



COVERSHEET

Minister	Hon Dr David Clark	Portfolio	Commerce and Consumer Affairs
Title of Cabinet paper	Approval to release discussion documents: Amendments and regulations to support the new regime for the conduct of financial institutions	Date to be published	1 June 2021

List of documents that have been proactively released

Date	Title	Author
14 April 2021	Approval to release discussion documents: Amendments and regulations to support the new regime for the conduct of financial institutions	<i>Office of the Minister of Commerce and Consumer Affairs</i>
14 April 2021	DEV-21-MIN-0063 Cabinet Economic Development Committee: Minute of Decision: Supporting the New Regime for the Conduct of Financial Institutions: Release of Discussion Documents	<i>Cabinet Office</i>

Information redacted

YES / NO

Any information redacted in this document is redacted in accordance with MBIE's policy on Proactive Release and is labelled with the reason for redaction. This may include information that would be redacted if this information was requested under Official Information Act 1982. Where this is the case, the reasons for withholding information are listed below. Where information has been withheld, no public interest has been identified that would outweigh the reasons for withholding it.

Some information has been withheld to maintain the confidentiality of advice to Government.

In Confidence

Office of the Minister of Commerce and Consumer Affairs

Cabinet Economic Development Committee

Approval to release discussion documents: Amendments and regulations to support the new regime for the conduct of financial institutions

Proposal

- 1 This paper seeks approval to release two discussion documents entitled:
 - 1.1 *Treatment of intermediaries under the new regime for the conduct of financial institutions; and*
 - 1.2 *Regulations to support the new regime for the conduct of financial institutions.*

Relation to government priorities

- 2 Banking and insurance services are essential to enable individuals to effectively participate in society. The purpose of the new regime for the conduct of financial institutions is to ensure the fair treatment of consumers. This relates to the government commitment to deliver open, transformative and compassionate government as well as to support healthier, safer and more connected communities.

Executive Summary

- 3 To inform final policy decisions, I propose to release two discussion documents to seek feedback on:
 - 3.1 options to address issues related to the treatment of intermediaries in the Financial Markets (Conduct of Institutions) Amendment Bill (the Bill); and
 - 3.2 regulations to support the new conduct regime.

Treatment of intermediaries under the new regime for the conduct of financial institutions

- 4 The Bill imposes requirements on financial institutions to oversee any intermediaries distributing or managing their products to ensure good outcomes for consumers. Stakeholders have raised concerns about these obligations throughout the policy process and following Select Committee report back, despite amendments made to the Bill. These concerns include that the obligations are too broad, unclear or duplicate the new regulatory regime for financial advice.

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- 5 Stakeholders have noted that the Bill as it stands would create high compliance costs with little consumer benefits and that if these impacts continue, intermediaries could reduce the number of institutions they work with, which could reduce competition and product choice for consumers.
- 6 The first discussion document seeks feedback on potential options to address these issues including by clarifying the level of oversight that financial institutions must have in relation to their intermediaries in a way that ensures appropriate responsibility, but avoids compliance costs and duplication of regulation.

Regulations to support the new regime for the conduct of financial institutions

- 7 The Bill imposes certain duties on financial institutions to have and comply with a “fair conduct programme” and to comply with regulations that regulate incentives. Regulations are likely necessary to support these duties and to ensure the fair treatment of consumers.
- 8 The second discussion document therefore seeks feedback on the following areas for possible regulations:
 - 8.1 Setting out further minimum requirements with respect to fair conduct programme requirements, for example in relation to complaints handling and insurance claims handling;
 - 8.2 Regulating sales incentives;
 - 8.3 Prescribing the content and form of information about fair conduct programmes that must be made publicly available.

Background

- 9 The Bill was reported back to the House on 7 August 2020 and is awaiting its second reading. The Bill creates a new regime to regulate the conduct of financial institutions. It gives effect to previous Cabinet decisions regarding the creation of a new licensing regime for banks, insurers and non-bank deposit takers (collectively referred to as financial institutions) in respect of their conduct [DEV-19-MIN-0237 refers].
- 10 The Bill responds to recent reviews of financial institutions which identified significant weaknesses in the conduct and culture of institutions in the financial sector. In particular, deficiencies were identified in respect of governance and management of conduct risks, and a lack of focus on good customer outcomes. These reviews include the 2018 FMA and Reserve Bank of New Zealand (RBNZ) reviews of banks and life insurers’ conduct and culture and the Ministry of Business, Innovation and Employment’s (MBIE) review of insurance contract law.

- 11 Key elements of the new regulatory regime contained in the Bill are:
- 11.1 Financial institutions will be required to be licensed under Part 6 of the Financial Markets Conduct Act (FMC Act) by the Financial Markets Authority (FMA) in respect of their conduct in relation to consumers;
 - 11.2 The introduction of the 'fair conduct principle', where financial institutions must treat customers fairly;
 - 11.3 Financial institutions will be required to establish, implement, maintain and comply with effective fair conduct programmes, which comprise policies, processes, systems and controls that are designed to ensure the institutions meet the fair conduct principle;
 - 11.4 Financial institutions will be required to have policies, processes, systems and controls to train, monitor and manage any intermediaries that are involved in the provision their products and services to consumers;
 - 11.5 Financial institutions and the intermediaries of those institutions will be required to comply with regulations regarding sales incentives. Cabinet has already agreed that sales incentives based on volume or value targets will be regulated [DEV-19-MIN-0237 refers].

Treatment of intermediaries under the new regime for the conduct of financial institutions

Obligations that apply in respect of intermediaries

- 12 The Bill imposes obligations on financial institutions to have systems and processes in place for training, monitoring and managing their intermediaries to ensure the fair treatment of consumers.
- 13 An 'intermediary' is defined broadly in the Bill and captures people selling and distributing products (e.g. insurance or mortgage brokers) as well as administrative, advisory and fulfilment services that support the provision of the financial institution's products and services (e.g. insurance claims management companies, lawyers and panel beaters).
- 14 Stakeholders have raised concerns about the Bill's obligations that relate to intermediaries throughout the development of the Bill. These generally relate to the fact that the Bill requires financial institutions to monitor or manage the conduct of independent third parties. Some concerns that have been raised are that the definitions and requirements in the Bill relating to intermediaries:
- 14.1 are too broad;
 - 14.2 are unclear;
 - 14.3 overlap with or duplicate the regulation of financial advice under the Financial Services Legislation Amendment Act 2019 (and are therefore unnecessary); and

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- 14.4 would require compliance in practice by intermediaries with multiple compliance programmes.
- 15 Stakeholders have noted that as a result of these issues:
- 15.1 The obligations would require significant resourcing and time commitment from both financial institutions and intermediaries to comply, with little value to consumers (e.g. amending or creating agency agreements to manage the conduct of intermediaries who have little or no direct involvement in providing or managing a financial institution's products or services (e.g. lawyers, panel beaters)).
- 15.2 Financial institutions may be doing more than is necessary or appropriate with respect to training, supervising and managing intermediaries. Examples of this have already been seen in the market include requiring annual audits of every intermediary by an independent third party, rather than doing assessing conduct on a risk-based basis.
- 16 Stakeholders have noted that if these impacts continue, there could be significant structural impacts on the market, such as intermediaries reducing the number of institutions they work with. This could reduce competition and product choice for consumers.
- 17 The Finance and Expenditure Committee made a number of amendments to the provisions in the Bill relating to intermediaries to narrow their level of liability. However, stakeholders have continued to raise concerns about the Bill's provisions.

Key features of discussion document on the treatment of intermediaries

- 18 In response to these concerns raised by stakeholders, I propose to release the discussion document entitled *Treatment of intermediaries under the new regime for the conduct of financial institutions* for public consultation.
- 19 The discussion document describes the problems we have heard from stakeholder feedback, possible options for solving them and the benefits or costs of those options.
- 20 The purpose of seeking formal feedback is to hear from a wide range of stakeholders and to seek robust and enduring solutions to these outstanding concerns before the Bill is finalised and passed.
- 21 The discussion document proposes two categories of changes, which are:
- 21.1 Narrowing the definition of an 'intermediary' to ensure we capture the types of activities conducted by intermediaries that pose the highest conduct risks to consumers. This primarily means those involved in sales and distribution of financial products (e.g. brokers and financial advisers), but not administrative, advisory or fulfilment services. These types of services would continue to be covered by the generic concept of an 'agent', with different obligations.

- 21.2 Clarifying the level of oversight that the Bill requires financial institutions to have in relation to their intermediaries.
- 22 Overall, the obligations on intermediaries aim to ensure that financial institutions are meeting their responsibility to treat consumers fairly, regardless of the distribution channel for their financial products and services. One of the key issues identified in the FMA and RBNZ reviews was that some financial institutions were not taking adequate responsibility for customer outcomes when products were sold by intermediaries and make little effort to maintain visibility of customer outcomes where an intermediary is involved. Another key objective, however, is to ensure consistency with, and avoid duplication of, obligations that apply directly to intermediaries that are regulated as financial advisers.
- 23 As noted above, the Bill is currently awaiting the Committee of the whole House stage. Feedback via public consultation and advice from officials will inform me whether amendments to the Bill via a Supplementary Order Paper (SOP) are necessary.

Regulations to support the new regime for the conduct of financial institutions

- 24 The Bill imposes a number of core obligations on financial institutions, with minimum requirements specified in the Bill and further detailed requirements intended to be contained in regulations. As noted above, these obligations include duties to have and comply with a “fair conduct programme” that is designed to ensure the fair treatment of consumers and a duty to comply with regulations that regulate sales incentives.

Key features of discussion document on regulations to support the new regime for the conduct of financial institutions

- 25 I propose to release the discussion document entitled *Regulations to support the new regime for the conduct of financial institutions* for public consultation. It is considered best practice to develop regulations to support a Bill alongside the passage of the Bill through the House. This minimises the risk that the Bill does not have the necessary empowering provisions to enable the regulations to be made.
- 26 This discussion document seeks feedback on whether where regulations may be necessary to:
- 26.1 prescribe additional requirements in areas where further prescription is important to ensure the fair treatment of consumers, or
 - 26.2 support existing duties in the Bill.
- 27 The different sections of this discussion document include:
- 27.1 Options to add or clarify requirements for fair conduct programmes, including around:

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- 27.1.1 the design and distribution of products and services, including identifying the likely consumers for financial products and services, and taking reasonable steps to ensure the provision of those financial products and services are distributed to the identified group of likely consumers;
- 27.1.2 the identification and management of risks that may impact a financial institution's ability to comply with the fair conduct principle;
- 27.1.3 the identification and remediation of conduct issues, for example that remediation processes must be adequately resourced;
- 27.1.4 handling consumer complaints, for example that complaints are investigated in a fair, timely and transparent manner;
- 27.1.5 handling insurance claims, for example ensuring employees' and agents' compliance with claims handling procedures;
- 27.2 Options to support the duties in the Bill on financial institutions and intermediaries to comply with regulations relating to sales incentives, including:
 - 27.2.1 Prohibiting sales incentives based on volume or value targets; or
 - 27.2.2 A principle-based prohibition on sales incentives;
- 27.3 Options on the form and substance of fair conduct programme summaries, which the Bill requires financial institutions to publish, which will provide consumers with some general information about the standard of conduct they should expect from their financial institution;
- 27.4 A technical proposal to make it clear that insurance contracts are covered by the 'fair dealing' provisions of the FMC Act that cover misleading and deceptive conduct to ensure the FMA can take action against misleading conduct in relation to insurance contracts.

Next steps

- 28 The two discussion documents will be released for public consultation following Cabinet approval. MBIE will analyse the submissions and provide me with further advice.
- 29 I will seek Cabinet policy decisions on the regulations to support the new conduct regime and the treatment of intermediaries in the Bill by August 2021, taking into account feedback from consultation.
- 30 The changes proposed in the discussion document relating to the treatment of

Legal professional privilege

Legal professional
privilege

Financial Implications

31 There are no financial implications from the recommendations in this paper.

Legislative Implications

32 The release of the two discussion documents do not raise any legislative implications. However, most options in the two discussion documents would require legislative or regulatory changes to implement them.

Impact Analysis

33 In relation to the discussion document regarding regulations to support the new conduct regime, the Regulatory Impact Analysis Quality Assurance panel at Ministry of Business, Innovation and Employment has reviewed the discussion document and confirms that it substitutes for a Regulatory Impact Statement. The discussion document is likely to lead to effective consultation and support the delivery of a quality regulatory impact analysis to inform subsequent decisions.

34 In relation to the discussion document regarding the treatment of intermediaries, the Regulatory Quality Team at the Treasury has determined that the regulatory proposals in this paper are exempt from the requirement to provide a Regulatory Impact Statement on the basis that the substantive issues have been addressed by previous impact analysis [DEV-19-MIN-0237 refers].

Population Implications

35 There are not expected to be significant implications on specific population groups as a result of the options discussed in the two discussion documents.

Human Rights

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

Consultation

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

38 The Parliamentary Counsel Office has been consulted on the legislative implications of the policy proposals contained in the two discussion documents.

Communications

- 39 A press release will be issued along with the release of the two discussion documents for six weeks' public consultation.

Proactive Release

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

Recommendations

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

- 1 **note** that the Financial Markets (Conduct of Institutions) Amendment Bill, which introduces a new regulatory regime regulating the conduct of financial institutions, was reported back to the House on 7 August 2020 and is awaiting its second reading;
- 2 **note** that stakeholders have raised concerns about the provisions in the Financial Markets (Conduct of Institutions) Amendment Bill that relate to the treatment of intermediaries;
- 3 **note** that the discussion document on the treatment of intermediaries describes problems with the requirements on intermediaries in the Financial Markets (Conduct of Institutions) Amendment Bill and possible options for resolving them including:
 - 3.1 amending the definition of an intermediary to focus on sales and distribution activities;
 - 3.2 narrowing the obligations that apply in respect of intermediaries;
- 4 **note** that the discussion document on regulations to support the new regime for the conduct of financial institutions seeks feedback on proposed regulations regarding:
 - 4.1 further minimum requirements that must be included in fair conduct programmes;
 - 4.2 the regulation of sales incentives;
 - 4.3 the form and substance of information about fair conduct programmes that financial institutions must make publicly available;
 - 4.4 a technical proposal to make it clear that insurance contracts are covered by the 'fair dealing' provisions of the Financial Markets Conduct Act;
- 5 **approve** the release of the discussion document *Treatment of intermediaries under the new regime for the conduct of financial institutions*;

I N C O N F I D E N C E

- 6 **approve** the release of the discussion document *Regulations to support the new regime for the conduct of financial institutions* and the accompanying consumer summary;
- 7 **authorise** the Minister of Commerce and Consumer Affairs to make minor and technical changes to the discussion papers referred to in paragraphs 5 and 6, and the accompanying consumer summary prior to their release;
- 8 **invite** the Minister of Commerce and Consumer Affairs to report back to Cabinet by August 2021 with the outcomes of consultation and proposed policy changes.

Authorised for lodgement

Hon Dr David Clark
Minister of Commerce and Consumer Affairs

Appendices

Appendix 1: Discussion Document: *Treatment of intermediaries under the new regime for the conduct of financial institutions*

Appendix 2: Discussion Document: *Regulations to support the new regime for the conduct of financial institutions*

Appendix 3: Consumer Summary: *New regime for the conduct of financial institutions*