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Financial Markets
Small Business, Commerce and Consumer Policy
Ministry of Business, Innovation and Employment

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SUBMISSIONS ON FIT FOR PURPOSE FINANCIAL SERVICES CONDUCT REGULATION

Thank you for the opportunity to submit on matters raised in MBIE's *Fit for purpose financial services conduct regulation* discussion document (**Discussion Document**). These submissions are made by Cygnus Law Limited (**Cygnus Law**) on its own behalf.

Simon Papa is the director of Cygnus Law. He has 20 years' experience in corporate and commercial law and has significant experience advising financial services businesses on commercial and compliance matters.

In these submissions we refer to the:

- 9 December 2019 *Regulatory Impact Statement: Regulatory regime to govern the conduct of financial institutions* (**RIS**)
- April 2019 *Conduct of Financial Institutions Options paper* (**Options Paper**)

The submission form, with detailed submissions, is attached as an appendix to this letter. Cygnus Law's introductory comments and submissions are below, and are referred to the submission form.

The Discussion Document relates to the conduct of financial institutions (**CoFI**) law in the Financial Markets (Conduct of Institutions) Amendment Act 2022 that will come into force on 1 April 2025 by way of amendments to the Financial Markets Conduct Act 2013 (**FMC Act**).

INTRODUCTION

Cygnus Law does not concur with the view presented in the Discussion Document that the "overall intent and framework of the CoFI Act is sound". In our view the CoFI regime is:

- not consistent with the problems it was implemented to resolve;
- reflects inadequate policy development;
- undermines fundamental market mechanisms; and
- likely to impose costs of implementing and managing the regime across dozens of financial institutions that will be greater than the value of the benefits it will generate.

Having said that, we recognise that the Government has confirmed that it does not intend to seek repeal of the CoFI regime (as proposed by the National Party during the 2023 election campaign). Rather it proposes to make changes to address some concerns.

We submit that any changes to the CoFI law should have effect from the commencement date of the regime on 31 March 2025. If not, then we submit that the commencement date should be extended to give financial institutions subject to the CoFI regime (**Institutions**) time to comply with updated requirements, to avoid unnecessary costs arising from complying with obligations that are subsequently changed or removed.

Background to the CoFI Law

The CoFI regime arose out of the findings of the Australian royal Commission into the banking industry that was published in February 2019. Following that the FMA and the Reserve Bank carried out a review of the banking and insurance sectors and issued review reports in 2021. The reports did not identify the same issues as those found by the Australian Royal Commission, with the primary finding being that financial institutions had inadequate systems and infrastructure to support compliance. The reports were thematic and qualitative and much of the specific information provided was anecdotal. The reports provided no detailed analysis, for example estimating the costs incurred by consumers as a result of misconduct identified in the reports. The reports did not identify whether some issues could be addressed under current law. The lack of any detailed analysis is confirmed in the RIS, which states that:

> "This RIS relies on a range of qualitative data to assess the impacts of the proposed options, including previous findings from the FMA/RBNZ reports and report-backs, and anecdotal evidence from public submissions. The sources used did not include much quantitative evidence of the problems identified or quantitative assessments of the costs and benefits of the options."

The FMA and Reserve Bank reports noted a number of instances of alleged non-compliance. It appears that all of those instances were subsequently the subject of successful enforcement actions by the FMA for breach of "fair dealing" obligations in the FMC Act. This highlights that existing law already prohibits the examples of misconduct identified in the reports. The Options Paper downplayed the effectiveness of existing law to address the concerns raised but provided no analysis to support that. The law that eventuated, in the form of the CoFI regime, is only loosely connected to the underlying problems it purports to address.

Consumers assumed not to act rationally

Rather than being developed as a response to the issues identified in the FMA and Reserve Bank reports, in our view it appears that the CoFI law that eventuated was primarily based on a starting point that consumers cannot be trusted to make decisions for themselves. For example, the responsible Minister at the time the CoFI law was being developed is quoted as saying that, in connection with the CoFI law (and new financial advice law), "No matter how much you earn, generally New Zealanders aren't very good at managing their money". Another example of this thinking is from the key official responsible for the CoFI reforms, who was quoted as saying:

> "New Zealand's journey represents a wider shift happening all over the world, where countries are moving away from regulation on the assumption of the "rational decision maker" - i.e., the idea that the customer will always choose what is right for them, so long as they are given the right information.… banks and insurers will instead need to prove that they have met a regulator-determined bar, and are actively engaged in ensuring that customers are treated fairly."

The problem with this "journey" away from assuming that consumers are capable of making rational decisions is that that assumption underpins our entire market economy. The "fairness" principle at the core of the CoFI law attempts to introduce a new paradigm, in place of the assumption that consumers make rational decisions. Under that paradigm Institutions and the State are, to a significant degree, supposed to understand what consumers want and to direct them to make the right decisions. We have seen no validation of how that approach will result in better outcomes overall, be cost-effective or address the underlying causes of poor financial outcomes including inequality. We are not suggesting that fairness isn't something Institutions should strive for but, as we note below, these "fairness" standards are being asked to do work that they're not designed for.

The logical result of that policy underpinning the CoFI law is FMA's draft "Fair Outcomes" guide released in November 2023 (**Guide**). It is clear from the draft Guide, and from previous conduct and statements of the FMA, that the FMA considers it has an ambit to regulate all aspects of the conduct of financial institutions, whatever their size and whether or not they are licensed. Amongst other matters, the draft Guide proposes that FMA will have a role in determining what products and services are provided by financial institutions (not just regulating those actually provided) and in regulating the prices of financial products and services. With respect to regulating prices, FMA refers to that as regulating a "fair exchange of value" between institutions and consumers. However, it is clear that its desire is to have a direct role in price setting. FMA has already imposed a "fair exchange of value" obligation on licensed fund managers, largely in reliance on FMA's general licensing powers in the FMC Act. A key concern we have with the CoFI regime is that it provides a more sound legal basis for FMA to implement such initiatives. The overall effect of such initiatives is that the State (represented by FMA) and financial institutions will decide what is best for consumers, with consumers only having peripheral role, undermining basic market precepts.

Shortcomings in the development of CoFI Law

Our concerns about the CoFI law are supported by the RIS. The RIS noted that:

> "The timing for decisions has been a constraint on the scope for decision making. As noted in Section 1, the Minister of Commerce and Consumer Affairs has directed MBIE to prepare legislation to be introduced by the end of 2019. We think a broad financial conduct regime is required.
> This RIS sets out a high-level framework for a broad conduct regime but the details will need to be fleshed out over time, through regulations and potentially further legislative changes, once there has been opportunity for further policy thinking."

The RIS also highlighted the risk that the costs of CoFI law may outweigh benefits achieved:

> "Costs of compliance and lack of certainty exceed the benefits of regulation: Moderate impact. A compliance programme requirement increases compliance costs for entities but should enhance certainty and support monitoring and enforcement. To reduce the impact of this risk we also intend to start with a relatively small regulated population before considering the inclusion of other institutions who offer similar financial products and services."

This clearly highlights that the CoFI legislation was rushed and that further work was required to develop the regime including through regulations and further legislative changes. No regulations have been prepared except in relation to controls on incentives at financial advice providers. The current initiative presents an opportunity to address shortcomings caused by the rushed preparation of the CoFI law.

Costs of CoFI law may outweigh the benefits

That very significant costs (direct and indirect) are being imposed on Institutions by CoFI law are confirmed in the Cabinet Paper on the CoFI bill. The RIS stated:

> "44.2 Licensing can impose considerable costs on both the regulated entities and the regulator, depending on the licence obligations. These costs may be passed on to customers. In the worst case scenario, additional regulatory costs may push smaller players out of the market (e.g. small credit unions).
>
> 44.3. Licensing can create barriers to entry for new players. This could have an impact on future opportunities for enhanced competition and the structure of the market.

There are other significant costs, as noted in the RIS:

> "The regulator will see a large increase in costs. This will include costs of monitoring and enforcement of the duties, compliance programme obligations and developing guidance."
>
> "Some of the increased costs to regulated parties may be passed on to consumers in the form of higher interest rates, premiums etc. This is likely to be a relatively small amount spread over a large number of customers."

The likelihood that such costs create a significant barrier to entry into the banking sector, and help to explain the profit margins of the large banks, was identified in the Commerce Commission's March 2024 draft report on its market study into personal banking services. We consider that the apparent lack of strong opposition from most of the Institutions subject to the CoFI law indicates that they are able to pass the associated costs on to customers and possibly that they are not unhappy with the creation of further barriers to entry.

The RIS dismisses the costs noted as "a relatively small amount spread over a large number of customers". That argument could be made of most regulatory measures but completely misses the point. That is that the cumulative effect of the costs will be significant and will likely lead to a misallocation of resources away from more productive activities and increase barriers to entry, without commensurate benefits being generated.

FMA agreed to provide guidance to smaller Institutions because of the concern about the costs being imposed on them by CoFI law. That guidance was released publicly on 14 June 2024. Such guidance is a common outcome when regulation is designed for large businesses with limited or no effort to consider its effects on smaller businesses. That guidance is rarely effective to overcome the failure to properly design regulatory measures. The FMA guidance is consistent with that. The guidance is high level. It is difficult to see how it improves matters for smaller Institutions in any substantive way, as shown in the following platitudes from that guidance:

- "Ideally, an FCP will be 'right sized' for your business. Smaller, simpler businesses are likely to need a less complex FCP."
- "Regardless of the structure, it's important you design something that will work for your business. It shouldn't be copied or adapted from somewhere else if it's not going to suit the way you work."

The problem with "fairness" as an overarching legal standard

The CoFI regime has an overriding principle that Institutions treat their customers "fairly" with numerous specific requirements imposed via development of a "fair conduct programme". A conduct licence is required. Cygnus law is not at all suggesting that it is inappropriate to treat customers fairly or that Institutions should not strive to do so. However, as we note below, "fairness" falls substantially short as a standard to regulate market conduct generally.

The law has for a centuries recognised "fairness" and some other moral principles as legal standards. However, use of such standards has operated within fairly tight constraints and often in areas of where moral considerations are paramount, for example in family matters. The problem with "fairness" as a legal standard is that it is a moral principle and so inherently subjective. Having said that, New Zealand has fairness standards in other areas of commercial law. In fact there is an array of conduct law that already significantly governs the conduct of financial institutions. The Options Paper noted that but it didn't include a gap analysis to identify where the law is lacking. Instead, each Institution has been told that CoFI law requires them to do that themselves as part of their implementation of fair conduct programmes.

An example of law that is based on concepts of fairness is the unfair contract term law in the Fair Trading Act 1986. In the case of unfair contract term law the core subject matter of a contract, and the upfront price, are excluded from the scope of that law. That's because that would involve regulating the nature of the products & services themselves, and their prices. Those matters were previously assumed to be best left to the markets, not the law or regulators, on the basis that they are no better (and probably worse) than market participants at efficiently allocating resources within markets. Likewise, to date, financial markets law has generally regulated matters peripheral to the financial products & services themselves, such as disclosure, governance, management capability, business infrastructure and misleading conduct. So the key change introduced by CoFI is the direct regulation of financial products & services. However, there is a huge body of evidence in New Zealand and overseas that shows that, in general, direct State regulation of core aspects of markets only produces negative outcomes. Accordingly our submissions seek to place greater emphasis on market mechanisms to support consumers to achieve better outcomes.

Yours sincerely
Cygnus Law Ltd

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Simon Papa
Director

APPENDIX

Submission on discussion document: *Fit for purpose financial services conduct regulation*

Your name and organisation

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Responses to discussion document questions

Introduction

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

See Cygnus Law's additional submissions in the Introduction above.

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

Do you support removing or amending some of the minimum requirements for fair conduct programmes? What are the advantages and disadvantages of this option?

Yes. See below.

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

The requirements in section 446J(1), when broken down, set out dozens of requirements. Even taking into account the ability to control the ambit based on various factors, including the nature, size and complexity of the business (section 446J(2)), the requirements are onerous overall. The Discussion Document states "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." It is unclear what "other evidence of consumer harm" means. However, the requirements are simply an "everything including the kitchen sink" compliance regulator wish list and go far beyond issues identified in the reports or the Options Paper. In addition, FMA has, via its licensing powers, imposes further requirements on Institutions as a condition of obtaining a conduct licence, including in relation to outsourcing, business continuity and operational resilience, that are completely unrelated to the issues giving rise to the CoFI regime.

Those factors support removing requirements that are not properly validated and removing FMA's power to impose additional obligations via the licensing regime (this will likely be addressed by the proposals in the Options Paper to require rationalisation of licensing requirements).

The section 446J(1) requirements impose costs on businesses that are very likely to be greater than the benefits arising from their implementation (a valid conclusion in our view, given the high costs involved in implementing such complex regimes and that there was almost no analysis of the resulting benefits of CoFI law). The costs are particularly significant for smaller Institutions and will represent a large barrier to entry. As noted, the number of requirements mean that it is very difficult, in practice, for smaller Institutions to truly right-size their programmes so they're cost effective. So the section 446J(1) requirements will very likely impose significantly greater proportional costs on smaller Institutions, both existing Institutions and those trying to enter the market.

Some requirements go further than licensing standards in equivalent areas that are imposed by FMA, and for no clear reason. These requirements attempt to regulate almost all facets

of the products and services provided by Institutions including what products are provided, requiring management and operational structures to be expressed in detail, requiring "regular and comprehensive reporting", mandating employee training and maintenance of employee competence, maintenance of misconduct procedures, and controls on incentives. It's not that those requirements are inappropriate, it's just raise the following questions:

- Whether the costs imposed implementing and maintain them are justified.
- Why these matters need to be minutely documented as part of a licensing regime?
- Why it isn't possible to regulate outcomes in some areas as an alternative?

In her 31 January 2024 speech at a Financial Services Council event, FMA's Chief Executive Samantha Barrass stated that "It's not for us to go through your fair conduct programme line by line. We're not going to be signing them off. The responsibility for these programmes sits with the Board of the institutions." However, the whole point of licensing is that the licensed person meets pre-determined standards and that the regulator checks and confirms that before granting a licence. It would be like applying for a driver licence and being told by the person assessing your driving that the fact you're driving is good enough and that they're not going to check how good your driving actually is. That is not the approach that FMA takes with other types of licence, where it considers in detail whether licensing standards have been met. In our view, FMA's attitude (as articulated in the 31 January speech), the open-ended nature of "fairness" based law, and the very large costs CoFI is imposing on the Institutions, means that licensing is not an appropriate process to implement these requirements. In fact, there was never any proper validation of why licensing, the most gold-plated form of regulation, was considered appropriate in the first place. Our view is that these matters are best addressed through improvements to law and enhanced enforcement, with licensing only considered if that does not appear to be address the concerns that led to these reforms. On that basis we submit that the fair conduct programme concept be maintained but that it is not necessary to obtain a conduct licence. That will significantly reduce costs for FMA, which will not have to process further applications for licences and will reduce the burden on the Institutions without significantly reducing the benefits to be achieved through operation of fair conduct programmes.

If that submission is not accepted, we submit that there be no requirement for prior-FMA review of a fair conduct programme as a condition of obtaining a licence and that programmes be considered by FMA after the regime comes into force as part of ongoing monitoring and enforcement activities. That will give Institutions more flexibility and will likely make little practical difference, given that FMA does not appear to be carefully reviewing fair conduct programmes in any case.

As a general comment, we consider it is inappropriate that licensed financial advice providers (**FAPs**) are required to be overseen through fair conduct programmes. FAPs are already extensively regulated including through a requirement to hold a licence issued by FMA and to meet requirements set out in a 40 page "Guide to Financial Advice Provider licence requirements and application kit" and standard conditions issued by FMA. We can see no reasonable basis for additional oversight of FAPs via the CoFI regime and submit that licensed FAPs be removed as "intermediaries" subject to the CoFI regime.

We submit that the requirement at section 446J(1)(a) be removed. The CoFI law should focus on conduct that is not already addressed by existing law. In our view previous non-compliance was a result in part of a lack of enforcement of existing conduct law, which was stepped up at a later date. Also, of the laws listed in section 446J(1)(a), FMA does not have any powers to enforce Consumer Guarantees Act, Fair Trading Act or CCCFA (though that is planned to change). It does not make sense to give FMA power to oversee implementation of policies, procedures, systems and controls in relation to such laws, and to take action if

they are inadequate, without the ability to enforce compliance with the laws themselves. In fact, we propose as an alternative that FMA's ambit is extended to encompass those laws by adding them to Schedule 1 of the Financial Markets Authority Act. Giving FMA power to take action if such laws are breached will reduce the need for upfront regulation through the requirements and licensing.

Regulation 446J(1)(b) relates to "designing, and managing the provision of, the financial institution's relevant services and associated products to consumers, including by…". The primary obligations are in sections 446(2)(d) and 446D(1)(a). Issues with product design were not identified in the FMA and Reserve Bank reports so we do not consider there is any basis for including them in the CoFI regime. Given the significant implications of these provisions, we can see no basis for making the lists of requirements a non-exclusive list so we submit that the word "including" in s446(1)(b) be deleted. In Australia product design provisions are governed by a separate part of the Corporations Act, which detailed provisions governing them supported by extensive guidance from ASIC. We don't consider it is appropriate to implement most aspects of such a far-reaching obligation as part of a fair conduct programme regime as subsidiary matters. We submit that the product design provisions be removed entirely. If that submission is not accepted, we propose the changes below.

We submit that the requirement at regulations 446J(1)(b)(iv), (v) and (vi) be removed, and implemented in a more targeted way. Amongst other matters these require Institutions to "regularly [review] whether enhancements or improvements in the financial institution's relevant services or associated products should be made available to those consumers (when viewed as a group); and" and "ensuring that any enhancements or improvements identified under subparagraph (v) are made available within a reasonable time". These are broad, very ambitious and very consequential requirements, which go to the core of products and services provided by Institutions. We do not consider it is appropriate to implement them as a checklist of matters as part of a fair conduct programme. To monitor and enforce compliance, FMA will have to become involved in determining what products and services should be provided by Institutions. As noted in the introduction to these submissions, there is no reason to think that the State is up to the task of making such determinations. If this requirement is to be maintained, it is submitted that it is imposed by a separate regime with greater detail and specificity, which should help to reduce the of large costs Institutions will incur in complying and the risk of regulatory over-reach into areas where the State is unlikely to have expertise to appropriately regulate. We submit that such separate law should be much more focused on particular products of concern, where there is evidence that customer's have, in the past, been treated unfairly.

We submit that the requirement at regulation 446J(1)(b)(i) be removed. This requires the "designing and managing incentives to mitigate or avoid the actual or potential adverse effects of incentives on the interests of consumers, so far as is reasonably practicable". We consider that there is no justification for such a wide-ranging control on incentives. We consider that any controls on incentives should be focused on particular areas of concern, which is the case with the rules on incentives for financial advice providers. Those controls took into account extensive analysis and policy development in Australia in this area, so there is significant validation for those controls and supporting policy analysis. That regulation 446J(1)(b)(i) is hard to implement is confirmed by the addition of the proviso that that is required "so far as is reasonably practicable". This creates an unacceptably vague standard in our view - it leaves Institutions vulnerable to making the wrong judgment call and risks an overly conservative approach to assisting clients to find the right products and services. This is one of many areas where smaller Institutions are left in a difficult position, as the difficulties posed in trying to implement such extensive, but vague, requirements

cannot be addressed by reference to size or scale- it will require all Institutions to design complex incentive control arrangements.

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

The changes submitted above would reduce compliance costs for businesses while being unlikely to substantively change the intended outcomes for consumers.

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

What are the advantages and disadvantages of adding an express minimum requirement for fair conduct programmes relating to fees and charges?

As noted in the introduction, FMA is engaging directly in price regulation. We consider that FMA should not have any role in regulating prices or "exchange of value". Regulating matters such as "fees and charges materially outweighing benefits to customers" will involve FMA directly regulating prices. To the extent that is required, that is an area where the Commerce Commission has expertise and should have the required mandate. We are less concerned about concepts such as "transparent fee structures" as this is a requirement that is already governed by "fair dealing" rules in the FMC Act.

We submit that the FMC Act be amended to include same restriction as unfair contract term law in the Fair Trading Act, which is that terms that "set the upfront price payable under the contract" are not subject to the fair conduct principle. In addition, we submit that the FMC Act be amended to state that FMA does not have the power to regulate the upfront price payable with respect to financial products and services expect to the extent FMA is expressly empowered to regulate such matters.

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

We consider that the disadvantages are that the Institutions are already subject to extensive requirements relating to complaints under dispute resolution scheme law, and are subject to the rules of the relevant schemes. The Dispute resolution regime appears to operate effectively and efficiently overall so we cannot see much advantage from imposing additional obligations via CoFI law.

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

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?

We support removing some, but not all, of the minimum requirements, for the reasons noted above. However, we consider that, if the fair conduct programme concept is to be retained, that Institutions should have certainty about what the requirements are, especially for the smaller Institutions that don't have the resources required to elucidate their meaning. In any case, in the absence the minimum requirements FMA, through its monitoring and enforcement conduct, will have to determine what those requirements are. That is less than optimal from a rule of law perspective. Accordingly, we submit that the section 446J requirements should be all of the requirements for a programme, rather than minimum requirements. If additional matters need to be added to programmes that can be achieved via prescribing them under regulation 446J(m).

We submit that:

- section 446G(1) is amended as follows- "Every financial institution must establish, implement, and maintain an effective fair conduct programme in accordance with section 446J"
- The heading of section 446J is amended as follows: "~~Minimum~~ R~~r~~equirements for fair conduct programme".

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

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?

No. As noted above, the requirements are very extensive and onerous, and are difficult and costly to implement, particularly for smaller Institutions.

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

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?

Yes. See 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: retain status quo (Option B1)

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?

For the reasons noted in the introduction, we do not support the maintenance of the status quo. While the principle is not enforceable in itself, it is indirectly via its effect on the interpretation of the specific requirements imposed on Institutions. So it is not simply a

statement of principle, it indirectly determines how Institutions run their businesses. The fair conduct principle should not be used to replace the market as the primary arbiter of the products and services the market provides, including that it should not undermine the agency of individuals to decide what products and services are appropriate for them. Having said that, we consider that, it would be preferrable to rely on general standards of "fairness", which the courts are familiar with, rather than trying to further define what "fairness" means in ways that are likely to introduce more uncertainty and to extend the law in ways that are not appropriate.

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?

Taking those factors into account, we submit that the following requirements in the fair conduct principle in section 446C(2) be removed from the fair conduct principle, or the amended, as follows:

assisting consumers to make informed decisions

We submit that this requirement be removed. While we understand the intent behind this, this seems to place Institutions in a difficult position as, in many cases, the assistance is likely to risk the provision of financial advice, a regulated service, where the customer does not require that. We consider this is best deal with via specific requirements such as that to communicate in a "timely, clear, concise, and effective manner", and via the other requirements described below.

As noted in the introduction, the CoFI law appears to reflect a view that consumers are passive recipients of financial products and services and cannot be trusted to make rational decisions for themselves, as exemplified in this fair outcome. There are many studies that show that increasing safety of products and services (cars being one example) lead to more hazardous behaviour by the users of those products and services. By focusing excessively Institutions, CoFI law risks taking away consumer agency and empowerment with the result that moral hazard is increased. So CoFI law risks fundamentally undermining basic market concepts and to consumers achieving worse, not better, outcomes. To address that risk we submit that new requirements be added in section 446C(2), to ensure Institutions and FMA maintain an appropriate balance, and to support fair and efficient operation of financial markets, as follows:

- "treating customers with respect including respecting their autonomy"
- "empowering consumers to make financial decisions that are appropriate for them in their circumstances"
- "assisting customers to access financial advice, where appropriate"

paying due regard to consumers' interests

"due regard" simply introduces a further standard with no clear meaning. There is a separate obligation requiring Institutions to act "ethically, transparently, and in good faith". The good faith obligation will likely encompass "due regard" and is an established concept in law so reduces uncertainty. Accordingly we submit that this requirement be removed.

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)

As we note elsewhere in these submissions, this type of product design obligation is very extensive and ambitious and, as one example, in Australia is implemented through specific legislation not as a subsidiary matter as part of a "fair conduct" regime. Also, this requirement is not an elucidation of a principle but a very focused regulatory measure, so it is not appropriate for it be listed as a requirement of the fair conduct "principle". Accordingly we submit that this requirement be removed.

The RBNZ and FMA review of the banking and insurance sectors did not provide any cogent evidence to support this measure, as there was little, if any, evidence that Institutions were designing poor quality products. While that can be an issue, the FMA already has a power to prohibit the provision of products that are inappropriate.

In addition to those matters, we noted in the introduction that FMA, in its draft "Fair Outcomes" guide, indicated that it wants to become involved in regulating what types of financial products and services are provided by all financial service providers, under the outcome 1 "Consumers have access to appropriate products and services that meet their needs". In its description of the "access" component FMA states that "Access refers to the availability of financial products and services that meet diverse consumer needs, including their personal circumstances, preferences, goals, risk tolerance, and values." While we acknowledge that that outcome is describable in principle, we're concerned that it indicates an intent to regulate what types of financial products and services are provided with no evidence to support why that is appropriate. We are concerned that FMA will use CoFI law as a basis to support such initiatives. Accordingly, we consider that the fair conduct principle should include the following, as sub-section 446C(4), to acknowledge that fair conduct does not require Institutions to provide any particular types of products or services (rather, CoFI should regulate the products and services actually provided or planned to be provided):

> "446C(4) The fair conduct principle and the requirements of fair conduct programmes do not require financial institutions to provide any particular financial products or services or classes of financial products or services, or to provide them to any particular group or class of consumers."

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

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

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

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?

Yes. CoFI law is but one example of law applied with little or no thought given to the extensive existing law that governs conduct of financial institutions and other businesses. No gap analysis was prepared as part of the development of CoFI; with many of the CoFI requirements already being covered by existing laws. There was no proper consideration of whether those laws were effective and whether they could be updated to address the concerns identified, rather than creating any entirely new regulatory regime. This is one example of a wider problem. Another example is licensing regimes imposed by FMA and other regulators with little thought to their overall interaction or their cumulative effect. So a single conduct licence presents significant advantages. It will require FMA to revisit its licensing regime and licensing guides, but we consider that is a positive outcome. It is far more cost-effective for FMA to undertake that exercise once than to impose costs on hundreds of businesses of having to navigate overlapping regulatory regimes. It will mean less repetition is required for Institutions with multiple licences and means that FMA does not have to consider the same or similar matters multiple times.

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.

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

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

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.

Yes.

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.

Yes.

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?

There is a pressing need to consolidate regulation of the AML/CFT regime and improve its current inadequate oversight by AML/CFT supervisors, the Ministry of Justice and Police. That imposes high externalities on the 10,000+ reporting entities. At the very least the production of guidance and other matters relevant to all supervisors should be as consolidated within one entity. Ideally AML/CFT supervision and enforcement should be carried out by one supervisor. Currently, it appears that co-ordination between the supervisors is poor. As one recent example, the supervisors produced guidance on significant changes to the AML/CFT regime that came into force on 1 June 2024 only weeks before that date. That's despite the relevant regulations having been promulgated in June 2023. AML/CFT reporting entities are required, by law, to "have regard" to such guidance materials. Many reporting entities were already well underway on updating their compliance programmes and then had to consider the guidance very late in the process. So it was not acceptable, in our view, for the guidance to be released at such a late stage.

A key part of the AML/CFT regime is the monthly "The Suspicious Activity Report" prepared by the Financial Intelligence Unit of the Police. This provides reporting entities with information on current and emerging money laundering and terrorist financing risks. The quality of that report was never particularly good. In any case the most recent monthly report was issued in August 2023.

These are not the only issues but they highlight a system that is barely functional and which needs an overhaul.

E. Ensuring the FMA has effective tools

Option E1. Introduce change in control approval requirements

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.

No. We are not opposed to such a requirement in principle. However, FMA has been operating licensing regimes for more than 10 years, yet the Discussion Document provides no evidence of, or analysis of, specific issues that have arisen to support this proposed change. If this is necessary then, in our view, FMA needs to validate why the change is necessary. That is required because such a power significantly impinges on the rights of owners of regulated businesses to sell some or all of their business.

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?

Only firms licensed by FMA. We can see no basis for FMA to have a say in change of ownership of non-licensed firms, given that FMA does not directly oversee them and does not approve the existing ownership structure. Again, this is a significant power and its introduction needs to be properly validated.

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

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

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.

Yes, with respect to on-site inspection powers, but "no" to without notice inspections. It appears that FMA is seeking both the power to carry out on-site inspections and to do so without notice. This part of the Discussion Document appears to confuse FMA's lack of on-site inspection powers in most areas with the question of whether it should be able to carry out such inspections without notice.

With respect to without notice inspections, we consider that any such power needs to be properly validated. As noted above, with respect to change of control approval, if FMA thinks without notice inspections are necessary it has ample information on which to validate that. The Discussion Document provides no indication of such validation. There is reference in the Discussion Document to the risk of "rent a crowd" approaches and to "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." However, "rent a crowd" and place of business concerns arose from the "place of business" threshold in the Financial Service Providers (Registration and Dispute Resolution) Act 2008. That threshold was removed in March 2021 to address those concerns, so that is no longer relevant and so not a justification to grant FMA the power it seeks.

Also, the FMA has the ability to apply to the Court for a search warrant that could allow it to carry out without notice on-site inspections. So FMA does not have an "inability" to carry out on-site inspections without notice. So this addresses the concern in the Discussion Document about compliance with IOSCO principles- the search warrant power means that FMA complies with those principles. The fact that the search warrant power requires judicial approval highlights just how intrusive such powers are- we again consider that proper validation is required to support providing FMA with such powers. While we acknowledge FMA already has that power in some circumstances, as do other regulators, that is not a justification for extending the power. The State should only be granted such power when there is evidence that they are required.

The Discussion Document states "when the FMA Act was drafted it was understood that this power [we assume without notice inspections] 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." We doubt there was any such "understanding" and, even if there was, that does not in any way justify changing the law. FMA has operated without that power for 13 years so, again, the question is why FMA needs that power now.

The court case that confirmed that FMA's section 25 power did not permit without notice requests for information was *Perpetual Guardian Ltd v Financial Markets Authority* [2012] NZHC 2307. In that case it appeared there was little or no justification for the use of section 25 without notice. So this highlights the risk of misuse of that power. That means, in our view that, if without notice inspections are granted, they should be subject to significant controls. We don't consider it is sufficient that such powers are simply subject to an obligation that they are "exercised at a reasonable time and in a reasonable manner" as noted in the Discussion Document. That's because there is evidence that such powers are not always exercised in that way and because there is every reason to impose higher standards.

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?

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

The law should require that without notice inspections are only permitted where FMA considers that there is a real risk that relevant information may be destroyed or removed.

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

Currently FMA carries out on-site inspections routinely with consent of the regulated entities, without the need to exercise any particular powers. However, to support that, FMA requires, under licence conditions, that "Your arrangements must ensure that your retail clients consent to us viewing or obtaining your records." (or similar). This is an attempt to fashion an inspection power that FMA can use via voluntary consent. However, we consider that the use of the power to make licence conditions does not empower FMA to create alternative on-site inspection regimes and that such requirements are *ultra vires*. If FMA is granted an on-site inspection power (whether or not without notice inspections are permitted) we submit that FMA should be prohibited from imposing such requirements via licence conditions.

Option E3: Introduce an expert report power for the FMA

Should the FMA have the ability to commission expert reports? Please explain your answer, including why the current approach does or does not work.

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?

What safeguards should there be for an expert report power?

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

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

3*:* Limitations and constraints on analysis

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

4: Implementation
Do you have any comments on implementation of these reforms?
We strongly submit that the regime's implementation is delayed by 12 months, so that relevant changes to law can be made, so that Institutions have time to implement them, and so that Institutions can better implement existing requirements. If that is not accepted then we submit that the implementation is delayed for smaller Institutions by 12 months. We see no real detriment arising. Institutions can voluntarily implement the CoFI requirements if they wish. Also, given it is already 5 years since the final report of the Australian Royal Commission was issued, we do not see such a delay as being material in context.

Other comments