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Ministry of Business, Innovation & Employment

FROM Privacy of natural persons

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DATE 19 June 2024

Submissions in response to Fit for Purpose Financial Services Conduct Regulation discussion document

1. This submission has been prepared by Bell Gully in response to the "Fit for Purpose Financial Services Conduct Regulation" discussion document of May 2024 (the **Discussion Document**).

2. We have significant expertise and experience in the law relating to the regulation of financial markets and welcome the opportunity to make submissions on the Discussion Document. We have been closely involved with the Financial Markets (Conduct of Institutions) Act 2022 (**CoFI Act**) since inception, having already made submissions on:

   (a) MBIE's April 2019 Conduct of Financial Institutions Options Paper;

   (b) the initial draft of the Financial Markets (Conduct of Institutions) Amendment Bill that was introduced to Parliament;

   (c) the discussion documents on regulations to support the new regime for the conduct of financial institutions and the treatment of intermediaries under the new regime for the conduct of financial institutions that were released by MBIE in April 2021; and

   (d) the Financial Market Authority's (**FMA's**) consultation on proposed fair outcomes for consumers and markets dated November 2023.

3. The matters addressed in this submission reflect our experience in advising on financial regulatory matters in New Zealand, our experience with financial regulatory regimes overseas, and the feedback we have received from international firms with whom we work.

4. We do not propose to comment on every question identified in the Discussion Document. Instead, our focus has been on specific aspects of the CoFI Act and CoFI regime (see Options A to C of the Discussion Document) and the proposals to expand the FMA's powers (see Option E of the Discussion Document).

5. In general terms, we support much of the thinking that sits behind the Government's reassessment of the CoFI regime and the general move towards simplifying and minimising the compliance burden without compromising fair customer outcomes. However, we are concerned that significant expansions to the FMA's powers have been proposed without a sufficiently prominent notification of the proposals or a sufficient timeframe for meaningful consultation.

6. In our view, proposals that the FMA be given power to approve changes of control, conduct onsite inspections without notice and demand skilled persons reports require a dedicated consultation process over a longer timeframe in order to support appropriate regulatory design. We also question the necessity of these new powers, particularly at a time of significant regulatory change and uncertainty.

7. Against that background, we set out our views on the questions posed in the Discussion Document in the **enclosed** schedule.

8. Many of the questions in the Discussion Document also raise issues of operational detail and practical impact on which we expect regulated entities to have developed insights. We encourage MBIE to give careful consideration to their feedback.

9. The views expressed in the submission are those members of our firm involved in the review of the Discussion Document: Blair Keown, Richard Massey, Katie Dow, Adam Conti and Kate Crichton. They do not necessarily represent the views of our clients.

Yours faithfully
Bell Gully

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Blair Keown / Richard Massey / Katie Dow / Adam Conti / Kate Crichton
Partner / Partner / Special Counsel / Senior Associate / Lawyer

Schedule

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

1. We agree with the criteria identified in the Discussion Document.

2. Given that Section E of the Discussion Document – "Ensuring the FMA has effective tools" – raises questions about the persons to whom certain proposals should apply, it may be appropriate to consider an additional criterion: whether the proposals promote an even playing field between financial service and product providers.

1: OPTIONS FOR COFI ACT REFORM
A. Options for amending minimum requirements for fair conduct programmes
Option A1: Remove / amend some minimum requirements for fair conduct programmes
Question 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. We agree that some of the minimum requirements can be removed and/or amended in order to strip out unnecessary duplication. We therefore support many (but not necessarily all) of the changes proposed at paragraph 30 of the Discussion Document.

4. In summary:

   (a) Paragraph (a) (enabling the institution to meet its legal obligations to consumers) has always stood out as an unhelpfully vague requirement and we support its removal.

   (b) Care may be required in respect of the wholesale removal of paragraph (c)(i) to (iii) (identifying, monitoring, and managing conduct risks) if the government's intention is that "in most circumstances equivalent requirements will still be needed in fair conduct programmes".[1] We would also be concerned if the removal of paragraph (c)(i) to (iii) from the legislation was to be wrongly interpreted as eliminating the ability to adopt a risk-based approach as a necessary component of a fair conduct programme.

   (c) We agree that paragraph (e) could be retained as it relates to agents but removed as it relates to employees (on the basis that paragraphs (f) to (h) contain more prescriptive requirements for employees). We also agree that paragraphs (f) to (h) can be further consolidated into a set of high-level requirements which provide institutions with a greater degree of latitude to decide how they will best ensure that relevant employees meet the fair conduct principle.

[1] See paragraph 30(b) of the Discussion Document.

(d) We agree that paragraph (k) (reviewing the effectiveness of the programme) duplicates the overriding requirement that financial institutions "establish, implement, and maintain effective fair conduct programmes" and we support its removal.

Question 3
Which requirements should be removed or amended, if any? Please explain what changes you would like to be made

5. Please see our response to question 2 above.

Question 4
What would be the impact of removing or amending particular requirements (for example, on compliance costs for businesses)?

6. Please see our response to question 2 above.

7. We expect that the removal of duplicative requirements and the simplification of other prescriptive standards will reduce uncertainty. The elimination of unnecessary prescription may also enable institutions to develop policies, processes, systems and controls that more directly respond to their activities and the specific conduct risks they present.

Question 5
Do you have any other comments on the minimum requirements for fair conduct programmes?

8. We repeat our comments at question 2 above.

Option A2: Potential additions to minimum requirements for fair conduct programmes
Question 6
What are the advantages and disadvantages of adding an express minimum requirement for fair conduct programmes relating to fees and charges?

9. We do not support an express minimum requirement for fair conduct programmes relating to applying, disclosing, and reviewing fees and charges.

10. In summary:

(a) A requirement relating to the disclosure of fees and charges is unnecessary because it is already addressed by the minimum requirement at paragraph (j) (i.e. "communicating with consumers about the financial institution's relevant services or associated products in a timely, clear, concise, and effective manner").

(b) A requirement relating to the application and review of fees and charges implies that the FMA could intervene in substantive questions of pricing and value despite there being no general statutory limitations on pricing that an institution can impose for its services. This would be a significant expansion of New Zealand's existing regulatory settings without a clear legal basis.

(c) To date, the FMA has confined its scrutiny of value for money to the KiwiSaver and managed investment schemes sector as well as examining how providers communicate with customers in relation to poor value products. This scrutiny has had an obvious statutory basis (e.g. KiwiSaver Act 2006, part 4 subpart 2 and part 2 of the Financial Markets Conduct Act (**FMCA**)). In our view, a broader remit to examine pricing and value would require a similar statutory mandate.

(d) Pricing and value are not easy concepts to regulate, particularly in the absence of a detailed underlying legal regime. The United Kingdom's ongoing attempts to address value for money in the pensions industry illustrates the complexity of the issue, the difficulties in reliably assessing whether consumers are receiving value for money, and the need for primary legislation to facilitate effective regulation.

Question 7
What are the advantages and disadvantages of adding an express minimum requirement for fair conduct programmes relating to complaints processes?

11. It is unclear what an express minimum requirement relating to "recording and resolving" consumer complaints would add to existing regulatory requirements. In particular:

(a) Section 446H of the FMCA already requires financial institutions to publish information to enable consumers to understand how to make a complaint about relevant services and associated products;

(b) The minimum requirement at s 446J(1)(j) already deals with "communicating with consumers about the financial institution's relevant services or associated products in a timely, clear, concise, and effective manner"; and

(c) Financial institutions are also required to be members of a dispute resolution scheme under the Financial Service Providers (Registration and Dispute Resolution) Act 2008 and handle complaints in accordance with the rules of the relevant scheme.

Question 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?

12. Please see our responses to questions 6 and 7.

Option A3: Remove all minimum requirements for fair conduct programmes
Question 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?

13. Removing all of the minimum requirements for fair conduct programmes might introduce uncertainty into the CoFI regime by removing the criteria that institutions have been relying on as a baseline for compliance without providing any replacement requirements.

14. It is also unclear how the removal of all minimum requirements could practically occur given that any legislation to do so will not be passed until after the CoFI regime (and the existing minimum requirements have come into force).

Option A4: Retain minimum requirements for fair conduct programmes without change
Question 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?

15. Please see our response to question 2 above.

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

16. Please see our response to question 2 above.

B. Options for amending fair conduct principle
Option B1: Keep the fair conduct principle open-ended
Option B2: Make the fair conduct principle definition exhaustive
Proposal: proceed with Option B1 (retain status quo)
Question 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?

17. In our view, there is little difference between an open-ended and an exhaustive formulation of the fair conduct principle. The proper content of the fair conduct principle will necessarily be informed (and constrained) by the existing non-exhaustive matters at s 446C(2) and it will be difficult to argue that fairness requires something that contradicts or is inconsistent with those matters. In these circumstances, the interests of certainty might favour the fair conduct principle being defined in exhaustive terms.

Question 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?

18. Please see our response to question 12 above.

Question 14
Do you have any other suggestions or comments in relation to the fair conduct principle?

19. Please see our response to question 12 above.

Question 15
Do you have any comments in relation to other areas of the CoFI Act that have not been covered in this section?

The fair conduct programme requirements should not be civil liability provisions

20. We suggest that the duties at sections 446G, 446H and 446I should not be civil liability provisions so that a breach of those duties does not expose the institution to pecuniary penalties (or other enforcement consequences).

21. Unlike other civil liability provisions, the requirements of a fair conduct programme and sections 446G, 446H and 446I are inherently contestable. In that context, a financial institution should not be exposed to pecuniary penalties for exercising a good faith judgment because the FMA may disagree with that judgment and/or persuade a Court that the FMA's view is to be preferred.

22. It is also unclear how the pecuniary penalty provisions would apply to breaches of these duties. Under the FMCA, the maximum pecuniary penalty in any case is the greater of the consideration for the transaction that constituted the contravention (if any); 3 times the amount of the gain made, or the loss avoided, by the person who contravened the civil liability provision; and $5 million.[2] We would be highly concerned if a financial institution was to be exposed to a potentially swingeing penalty because of an artificial view of the gains or avoided losses that can somehow be connected to an inadequate fair conduct programme.

23. In our view, sections 446H and 446I may be more effectively policed and enforced via the market services licence and the FMA's ability to amend, vary or add to licensing conditions as part of that licence.

The CoFI regime should not be enforceable by private persons

24. The creation of new statutory duties carries a risk of civil claims being brought for apparent breaches of those duties (e.g. claims for a declaration of contravention and/or a compensatory order (if those duties are civil liability provisions) and more novel common-law based claims (if those duties are not).

25. In our view, allowing any private law claims (particularly in the early stages of a new conduct regulation regime) carries a number of risks. Principles-based regulation is necessarily uncertain and often exists to deal with situations not specifically envisaged by detailed rules. In this context, those subject to the new regime could be faced with (unmeritorious) class action claims, multiple one-off claims, and potentially inconsistent tribunal and court decisions arising out of unfamiliar and deliberately imprecise regulatory requirements.

26. Unlike the FMA, individual litigants are not bound by statutory objectives, a model litigant policy or an enforcement guide. An individual litigant also tends to focus on the specific facts of its own case (and the particular effects that it has suffered). The FMA necessarily adopts a broader view of the cases that come before it. Private claims could therefore distort the intended scope of the regulatory regime.

27. In these circumstances, we suggest that the CoFI Act should be amended to provide that the "fair conduct principle" and the duties at sections 446G, 446H, 446I, 446J and 446K of the FMCA do not create duties that are actionable at the suit of anyone other than the FMA.

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2 s 490, FMCA.

That is effectively the position in the United Kingdom, where there is no right of private action for breach of the FCA's principles for business (as distinct from other regulatory rules).

28. On this approach, the FMA would be permitted to take action against financial institutions and their intermediaries for breaches of these duties (although see our comments above about s 446G, 446H and 446I not being civil liability provisions). The necessity of permitting private law claims can be reviewed after the conduct regulation regime has been implemented, given time to operate, and is broadly understood in practice.

Publishing a summary of a fair conduct programme may not serve a useful purpose

29. The existing requirement that financial institutions publish a summary of key matters about the fair conduct programme (see s 446H of the FMCA) is already a significant improvement from the broader publication requirements that were first tabled in Parliament. However, it is worth testing whether even the existing requirement to publish a summary is necessary.

30. We acknowledge that consumers may benefit from a public statement that enables them to understand how to make a complaint about a financial institution's relevant services and associated products (see s 446H(2)(a)(iii)). However, we otherwise question the practical benefit in a broader requirement that an institution publish and maintain at all reasonable times a summary of its fair conduct programme. In summary:

    (a) A "fair conduct programme" is unlikely to comprise a single document and will likely rely on a number of policies, processes, systems, and controls that are not designed to be readily understood by consumers such that any summary may not be helpful information for them.

    (b) There may also be significant variation in the information published across financial institutions which may limit a consumer's ability to draw meaningful comparisons between service and product providers. To our knowledge, no comparable financial regulatory regime in any other jurisdiction requires such material to be publicly available.

    (c) A "fair conduct programme" will be a living document that is subject to constant change. In these circumstances, a requirement to maintain a summary of the product at all reasonable times could translate into an onerous requirement to continuously review the summary to make sure that no aspect of it becomes incorrect or outdated due to a change of a process, policy, system or control.

31. As above, we expect customers may be more interested in the complaints process and the steps that are available to them in the event that they do not consider they have been treated fairly. We note that MBIE had previously consulted on a proposal for financial institutions to publish a summary of the process for making a complaint or, at a minimum, the contact details to make a complaint.

32. In our view, that could be the full extent of the duty to publish information about a fair conduct programme. This would be consistent with the Financial Service Providers (Registration and Dispute Resolution) Act 2008 which already requires financial service providers to be a member of an approved dispute resolutions scheme and for the rules of the scheme to be publicly available.

2. OPTIONS FOR REGULATORY FRAMEWORK AND POWERS
C. Consolidating financial market conduct licences
Option C1: Amend the FMC Act to require the FMA to issue a single licence covering different classes of market service
Question 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?

33. We support the proposal for the FMA to issue a single conduct licence across market services.

34. In principle, consolidation and simplification of separate licences should result in the lightening of unnecessary compliance burden on market participants over the long term. However, whether it will in practice (and if so, to what extent) remains to be seen and will be dependent on both the particulars of a new consolidated licencing process and the FMA's approach to ongoing supervision of licensees.

35. In consolidating licences, care should be taken to ensure that, to the extent possible, licence conditions for different market services are not duplicated or conflicting (for example, between Financial Advice Provider and CoFI licences), and reporting and information gathering requirements for those different market services are simplified. Doing so should streamline and reduce licensees' compliance burden over the long term.

36. Paragraph 73(d) of the Discussion Document proposes that as part of the implementation of the licence consolidation, the current FMCA provisions enabling variation, suspension or cancellation of licences would continue to apply, with the ability to exercise these in relation to particular market services. Whilst that approach is appropriate, we consider that the FMA should ensure that 'cross-contamination' does not occur; that is, a breach of one licence condition for a particular market service should not affect the licence insofar as it relates to another market service (or to the consolidated licence as a whole). We submit that this should be clarified in the governing legislation.

37. Given the commencement date of the CoFI regime, we welcome the indication at paragraph 73(e) of the Discussion Document that licensing consolidation will not take place until after the initial CoFI licensing process is complete. We agree that approach is appropriate to prevent further uncertainty, costs and delay.

Question 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.

38. Please see our response to question 16 above, particularly in relation to cross-contamination.

Question 18
Are there any other matters that should be considered around market services conduct licensing?

39. Please see our response to question 16 above.

D. Enabling reliance on another regulator's assessment
Option D1: Amend legislation to enable the FMA and RBNZ to rely on an assessment by the other regulator where appropriate
Question 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.

40. n/a

Question 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.

41. n/a

Question 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?

42. n/a

E. Ensuring the FMA has effective tools
Option E1: Introduce change in control approval requirements
Question 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.

<u>General observations</u>

43. Option E of the Discussion Document proposes significant expansions to the existing powers of the FMA (e.g. approval of changes of control, onsite inspection powers, and skilled persons reports).

44. Given the significance of these proposed powers, we would have expected them to be the subject of a standalone consultation that clearly drew attention to the proposed changes and allowed a reasonable time frame for submissions. However, that has not occurred.

45. Rather:

(a) the public announcement of the consultation process did not say anything about the possibility of an expansion to the FMA's powers. An expansion in the FMA's powers was noticeably absent from the list of possible phase 1 and 2 reforms that were set out in the announcement;[3]

(b) the existing proposals for expanding the FMA's powers have been included at the very back of the Discussion Document;

(c) the overriding focus of the Discussion Document are proposals that have a fundamentally different character (i.e. adjustments to the Financial Services (Conduct of Institutions) Amendment Act and the CoFI regime);

(d) the website hosting the Discussion Document describes the purpose of the proposed reforms in terms that do not in any way reflect the possibility of expanded FMA powers (i.e. "simplifying the regulation of financial services", "removing undue compliance costs for financial markets participants" and "promoting fair, efficient and transparent financial markets to improve outcomes for consumers."[4]); and

(e) respondents have been given four weeks to express their views (assuming they identify the proposals and their significance in the first place).

46. We are concerned that the consultation process does not adequately reflect the significance and potential impact of the proposed expansions to the FMA's powers. As a result, there is a real risk that wide-ranging and potentially intrusive powers will be implemented without meaningful public and industry scrutiny.

47. We also question the necessity of suddenly expanding the FMA's powers at a time when the industry is already adapting to a dramatically different and rapidly changing regulatory landscape. For example:

(a) banks, insurers, non-bank deposit takers and their intermediaries are all adjusting to COFI regime and the imminent application of a conduct regulation regime that has never existed in New Zealand and may change shortly after implementation (given the Discussion Document's indication that legislation reflecting the current consultation will not occur until after the CoFI regime comes into force);

(b) responsibility for the Credit Contracts and Consumer Finance Act 2003 (**CCCFA**) is shifting to a new regulator and the government is considering changes to the requirements of the CCCFA and responsible lending code;

(c) the FMA is currently consulting on the adoption of a "fair outcomes" approach to regulation; and

(d) the Government is also considering the possibility of FMA licensing for those that act as a creditor under a consumer credit contract. This has the potential to bring a

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3 https://www.mbie.govt.nz/about/news/government-announces-package-of-financial-services-reforms

4 See https://www.mbie.govt.nz/business-and-employment/business/financial-markets-regulation/2024-financial-services-reforms/fit-for-purpose-financial-services-conduct-regulation-summary-of-discussion-document

significant population of persons within the scope of direct FMA regulation for the very first time.

48. As a result, we suggest that now may not be the appropriate time to provide the FMA with further intrusive powers. We also suggest that the necessity for each proposed power be carefully tested against its intended purpose and the available evidence.

Specific observations

49. We question the merits of introducing a FMA change of control process in addition to the existing RBNZ process.

50. The RBNZ change of control process is already complex, time consuming and challenging to navigate. The application of a similar process to licensed entities who have not previously had to navigate the process under the RBNZ is likely to impose a considerable regulatory burden. For dual-regulated firms, the introduction of a parallel FMA process in which an additional regulator applies different criteria to the same proposed transaction will lead to further cost, delay and uncertainty (even noting the proposals for the RBNZ and FMA to rely on each other's assessments of certain matters).

51. We also question the need for such a process in light of the FMA's existing powers. Licensed entities are already required to notify significant changes to the FMA, including changes of control, under the general reporting condition (see r 191(1)(g) of the FMC Regulations). The FMA has the power at any stage to vary, revoke, add to, or substitute any conditions of licence at any time after the licence is issued. The FMA can also impose direction orders and stop orders where necessary to address immediate risks of misconduct.

52. Retaining the status quo would also maintain trans-Tasman comity. Australian financial services licensees and credit licensees are required to notify Australia's conduct regulator, the Australian Securities and Investments Commission (**ASIC**) of relevant changes in control within a certain time period but do not have to pursue a full change of control approval process. As in New Zealand, mandatory notification to ASIC provides the regulator with an opportunity to consider whether it needs to exercise other powers in relation to the licensee.

Question 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?

53. We question the necessity for a FMA change of control process in any form. Please see our response to question 22 above.

Question 24
Do you have any other feedback on the change in control requirements option?

54. Please see our response to question 22 above.

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

General observations

55. Please see our general observations in response to question 22 above.

Specific observations

56. The Discussion Document rightly identifies that on-site inspection powers are intrusive and should be designed consistently with New Zealand's legal and constitutional principles.

57. As the Legislation Design and Advisory Committee has stated:[5]

> **New search powers should be granted only if the policy objective cannot be achieved by other means**. If the information or evidence concerned can be obtained by means other than by granting new search powers (for example, by recourse to the common law, consent, or existing powers), those alternatives should be used. If new search powers are required, the approach that results in the least limitation on privacy rights should be adopted. Search powers should not be granted for the convenience of the agency or ease of prosecution.
>
> [Our emphasis]

58. Against that background, we query the need for such a power to be introduced in New Zealand. Our experience is that the FMA already has an extensive catalogue of powers that enable it to effectively discharge its functions (e.g. direction orders[6], stop orders[7], compulsory requests for information[8]).

59. The FMA's powers already go beyond those of equivalent regulators such as the Commerce Commission. Even the Serious Fraud Office does not have a power to conduct an onsite inspection without a warrant.[9] We are not aware of any tangible instances in which the absence of an onsite inspection power has impeded the FMA's work. We strongly encourage MBIE to rigorously test the justification for any such powers by reference to the available evidence and in light of the constitutional principles outlined above.

60. Contrary to what is stated in the Discussion Document,[10] Australia's conduct regulator does not have the ability to carry out on-site inspections without prior notice. As we understand the position, it is very unusual for ASIC to ever attend on-site without notice. Section 29 of the ASIC Act contains a very limited power of inspection that is limited to the books that a company is required to maintain under the applicable corporations legislation (i.e. it is not an inspection power of the type proposed in the Discussion Document).

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5 Legislation Guidelines: 2021 at Chapter 21.
6 s 468, FMCA.
7 s 462, FMCA.
8 s 25, Financial Markets Authority Act 2011.
9 See Serious Fraud Office Act 1990.
10 See paragraph 106.

61. Even in relation to this power, ASIC has publicly stated that notice would usually be given:[11]

> An inspection (unlike the powers to compel the production of documents) does not require us to issue a written notice. Although we are not required to give prior notice of an inspection, in many cases it will be appropriate and practical for us to make an appointment before conducting an inspection.

62. Trans-Tasman comity would therefore support retention of the status quo.

Question 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?

63. Any onsite inspection power should be confined to the minimum extent required to achieve the purpose it is needed to fulfil. However, please see our response to question 25 above and our view that such a power may not be necessary.

Question 27
What safeguards should be in place for on-site inspections without notice?

64. Please see our response to question 25 above and our view that such a power may not be necessary.

65. Where they can be justified, on-site inspection powers require substantial safeguards to prevent their misuse, limit their intrusion on relevant rights and interest and hold those exercising the power to account. We outline some necessary safeguards below:

    (a) The FMA should only be able to exercise the power at a reasonable time and in a reasonable manner consistent with the purpose of the power.[12]

    (b) The specific purposes for which the power can be exercise should be clearly and exhaustively set out in the empowering legislation to avoid any debate over what they are.

    (c) There should be exclusions for inspections of private dwellings and marae.[13]

    (d) The inspection should be expressly authorised in writing by the Chief Executive of the FMA.[14]

    (e) The delegates conducting the inspection ought to be appropriately trained, qualified and experienced.[15]

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11 See https://asic.gov.au/about-asic/asic-investigations-and-enforcement/asic-s-compulsory-information-gathering-powers/#inspect
12 See for example ss 111 and 112, Deposit Takers Act 2023 (**DTA**).
13 See for example s 133, Anti-Money Laundering and Countering Financing of Terrorism Act 2009 (**AML/CFT Act**) and s 112, DTA.
14 See for example ss 134 to 135, AML/CFT Act.
15 See for example s 134, AML/CFT Act.

(f) The ability of the subject to claim privilege over any material should be expressly preserved.[16]

(g) The FMA should not be permitted to share any information obtained from an on-site inspection with a regulator who does not have an equivalent power.

(h) Prior to commencing the inspection, the FMA should provide the subject of the power with a written notice which clearly sets out (i) the scope of the inspection including the terms and conditions of what the subject is required to do; (ii) the statutory provision(s) relied on by the FMA in exercising the power; (iii) the reasons for exercising the power; (iv) the purpose(s) for which the power is being exercised; and (v) a clear statement of the subject's rights (including to claim privilege and have the exercise of the power reviewed by a Court).

This will help facilitate a degree of review of and accountability for the exercise of the power. Given the comparatively greater degree of intrusion, the notice given by the FMA for an onsite inspection should be more comprehensive and detailed than notices given in connection with the exercise of other coercive powers such as stop orders.[17] A prescribed form of notice could be included as a schedule to the empowering legislation.

(i) The statutory regime could sensibly be supplemented by the FMA publishing and consulting on draft guidelines that publicly state how it intends to exercise the power. Amongst other things, these guidelines should set out the circumstances in which the FMA will look to exercise the power and the matters it will take into account when making that assessment. We suggest that the guidelines emphasise that an onsite inspection is a power of last resort.

Question 28
Do you have any other feedback on the on-site inspection option?

66. We repeat our responses to questions 25 to 27 above.

Option E3: Introduce an expert report power for the FMA
Question 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.

<u>General observations</u>

67. Please see our general observations in response to question 22 above.

<u>Specific observations</u>

68. It is not clear to us that an express power for the FMA to obtain an expert report is needed in New Zealand.

16 See for example s 24, Serious Fraud Office Act 1990 and s 133(5), AML/CFT Act.
17 See for example s 477, FMCA.

69. The FMA already has the ability to engage experts and can use its existing information gathering powers to provide them with the information they may need to perform any necessary diagnostic and monitoring work. Moreover, as the Discussion Document acknowledges[18], firms are also instructing experts and providing their analysis to the FMA on a voluntary basis without a dedicated statutory regime.

70. Trans-Tasman comity similar favours retention of the status quo. Contrary to what is suggested in the Discussion Document[19], Australia's conduct regulator (ASIC) does not have specific expert report powers. As in New Zealand, ASIC has requested licensees to obtain expert reports on a voluntary basis. Where necessary, they have imposed expert report requirements as part of an enforceable undertaking or by way of a licence condition. Both powers are already available to the FMA.

71. It is already open to the FMA to encourage a greater use of expert reports on a voluntary basis. In particular, the FMA could make clear (whether in its enforcement guide or elsewhere) that it will actively consider expert reports as an alternative to issuing s 25 notices and/or taking enforcement entity against a person.

72. For completeness, we do not consider that an expert reporting power would be appropriate for assessing compliance with the CoFI regime. Financial institutions have already invested considerable resources in preparing prepare their fair conduct programmes. In many cases this will have involved the engagement of external experts to provide advice and/or assurance. Requiring a further round of expert engagement would involve unnecessary cost. It might also lead to experts being instructed to "mark the homework" of their competitors.

Question 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?

73. We question the necessity for an expert report power in any form. Please see our response to question 29 above.

Question 31
What safeguards should there be for an expert report power?

74. We question the necessity for an expert report power in any form. Please see our responses to question 29 above.

75. We note that the skilled persons report regime in the United Kingdom has the benefit of specific statutory provisions,[20] a dedicated section in the FCA Handbook,[21] and a panel of skilled persons who have been approved by the FCA.[22]

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18 See paragraph 124.
19 See paragraph 122.
20 See ss 166 and 166A, Financial Services Markets Act 2000.
21 See SUP5.4 to 5.6 and SUP5 Annex 1, FCA Handbook.
22 See https://www.fca.org.uk/publication/documents/skilled-person-panel.pdf

Question 32
Is it appropriate that the firm concerned bear the cost of the expert report? Why / why not?

76. We do not consider it is appropriate for a firm concerned to bear the cost of the expert report other than on a voluntary basis.

77. In summary:

    (a) In practical terms, this would mean the extent of the expert work would be determined by a party that is not paying for the work (i.e. the FMA). That would risk significant scope creep and cost overrun.

    (b) Insofar as expert reports are employed to address limitations in the FMA's technical knowledge or expertise (see paragraphs 123 and 124 of the Discussion Document) that should be a matter for the FMA, not firms, to finance.

    (c) The FMA's existing information gathering powers already expose firms to significant costs. The process of responding to a s 25 notice is already costly and time consuming. The imposition of an expert report requirement on top of this would be particularly burdensome (and underlines how voluntary expert reports could be utilised as an effective alternative to a s 25 notice or ongoing FMA investigation).

    (d) The above concerns would apply with even greater force to any scenario in which a firm was also required to obtain an audit or review of the expert report.[23]

Question 33
Do you have any other comments on the expert report power option?

78. Please see our response to questions 29 to 32 above.

3: LIMITATIONS AND CONSTRAINTS ON ANALYSIS
Question 34
Are there any other areas and options for change that we should consider that have not been addressed in this discussion document?

79. Please see our response to question 22 regarding the adequacy of the consultation process for expansions to the FMA's powers.

[23] See paragraph 125(e) of the Discussion Document.