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Submission on discussion document – Fit for purpose financial services conduct regulation

1 This is a submission by Dentons Kensington Swan on the Ministry of Business, Innovation & Employment ('**MBIE**') discussion document *Fit for purpose financial services conduct regulation* dated May 2024 ('**Discussion Document**'). The Discussion Document seeks feedback on:

a options to streamline and improve provisions of the Financial Markets (Conduct of Institutions) Amendment Act 2022 ('**CoFI**' or '**CoFI Act**'), including amending the minimum requirements for fair conduct programmes ('**FCP**') and amending the fair conduct principle; and

b options to amend the regulatory framework and powers of the Financial Markets Authority ('**FMA**') in the Financial Markets Conduct Act 2013 ('**FMC Act**') and the Financial Markets Authority Act 2011, including:

i requiring the FMA to issue a single conduct licence for market services;

ii allowing each of the FMA and the Reserve Bank of New Zealand ('**RBNZ**') to rely on the assessments undertaken by the other regulator; and

iii introducing change in control approval requirements, 'without notice' on-site inspection powers, and expert report powers.

About Dentons Kensington Swan

2 Dentons Kensington Swan is one of New Zealand's premier law firms with a legal team comprising over 100 lawyers acting on government, commercial, and financial markets projects from our offices in Auckland, Wellington, and Christchurch. We are part of Dentons, the world's largest law firm, with more than 12,000 lawyers in over 200 locations.

3 We have extensive experience advising a range of banks, insurers, non-bank deposit takers, financial advice providers and financial service providers, many of which will be affected by the proposals set out in the Discussion Document.

General comments

4 With regard to the CoFI reforms, we are pleased that the duplication of requirements and unnecessary compliance costs that financial institutions face have been identified. In particular, we welcome the preferred option being proposed to simplify FCP minimum requirements. However, we

believe that some form of transitional relief for financial institutions is crucial if the proposed changes are to have any practical value. Such relief would allow institutions currently finalising their FCPs to take early advantage of any changes to the base requirements.

5 In relation to amending the fair conduct principle, we support defining the principle via an exhaustive list, on the basis that this would provide financial institutions with greater certainty and alignment with regulatory expectations.

6 Generally, we welcome the express recognition of the overly complex nature of the current financial markets regulatory framework. We tentatively support the proposal to consolidate market services licences granted under Part 6 of the FMC Act so long as such consolidation works in practice (including alignment of standard conditions and reporting obligations). It is also sensible that the FMA and RBNZ be able to rely on the other's assessments in areas of overlap, in order to promote regulatory efficiency.

7 We strongly oppose the introduction of the change in control approval requirements, without notice on-site inspection powers, and expert report powers to the FMA. We do not view these proposals as providing any benefit to the existing regulatory framework or achieving greater effectiveness of the FMA's functions. They will impose a greater regulatory burden on financial markets participants, contrary to one of the stated objectives of the reforms.

8 Thank you for the opportunity to submit. We would welcome the opportunity to discuss any of the points we have raised.

Yours faithfully

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Discussion document questions

Introduction

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

We broadly agree with the three main criteria identified for assessing the options raised in the review. In particular, we are pleased to see an express desire to increase certainty as to financial markets obligations and to avoid duplication of legislative requirements. We suggest that the term 'fair conduct' be used rather than 'good'. Reference should also be made to 'promoting and facilitating the development of fair, efficient, and transparent financial markets' as a key focus of the FMC Act.

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

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?*

In principle, we support MBIE's proposal to amend the requirements in section 446J(1) of the CoFI Act (as set out in paragraph 30 of the Discussion Document). We submit that if this proposal is implemented, that transitional relief from the currently prescribed minimum requirements be granted for financial institutions working towards fully implementing their FCPs in preparation for licensing and compliance with the CoFI regime. This will provide financial institutions opportunity for early adoption of the new requirements and reduce the cost of compliance. It is easier and more practicable to adopt those changes now, as FCPs are being developed and finalised, rather than seeking to overhaul them at a later date once the programmes are already up and running.

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

We agree with the proposed removal of paragraph (a) from section 446J(1) of the CoFI Act. That requirement simply creates unnecessary duplication for financial institutions to meet existing statutory obligations and necessitates a certain level of re-documentation of processes. It also creates the possibility of institutions being penalised both for a breach of the direct statutory obligations along with a breach of the duplicated fair conduct obligations.

We also agree with the proposed removal of paragraphs (c)(i) to (c)(iii) from section 446J(1). We note the record keeping obligation set out in paragraph (c)(ii) overlaps with standard condition 6 (record keeping) imposed by the FMA as part of the Standard Conditions for financial institution licences. Again, such duplication exposes institutions to the possibility of multiple breaches in respect of a single compliance failure. Perhaps the FMA's ability to impose conditions needs to be constrained so that it cannot create and impose conditions that duplicate or cut across clear statutory obligations – although we accept, in this case, that the preference is to remove the record keeping obligation, via removing section 446J(1)(c)(ii) and retaining the standard condition.

In regards to paragraph (e) of section 446J(1), we recommend limiting this obligation so it applies to agents of financial institutions only. Retaining 'agent' at paragraph (e) provides financial institutions' flexibility to set procedures or processes for those external individuals they engage and recognises that institutions do not have the same inherent oversight of those agents when compared to their own employees.

Paragraph (h) of section 446J(1) duplicates requirements. Sub-paragraph (i) – the obligation to obtain reasonable assurance on the competence of each employee – is inferred by the obligations to provide and ensure completion of ongoing training in paragraphs (f) and (h). Sub-paragraph (iv) – the obligation to monitor the treatment of consumers in line with the fair conduct principle – is inferred by the broader obligation in paragraph (d) to identify conduct that fails to comply with the fair conduct principle. Accordingly, these sub-paragraphs of section 446J(1)(h) could be deleted. The remaining elements of paragraphs (f), (g), and (h) regarding employees could then be consolidated to have less granular requirements.

In addition to the above, we also support:

a amending paragraph (j) of section 446J(1) to expressly carve-out prescribed statutory disclosure material and obligations, again to remove duplication of requirements and potential liabilities.

b removing paragraphs (k) and (l) of section 446J(1) as these obligations are inferred by the requirement for every financial institution to establish, implement, and maintain an effective FCP under s 446G(1) of the CoFI Act.

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

The amendment or removal of the requirements discussed above will alleviate the compliance burden for financial institutions and, importantly, reduce the duplication of obligations within CoFI itself and, with regard to the FMC Act, other financial markets and services requirements.

We do not believe that reducing the specificity of FCP requirements will make it more difficult for financial institutions to develop FCPs. The requirements to be removed or amended will reduce confusion and financial institutions should already be well-informed, including via available discussion material.

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

Nothing to submit.

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

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

This option to add further minimum requirements goes against the stated intent and purpose of MBIE's review of the CoFI regime – being to reduce prescription and provide greater flexibility for financial institutions to tailor their FCPs in accordance with the nature of their businesses. Accordingly, we do not support the implementation of this option. The addition of an express minimum requirement for FCPs relating to fees and charges would overlap with existing disclosure

requirements which many financial institutions are subject to, including fund fee and financial advice provider fee disclosure.

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

We do not support the addition of an express minimum requirement for FCPs relating to complaints process. Again, this option goes against the proposed criteria for MBIE's review of the CoFI regime, by adding prescription and thereby reducing flexibility, and duplicating other regulatory requirements. The current minimum requirements relating to the handling of complaints are already sufficiently robust. Complaints are expressly addressed in s 446D (setting out that responding to a complaint is an example of when the fair conduct principle applies) and in the duty set out in s 446H (detailing the complaints process to consumers). Further, such express requirement may again create unnecessary duplication. The recording and resolving of complaints as a result of conduct that fails to comply with the fair conduct principle is inferred by the requirement in s 446J(1)(d) – which requires the inclusion in FCPs of effective policies, processes, systems and controls for identifying such conduct, and taking reasonable steps to mitigate such conduct. Financial institutions must also comply with the Financial Service Providers (Registration and Dispute Resolution) Act 2008 ('**FSP Act**'), so the imposition of additional complaint and resolution requirements appear to be unnecessary.

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?*

Yes. The existing flexibility in the design of FCPs allows financial institutions to take a proportionate approach, and tailor the content of the FCPs for the size and nature of their business. This includes factoring in existing fees and charging arrangements and complaints processes to the extent appropriate, without requiring additional prescription in this regard.

Option A3: Remove all minimum requirements for fair conduct programmes

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?*

We do not support removing all FCP minimum requirements. Doing so would increase uncertainty and as a consequence increase compliance burdens and costs for financial institutions in understanding what the content of the FCPs should be, and how the fair conduct principle should be interpreted and applied.

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

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?*

We do not support retaining the current list of minimum requirements for FCPs without change, so long as FCPs developed under the current settings are not rendered non-compliant as a result of any changes made. As noted in our response to question 3, some of the current requirements duplicate existing regulator requirements or overlap with other FCP requirements (and obligations imposed by the FMA via licence conditions).

Removal or amendments to reduce unnecessary duplication eases the compliance burden and sets clear parameters as to what is strictly necessary, at a base level, for financial institutions to develop adequate and compliant FCPs.

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

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?*

Yes, as discussed, Option A1 reduces possible confusion caused by the duplication of obligations whilst the streamlining of key requirements will ease the compliance burden and costs, as well as regulatory risks, faced by financial institutions.

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)

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?*

We do not support maintaining the open-ended definition of the fair conduct principle. The open-ended definition exposes financial institutions to the risk of perceived non-compliance in the event of the FMA interpreting the principle in a way that differs from industry practice or understanding. This exposes financial institutions to unnecessary regulatory risk and uncertainty.

We propose that the definition of the fair conduct principle be made exhaustive (Option B2), so that the current list of matters under section 446C(2) would become a complete list. This provides greater certainty for financial institutions in developing, maintaining, and acting in accordance with their FCPs – for example, the monitoring and identification of conduct that fails to comply with those express elements of the fair conduct principle. This would also significantly reduce any risk of a disconnect between financial institutions and the FMA in the interpretation of the principle.

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?*

If our proposal for Option B2 is accepted, and to address MBIE's concern that doing so would unduly limit the application of the principle, we propose an addition of another element to the exhaustive list, providing for the definition to also include any other factors that may be provided for by way of regulations.

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

Regardless of what option is ultimately imposed, as a general principle we do not view the provision of regulator guidance as an appropriate avenue to set standards relating to the principle or how it is 'defined'. Guidance should not be used to impose additional requirements or requirements that differ from the underlying statutory requirement, intent, or purpose.

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

Nothing to submit.

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

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?*

At a high level we support consolidating licences to encompass all of the market services that a single legal entity has been approved to provide. This would provide greater certainty and clarity for institutions looking to become licensees for certain market services, than navigating through differing licensing processes of each of the market services. However, given the FMC Act and related licensing is nearly a decade old we consider it may be too late for this to make a meaningful difference, given the large majority of entities are already licensed.

Limiting a consolidated licence to a single legal entity is also unduly restrictive. A number of licensees have group structures or subsidiary structures whereby related entities hold several licences amongst them, including being authorised bodies in some instances. If consolidated licences are going to be introduced at this late stage, then the concept should be expanded to cover a related group of entities.

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.*

A negative consequence of any streamlining is that what would, at the moment, be a conduct concern with respect to one licensed service, such as under an entity's financial advice provider licence, would instead become a more general conduct concern. The current licensing regime allows for a ring-fencing of various elements of a business with respect to different licensed services. Any consolidation of licences should retain that distinction, i.e. a breach of a discretionary investment management service obligation is limited to that service and not the institution or entity as a whole.

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

Consolidation will not make any practicable difference unless overlapping obligations are aligned, such as annual regulatory returns, to alleviate larger ongoing regulatory burdens for firms that hold multiple market services licences. This should also involve streamlining of standard conditions imposed by the FMA for the different market services.

In addition, if this option is passed into law, transitional relief to support its smooth implementation, and minimise any consequential compliance costs, will be critical. In particular, existing licensed entities should not need to apply for a new consolidated licence. Instead, a consolidation of licences should be able to occur automatically with minimal administrative burdens imposed on market service licensees, with an ability for those licensees to opt out of the default process if they choose.

A generous transitional period to allow licensees to continue to rely upon processes in place to observe existing licence conditions would also be beneficial.

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

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.*

We welcome a clearer statutory basis for cooperation between the FMA and the RBNZ and support any reduction in unnecessary overlap in regulator assessment activity. However, we have concerns as to the extent to which the two regulators can actually engage effectively. If implemented, ideally this option should improve regulatory efficiency by avoiding the need to duplicate effort where a similar issue has already been considered by a regulator – such as commonalities in licensing application considerations of dual-regulated firms, primarily fit and proper assessments.

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.*

Yes. As above, reliance on the other regulator's fit and proper assessments and determinations in relation to say, a cyber breach that actually impacts the provision of a product or service, should be readily allowed.

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?*

We note the FMA and the RBNZ's relationship is formalised by a Memorandum of Understanding dated 13 August 2021 ('**MoU**'), which provides a list of matters that the parties have committed to in order to cooperate 'in a manner that ensures the most effective and efficient regulation of the New Zealand financial system'. As part of this reform to improve regulatory effectiveness, we encourage an assessment of the effectiveness of the MoU in achieving regulatory efficiency as a result of regulator coordination, and whether providing statutory backing to the other matters outlined in the MoU is warranted, in addition to amending legislation to provide for the above mentioned mutual reliance power.

E: Ensuring the FMA has effective tools

Option E1: Introduce change in control approved requirements

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.*

We do not support the introduction of change in control approval requirements into the FMC Act. Requiring approval to changes of control risks hampering normal business activity. Further, the large majority of entities licensed by the FMA are not of systemic importance to New Zealand's financial system or stability. The sale of a small financial advisory or discretionary investment management business should not need prior regulatory approval. As far as we are aware, the FMA does not

undertake any significant assessment of ownership or control at the point of licensing so such assessment upon change of control also seems unnecessary.

From a prudential perspective, assessment of changes in control by RBNZ is necessary, given the systemic importance of most of the institutions the RBNZ oversees. The same cannot be said from an FMA 'conduct' perspective. The prudential regulator has a specific interest in a change of control to assess whether such change will impact the financial strength of the institution, in line with the overall objective of prudential regulation to prevent financial fragility among individual financial entities and preserve financial system stability. Accordingly, such assessments are made against clear objective standards.

A change of control could in theory be imposed on default KiwiSaver providers, given the importance of that statutory framework. However, member interests for default schemes are already protected via supervisory oversight, custodianship, and governance requirements, with issues regarding change in control able to be addressed through default provider approval terms, so adding such a requirement is unnecessary.

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?*

We do not think the FMA should be granted change in control approvals. There is no need for the FMA to have such a power in relation to financial institutions because the RBNZ is already required to assess such changes in control and the prudential lens is the appropriate objective consideration for such assessments. The more subjective conduct lens that the FMA would bring to bear when considering changes in control for all firms licensed under Part 6 would be inappropriate.

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

Nothing to submit.

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

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.*

We do not support the ability of the FMA to conduct on-site inspections without notice. We view the existing FMA powers as sufficiently enabling the FMA to proactively monitor compliance. Any concerns on the shortcomings of the FMA's on-site inspection powers are already addressed through its ability to apply for a court-ordered warrant. The introduction of such an invasive power would only create an unreasonable intrusion for private commercial entities.

In respect of FSP Act matters, the new registration threshold requirements, whereby overseas providers with New Zealand retail clients need to be registered, means there is less need for the FMA to be concerned with New Zealand place of business inquiries. Further, if the FMA has concerns about a firm raising money from the public then it has broad stop order and direction order powers it can utilise alongside its information request and search warrant powers.

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?*

Nothing to submit.

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

If a 'without notice' on-site inspection power is introduced, we urge that such powers should only be used where the FMA is satisfied that there are reasonable grounds to suspect a criminal offence has been committed. But even then, existing search warrant powers should suffice.

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

Nothing to submit.

Option E3: Introduce an expert report power for the FMA

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.*

We do not support the ability for the FMA to commission expert reports. This creates liability for additional compliance costs to be imposed on licensed entities. This would be directly contrary to the objectives of the current reform process and the criteria against which reform options are to be considered. We are concerned that the FMA may also reflectively seek for expert reports to be provided as a default approach, rather than using the power on rare occasions only. If the FMA considers an expert report would be desirable in relation to a matter it is investigating, it already has the option of engaging with the financial markets participant in question to arrange for such a report, or commissioning one itself.

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?*

As mentioned, we do not support the ability for the FMA to commission expert reports from any financial markets participants.

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

If an expert report power was made available to the FMA then that power should not extend to monitoring or diagnostic purposes, i.e. the power should not be used in the ordinary course of the FMA supervisory role. That power should be reserved only for serious non-compliance concerns.

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

No. Requiring financial markets participants to bear the cost of an expert report, except as part of the penalties imposed on a finding of wrong-doing, runs contrary to the objectives of the current review. There is also a risk that the FMA could seek expert reports as a matter of standard practice thus imposing additional and potentially unnecessary compliance costs on licensed entities. The FMA should be required to contribute to the costs of reports and be required to cover all costs of a report if that report fails to highlight any serious shortcomings with the entity under review, i.e. the FMA should bear the risk regarding possible costs to ensure the regulator does not reflexively seek reports where they are unnecessary.

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

Nothing to submit.

3 LIMITATIONS AND CONSRAINTS ON ANALYSIS

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

Nothing to submit.

4 IMPLEMENTAION

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

We strongly recommend that transitional arrangements be included as part of the reforms. Financial institutions should be able to opt into compliance with the new minimum requirements. It would be helpful if some form of regulatory relief was offered to enable financial institutions to take early advantage of the proposed changes, with effective transitional relief also made available for any consolidation of licences issued under Part 6 of the FMC Act.