered by the single licensing regime (see the *Fit for purpose consumer credit legislation* discussion document).

73. In terms of how this option would practically be implemented:
    a. An amendment to the FMC Act would consolidate existing conduct licences held by a licensed firm into a single conduct licence.
    b. The current conditions that apply to each licensed service would continue to apply to each service.

c. Any bodies or entities authorised (under section 400 of the FMC Act) to provide a service under the current licence would continue to be authorised to provide that service under the single licence.
d. FMC Act provisions that enable licences to be varied, suspended or cancelled would continue to apply, with the ability to exercise these in relation to particular market services.
e. The licensing consolidation process would take effect after the initial CoFI licensing process is complete. This would avoid the uncertainty, costs and delay that would arise from changing the CoFI licensing process partway through.

74. This approach will future proof the FMC Act licensing framework for the addition of further market services and support the FMA to achieve operational efficiencies. While these matters fall outside the scope of this law reform process, we understand the FMA would be considering (for example):
    a. streamlining licence 'standard conditions' imposed by the FMA for the different market services
    b. better harmonising how the FMA collects data from licensed firms across all of their licensed market services, particularly annual regulatory returns which represent some of the larger ongoing regulatory burden for licensed firms, and especially firms that are dual regulated by the RBNZ.

16.	Do you support the FMA being required by legislation to issue a single conduct licence covering one or more market services? What are the advantages and disadvantages of this approach?
17.	Could consolidating existing licences into a single conduct licence give rise to any unintended consequences or costs for existing licensed firms? If so, please explain with examples where relevant.
18.	Are there any other matters that should be considered around market services conduct licensing?

D. Enabling reliance on another regulator's assessment

Background

75. The Government intends to reinforce the twin peaks model of financial regulation and ensure the roles and responsibilities of both regulators are clear. We expect that work in this area will be largely operational and a matter of the Government setting appropriate expectations for regulators. It is important that the regulators maintain their separate and independent mandates, while at the same time coordinating and cooperating in areas where they both have an interest to reduce duplication and regulatory burden.

76. We are considering whether there are opportunities to make changes to conduct legislation to better enable the RBNZ and FMA to work together and to reduce regulatory burden for financial markets participants. Ensuring that the regulators have aligned powers (as discussed in the next section) may also help facilitate coordination.

Status quo

77. There are some legislative provisions which require both regulators to assess similar matters in relation to licensed firms. This situation generally arises where a matter can have implications both for prudential soundness and market conduct/behaviour. For example:
    a. Section 396 of the FMC Act requires the FMA to issue a licence for a firm when, amongst other matters, it is satisfied that an applicant's directors, senior managers and proposed directors and senior managers are fit and proper persons. The RBNZ has similar requirements in relation to deposit takers and insurers in prudential legislation.
    b. Sections 402 and 403 of the FMC Act enable the FMA to impose conditions on firms' licences. Standard licence conditions for firms include matters relating to outsourcing, business continuity and technology systems. The RBNZ has similar requirements in relation to deposit takers and insurers in prudential legislation.

78. There are some legislative provisions that require the regulators to consult each other before issuing a licence (eg section 20 of the DTA, regulation 190 of the Financial Markets Conduct Regulations 2014 (FMC Regs)) or to have regard to whether an applicant is licensed by the other regulator (eg section 397(1)(b) of the FMC Act). These provisions ensure relevant information held and considerations known by the other regulator are taken into account in licensing decisions.

79. The FMA and the RBNZ currently coordinate and collaborate on matters of interest to both regulators, including through sharing information and undertaking joint supervisory and investigatory activity where appropriate and possible to do so. Both regulators have statutory functions to co-operate and share information with each other (see section 9 of the FMA Act and section 10 of the Reserve Bank of New Zealand Act 2021).

80. We understand the FMA and the RBNZ have also begun a process to discuss how to use their existing memorandum of understanding to address overlap concerns that have been identified. This work will provide greater clarity and certainty on the roles and responsibilities between the two regulators in areas of potential overlap and shared interest.

Problem/opportunity

81. Stakeholders have expressed concern that there is duplication between the licensing and ongoing monitoring/supervision requirements for firms that are dual-regulated under the conduct and prudential regimes. Areas such as initial fit and proper assessments and reporting on outsourcing, business continuity and technology systems (eg cyber resilience) have been identified as areas where both regulators require similar information from firms.

Option D1: Amend legislation to enable the FMA and RBNZ to rely on an assessment by the other regulator where appropriate <u>(preferred)</u>

82. This option would involve amending provisions in the FMC Act to explicitly enable the FMA to rely on an assessment by the RBNZ in assessing matters relating to dual-regulated firms, where there may be overlap between both regulators in terms of the assessment.

83. Equivalent amendments could be made to relevant prudential legislation to enable the RBNZ to rely on an assessment by the FMA where appropriate. This would recognise that in some

circumstances the FMA may be best placed to undertake work that RBNZ may later wish to rely on. We are interested in feedback on this approach but note that it would require consideration of whether it is within scope of this reform process.

84. We would need to consider the design of the provision carefully, including:
    a. whether the provision is broad (eg enabling the regulator to rely on or refer to work undertaken or produced by the other regulator) or tailored to particular requirements
    b. whether the provisions would be permissive or mandatory (ie whether the regulator is able to choose to rely on an assessment of the other regulator or whether the regulator is required to have regard to it).

85. This approach could be useful where both regulators would be undertaking broadly the same assessment. For example, assessing whether a director or senior manager is a fit and proper person in accordance with licensing requirements.

86. It is important to maintain the independence of both regulators and to recognise that both regulators have different remits. It will not be appropriate in all instances for one regulator to rely on an assessment undertaken by the other. For example, both regulators may request similar information from firms but the RBNZ's assessment may only involve considering matters through a prudential lens (eg assessing the soundness and stability of a firm) and the FMA may be required to make an assessment from a conduct perspective (eg assessing the impact on consumers). In these cases it will be more appropriate for the regulators to consider how they can work together operationally (eg aligning the content and form of information they request from firms on these matters, or developing a single joint form).

87. This option could reduce unnecessary overlap in requirements between the conduct and prudential regimes and could reduce compliance costs for financial institutions. Legislative amendments in this area could also provide additional certainty for operational arrangements between the FMA and the RBNZ to reduce regulatory overlap and provide clarity on roles and responsibilities between the two regulators.

19.	Should the FMC Act be amended to enable the FMA to rely on the RBNZ's assessment for appropriate matters? Please provide examples of any specific areas where you think this could be useful.
20.	Should there be equivalent provisions enabling the RBNZ to rely on the FMA's assessment for appropriate matters? Please provide examples of any specific areas where you think this could be useful.
21.	Are there any other improvements that could be made to the way the FMA and the RBNZ work together to reduce compliance costs and regulatory burden?

E. Ensuring the FMA has effective tools

Background

88. There are benefits to ensuring that the FMA has effective tools to monitor the compliance of regulated firms. Effective supervisory and monitoring tools allow the FMA to engage proactively and respond proportionately to harm. Without proactive enabling tools, the FMA may be limited to addressing harm through more formal investigation and backwards-looking tools such as enforcement action. The government has an objective of ensuring proportionate regulation in the financial markets system.

89. Once the CoFI licensing requirement comes into force, many financial institutions will also need to hold both a conduct and prudential licence to operate in New Zealand. The RBNZ and the FMA both have a legitimate interest in assessing and verifying the compliance of regulated firms with relevant requirements. Ensuring that both regulators have consistent tools may support an effective twin peaks model by creating alignment between the prudential and conduct regulators. It also ensures both regulators can act independently or jointly where appropriate and can address any regulatory gaps.

90. There are three areas where the FMA does not currently have tools to act proactively: change in control approvals, on-site inspection powers and expert person reviews. We are considering whether the FMA needs all or some of these additional tools and are seeking feedback on the advantages and disadvantages of introducing them, compared to the status quo.

Change in control approvals

Status quo

91. Prudentially regulated financial institutions need to obtain approval from the RBNZ before any change in control (ownership) of the financial institution and, in the case of licensed insurers, before a transfer, amalgamation or change in corporate form. The requirement to obtain approval applies to the proposed new controlling owner (the purchaser or acquirer).

92. The FMA has an expectation that licensed firms engage with it in advance of any change in control (see the reporting requirements in regulation 191 of the FMC Regs). However, the FMC Act does not contain similar provisions to those in prudential legislation.[4] This means firms licensed under the FMC Act are not required to obtain a regulatory approval from the FMA ahead of any change in control taking place. The FMA can take reactive action if issues arise after the change of ownership.

93. Both the RBNZ and the FMA have a separate and independent interest in a change in control:
    a. from a prudential perspective, the restructure may have an impact on the governance and financial strength of the insurer or on policyholder security
    b. from a conduct perspective, the restructure may impact on the interests of consumers and the firm’s ability to treat consumers fairly.

[4] After the CoFI Bill was reported back from select committee, targeted consultation was carried out on whether change in control provisions should be included in the Bill. The option was not pursued at the time as this would have delayed the passage of the CoFI Act.

Problem/opportunity

94. The current approach limits the FMA's ability to scrutinise the impacts of a change in ownership of a licensed firm on consumers before it takes place. A change in control can affect the treatment of customers and consumer outcomes by fundamentally changing the governance and operation of the licensed firm. A new owner may (for example) prioritise financial gain over the interests of existing customers.[5] As the FMA only has the ability to scrutinise a change in control after the fact, it may not be able to consider or place conditions on a sale to support the interests of customers.

Option E1: Introduce change in control approval requirements

95. Option E1 is to introduce a change in control approval requirement for FMC Act licensed firms similar to that which applies to prudentially licensed financial institutions:
    a. The thresholds for requiring approval would be aligned to prudential legislation, so that (for dual-regulated firms) approval of a transaction is required in the same circumstances when a prudential approval is required.
    b. The requirement to obtain approval would apply to the proposed new controlling owner (the purchaser or acquirer).
    c. To avoid imposing unnecessary compliance costs on firms, we also propose that (for dual-regulated firms) the FMA would coordinate with the RBNZ in conducting any assessment and may be able to rely on a joint request for information or rely on RBNZ assessments of an application (which could be linked to Option D1 above).

96. We expect the FMA would conduct this assessment against the licensing criteria in the FMC Act, including whether the change in control would affect the licensed firm's capability to effectively perform the licensed services, and whether there is any reason to believe that post-transaction the firm is likely to breach its market services licensee obligations.

97. As noted above at paragraph 92, the FMA already expects licensed firms to engage with it prior to a change in control. However, a formal requirement to obtain FMA approval would provide certainty and clarity for purchasers, licensed firms and consumers regarding expectations, particularly if the requirement aligns with the RBNZ's prudential assessment for dual-regulated firms. Purchasers would have transparency regarding the process and would have the opportunity to open a dialogue with the FMA (including taking steps to address any concerns) prior to the transaction taking place (as opposed to licensed firms having licence conditions varied, or in rare cases their licences suspended or cancelled, after the transaction has already happened).

98. A conduct assessment would enable the FMA to assess the impact a change in control may have on the firm's ability to effectively perform its licensed functions, as well as how the business and operating models proposed for the firm after the change will continue to meet conduct regulatory requirements.

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[5] See the Finance and Expenditure Committee's report into the petition of Andrew Body regarding the protection of the interests of AMP Life's policyholders (April 2021): ***https://selectcommittees.parliament.nz/view/SelectCommitteeReport/6a5de7a0-e3e7-46b1-a2ec-fd97e3e84aeb***

99. The introduction of change in control provisions under the FMC Act is also consistent with existing provisions under prudential legislation, creating alignment between the twin peaks and addressing the current gap in the regulatory settings which may impede the FMA's ability to act as an effective and proportionate regulator.

100. On the other hand, the addition of a change in control approval requirement for the FMA would carry compliance costs for the parties involved in the transaction and regulators. There may be direct costs for purchasers associated with applying for consent, in addition to opportunity costs and business costs caused by the uncertainty of waiting for approval.

101. For firms who are also prudentially regulated, it is expected that costs would not materially increase from the status quo where prudential approval is already required. As noted above, while the conduct and prudential assessments have different focuses, we anticipate that the FMA would work together with the RBNZ to ensure that dual assessments are carried out in a streamlined manner that avoids duplication of effort for the regulators and applicants for approval.

102. This option could apply only to firms licensed to act as a financial institution (the new market service introduced by the CoFI Act) or to all firms licensed under Part 6 of the FMC Act. Limiting the option to only financial institutions would mean that the FMA would continue to have limited ability to scrutinise changes of control of other licensed firms.

22.	Should change in control approval requirements be introduced into the FMC Act? Please explain your answer, including why the current approach does or does not work.
23.	Should change in control approval requirements apply only to firms licensed to act as financial institutions, or to all firms licensed under Part 6 of the FMC Act? Why?
24.	Do you have any other feedback on the change in control requirements option?

On-site inspection powers

Status quo

103. The FMA does not currently have the power to conduct on-site inspections, other than for Anti-Money Laundering and Countering Financing of Terrorism Act 2009 (AML/CFT Act) purposes.[6] The FMA can otherwise only carry out on-site inspections of regulated firms with consent, require specified information by written notice, or use search powers on the basis of a court-ordered warrant.

104. On-site inspection powers allow regulators to independently verify compliance with regulatory requirements and promote compliance. In very limited circumstances it may be necessary for regulators to conduct such inspections without notice at reasonable times. The absence of a consent or notice provision allows the regulator sufficient flexibility to turn up and inspect when

[6] Consultation was previously undertaken on a general on-site inspection power for the FMA, including as part of the Reserve Bank Act review in 2021. It was not progressed at that time due to the lack of a suitable legislative vehicle.

urgency may be required, or where advance notice would 'tip off' the entity and lead to a risk that information will be destroyed or records altered.

105. The RBNZ has recently been granted the power to undertake on-site inspections of deposit takers without notice under subpart 2 of Part 4 of the DTA following the Reserve Bank Act review. The power must be exercised at a reasonable time and in a reasonable manner consistent with the purpose of the power. Similar powers in relation to insurers are being considered through the review of IPSA.

106. Such powers are consistent with standard international expectations for financial markets conduct regulators like the FMA. International standards for securities regulation are set by the International Organization of Securities Commissions (IOSCO). IOSCO's principles require that conduct regulators have the power to carry out inspections of regulated entities on their premises without prior notice, when appropriate to verify compliance with regulatory requirements. Other international conduct regulators have the ability to carry out inspections on-site without prior notice (eg in Australia, the UK, Canada, the USA and Singapore).

Problem/opportunity

107. The FMA's inability to carry out an on-site inspection without notice may limit it from proactively monitoring compliance in circumstances where requiring consent or giving notice would result in a markedly different picture of compliance. For example, assessing firms registered on the Financial Services Provider Register (FSPR) where it is suspected they may not have a real place of business in New Zealand; in some instances, firms have been known to "rent a crowd" to give the impression of having real staff.

108. It may also cause delays in the FMA being able to understand issues and work with firms on addressing them, which in turn creates risks for consumers. For example, if the FMA has concerns about the financial health of a firm that is raising money from consumers, and the firm does not cooperate in arranging a visit, the FMA may instead need to rely on broad information requests. Waiting for the firm to respond may take a lengthy amount of time (during which the firm can continue to raise money). An on-site inspection power would enable the FMA to ascertain the firm's financial health quickly.

109. The lack of alignment with equivalent RBNZ powers may undermine coordinated and efficient supervision and monitoring by the twin peaks regulators (eg joint on-site visits where appropriate). The status quo does not align with international expectations and good practice, which risks reputational harm to New Zealand's financial markets.

110. The FMA's predecessor (the Securities Commission) had an equivalent power; when the FMA Act was drafted it was understood that this power had been covered by the information gathering powers in section 25 of the FMA Act, but court decisions have subsequently clarified that this is not the case.

Option E2: Introduce on-site inspection powers for the FMA

111. This option would give the FMA the power to conduct on-site inspections without consent or notice for the purpose of carrying out market conduct supervision of firms, including to verify

that firms have adequate policies, procedures and controls, and are complying with regulatory requirements. It would enable the FMA to:

a. obtain independent verification that firms have adequate policies and procedures, and are complying with regulatory requirements (including providing reliable information)
b. obtain any additional information and request copies of documents as appropriate, including a proper understanding of the operations of the firms, and the firms' risks and how they are managed
c. monitor how firms are addressing any risks and instances of non-compliance.

112. On-site inspections powers are by nature intrusive. They should be designed consistent with New Zealand's legal and constitutional principles. They typically require strong justification and careful design to ensure they balance rights and freedoms. In particular, any on-site inspection power would need to:
    a. identify the purpose clearly
    b. state who the power applies to
    c. be clear about the protection of information and confidentiality
    d. consider relationships with other supervisory powers, such as powers of inspection that require warrants
    e. specify if information gained through an inspection can be used for a different purpose, and shared with a different body.

113. Chapter 12 of the Legislation Guidelines of the Legislation Design and Advisory Committee[7] states that warrantless inspections without notice may be suitable for a regulatory regime if it can be established that this is an effective way of ensuring that regulatory requirements are being adhered to. However, "regardless of the content, all search powers must be proportionate to their objectives and all searches must be carried out by properly authorised and trained officers".

114. Appropriate safeguards would be put in place, consistent with the equivalent RBNZ powers and the FMA's powers under the AML/CFT Act. These would balance this proposed power with the rights and freedoms of firms. The power would not function as a 'search and seizure' power. We are interested in your views on what safeguards are appropriate, and expect these would include:
    a. only being able to exercise the power at a reasonable time and in a reasonable manner consistent with the purpose of the power
    b. exclusions for inspections of private dwellings and marae
    c. the authorisation or approval of persons carrying out inspections (and these persons being well-trained and having requisite expertise)
    d. confidentiality protections for information gained from inspection.

115. The vast majority of on-site inspections would still be carried out with notice and the firm's consent (eg through arranging an appointment with the firm's staff). However, the ability to conduct an on-site inspection without prior notice would ensure that the FMA has sufficient

[7] Available here: ***https://www.ldac.org.nz/guidelines/legislation-guidelines-2021-edition/new-powers-and-entities-2/chapter-21/***

flexibility to turn up and inspect in appropriate cases, eg where there is reason to suspect that giving notice will result in a different picture of compliance.

116. The FMA regulates a broad range of entities which raise different types of risks. The option could apply only to certain firms or in certain circumstances. Limiting the option to only licensed firms under Part 6 of the FMC Act (as opposed to all firms regulated by the FMA as financial markets participants) could result in not seeing the same benefits for the financial markets system (and would not enable the power to be used in the example scenario in paragraph 107 above), but would still enable coordinated supervision between regulators. Alternatively, the option could be limited to high-risk circumstances (given that unlicensed firms may in some instances raise greater conduct risks). We welcome feedback on this.

117. Assessing this option against the criteria, it would provide the FMA with a supervisory tool that is an alternative to seeking consent to a monitoring visit or sending multiple written notices requiring information, and in that sense is proportionate to the risk of harm. It would also enhance the twin peaks regulatory model by ensuring the FMA's powers are consistent with those of the RBNZ. Under the status quo, the FMA would need to seek consent in order to conduct a joint monitoring inspection with the RBNZ, which may lead to inefficiencies for both the regulators and firms.

118. This option would provide a deterrent for misconduct and help ensure ongoing and consistent compliance by encouraging firms to maintain high standards, which would in turn help maintain public confidence in the regulated sector and the regulator.

119. On the other hand, this option may increase compliance costs for some firms, as the FMA may exercise on-site inspection powers in circumstances where they previously had no ability to compel a firm to agree to an inspection. Our view is that only a small number of firms are likely to be directly affected. However, we acknowledge that some firms may consider they need processes and training in place to respond to the potential for an on-site inspection without notice.

120. In practice, the majority of firms (whether they are licensed or not) are already subject to a broad on-site inspection power available to the FMA under the AML/CFT Act, and/or consent to FMA monitoring visits. It is therefore unlikely in practice that most firms will experience any additional compliance costs.

25.	Should the FMA have the ability to conduct on-site inspections without notice? Please explain your answer, including why the current approach does or does not work.
26.	Should an on-site inspection power apply only certain firms or in certain circumstances, e.g. to firms licensed under Part 6 of the FMC Act, or to all firms regulated as financial markets participants? Why?
27.	What safeguards should be in place for on-site inspections without notice?
28.	Do you have any other feedback on the on-site inspection option?

Expert report powers

Status quo

121. The FMA currently holds a number of general information gathering powers, which allow the FMA to request information from a regulated firm in specific circumstances and allow it to make directions and obtain enforceable undertakings. However, the FMA does not have the ability to require a report completed by a suitably qualified person or entity approved by the regulator. This would be a diagnostic and monitoring tool used to inform further action by the regulated firm or by the FMA.

122. The RBNZ holds this type of power under various pieces of legislation (eg section 95 of the Banking (Prudential Supervision) Act 1989 and section 101 of the DTA), and it has also been adopted internationally (eg in the UK and in Australia).

Problem/opportunity

123. In order to use its regulatory tools effectively, the FMA needs to know what information to ask for, when to ask for it and how to interpret the information and draw reasonable conclusions from it. The ability to require an independent expert report would allow the FMA to exercise its powers more effectively by giving the FMA access to more technical knowledge or expertise than its staff currently have (eg technical accounting expertise, cybersecurity assurance, IT audits).

124. In the past, the FMA has asked firms to obtain these types of reports voluntarily. While firms generally cooperate with these requests, the reports provided may not always be fit for purpose (eg due to inadequate instructions or information being provided by the firm), which can result in further delays and costs. The FMA has also used its direction powers to compel a report or require firms to obtain a report as part of an action plan. However, these reports cannot be used for diagnostic and monitoring purposes given they are obtained in response to non-compliance.

Option E3: Introduce an expert report power for the FMA

125. This option would give the FMA the power to require firms to provide a report completed by a suitably qualified person or entity approved by the FMA. The power could provide (aligning with the RBNZ's powers):
    a. that the report may be on any matters relating to the business, operation or management of the firm or an associated person of the firm
    b. that the firm and associated persons are required to supply information relevant to the report
    c. that the FMA may require the report to be published (whether in whole or in part)
    d. that a contravention of these requirements without a reasonable excuse is a fineable offence
    e. that the firm may be required to obtain an audit or review of the report, which must be carried out by an auditor or other person approved by the FMA
    f. that the cost of the report would be borne by the firm concerned.

126. Again, this option could apply only to firms licensed under Part 6 of the FMC Act, or to all firms regulated as financial markets participants. Limiting the option to only licensed firms could

result in not seeing the same benefits for the financial markets system, but would result in lower total compliance costs for the market. We welcome feedback on this.

127. Assessing this option against the criteria, it would help the FMA gather intelligence to support a proportionate, risk-based and outcomes-focused approach to regulation, providing information to help the FMA better target the appropriate use of its powers and regulatory resources. Including a specific power in legislation adds certainty over the status quo, by making it a formal part of the FMA's regulatory toolkit and enabling firms to understand the role a report would play in FMA monitoring and supervision.

128. The FMA is only likely to commission an expert report in response to an identified concern or issue. Depending on the findings of the report, the FMA could decide to take further regulatory action if warranted. Alternatively, a firm may be able to act on recommendations in the report to resolve the concern without requiring further intervention from the FMA. This could be more proportionate than an 'enforcement first' approach and give firms the chance to remediate the issues. For example, in the UK, we understand it is uncommon for these types of reviews to be followed by enforcement action.

129. The proposal is likely to promote fair treatment of consumers and good conduct in financial markets because it would:
    a. allow FMA to diagnose concerns and support the capability of providers
    b. improve FMA's access to technical expertise and independent opinions
    c. help ensure adequate remediation and redress.

130. An expert report power could be particularly helpful in providing advice or opinions on compliance with CoFI's fair conduct principle. An expert may be well-placed to identify weaknesses and risks which may be cultural within an organisation, due to its ethos and leadership, which may not be captured by documented systems or processes.

131. Option E3 is likely to create compliance costs for firms where the power is used, including the cost of the expert and of addressing any recommendations. However, it may also mitigate unnecessary compliance costs to some extent. For example, if the FMA is not fully aware of the scope of an issue at the time it identifies non-compliance, more widespread or systemic issues may be missed at first instance, leading to longer and more drawn-out investigations. An expert could help properly identify the extent of any misconduct at the outset.

29.	Should the FMA have the ability to commission expert reports? Please explain your answer, including why the current approach does or does not work.
30.	Should an expert report power apply only to firms licensed under Part 6 of the FMC Act, or to all firms regulated as financial markets participants? Why?
31.	What safeguards should there be for an expert report power?
32.	Is it appropriate that the firm concerned bear the cost of the expert report? Why / why not?
33.	Do you have any other comments on the expert report power option?

3: Limitations and constraints on analysis

132. This discussion document was prepared under time constraints which only allowed for limited consultation. The Minister of Commerce and Consumer Affairs has met with a number of industry representatives to discuss issues related to financial services regulation and a possible package of reforms. MBIE has carried out targeted consultation with the FMA, the RBNZ, Treasury and the Commerce Commission but has not consulted industry stakeholders in the development of this discussion document. This document functions as part of our consultation to inform policy decisions.

133. In relation to Part 1 of this discussion document, because the CoFI Act is not yet in force, it is difficult to provide evidence with a high degree of certainty about how the regime is likely to operate or the costs it will impose. The options and analysis presented in this report are largely based on qualitative evidence of expected issues with the regime based on limited stakeholder engagement with industry as financial institutions develop their fair conduct programmes. In addition, we have considered qualitative feedback from a small number of submitters provided during the original consultation on the CoFI regime.

134. Given the objectives of the review, Part 1 of this discussion document considered only the options which would simplify or clarify the existing CoFI Act. It did not consider reworking or overhauling the key fundamental features of the CoFI Act, as this is not the aim of the review.

34.	Are there any other areas and options for change that we should consider that have not been addressed in this discussion document?

4: Implementation

135. The CoFI Act will come into force on 31 March 2025. This means financial institutions will be required to comply with the obligations of the CoFI Act from this date, and to apply for and receive a separate financial institution licence under the CoFI Act by this date.

136. Subject to Cabinet approvals, the amendment bill to implement options proposed in this discussion document is intended to be introduced to Parliament by December 2024. Taking into account time to progress through select committee and House stages, we expect the amendment bill to be passed no earlier than Q3 2025, and the obligations under it would likely commence in 2026 at the earliest.

137. We understand that many financial institutions are already well-progressed in preparing for the introduction of the CoFI regime. This includes developing their fair conduct programmes, and applying for, or preparing to apply for, a CoFI licence, in advance of the regime's commencement date and based on current legislative requirements. The Government has encouraged financial institutions to continue to prepare for the introduction of the regime, notwithstanding the announcement of the review.

138. We acknowledge that this timetable means financial institutions will need to comply with the current legislation (without amendments) until the amendment bill is passed and the obligations under it commence in around 2026. This may result in additional costs for financial institutions to review, and if necessary, adjust, their fair conduct programmes later to respond to any changes made through the amendment bill.

139. This risk can be mitigated with clear and proactive communication. Officials will work with stakeholders to ensure that stakeholders are aware of:
    a. the importance of continuing with implementation work and licence applications in preparation for the regime commencing on 31 March 2025
    b. the proposed timeline for the amendment bill.

140. This risk is also mitigated by the fact that the objective of the review is to ensure the requirements of the CoFI regime are streamlined and made more flexible. The intention is to allow financial institutions to have more freedom to tailor their fair conduct programmes in a manner that suits their own business on an ongoing basis. Therefore, although there may be some one-off costs involved relating to the need to review and adjust programmes in response to changes, these changes may reduce compliance burden and costs on an ongoing basis.

35.	Do you have any comments on implementation of these reforms?