



COVERSHEET

Minister	Hon Dr Duncan Webb	Portfolio	Commerce and Consumer Affairs
Title of Cabinet paper	Regulations and commencement order to support the Financial Markets (Conduct of Institutions) Amendment Act 2022: Authorisation for submission to the Executive Council	Date to be published	18 July 2023

List of documents that have been proactively released

Date	Title	Author
June 2023	Regulations and commencement order to support the Financial Markets (Conduct of Institutions) Amendment Act 2022: Authorisation for submission to the Executive Council	Office of the Minister of Commerce and Consumer Affairs
1 June 2023	Regulations and Commencement Order to Support the Financial Markets (Conduct of Institutions) Amendment Act 2022 LEG-23-MIN-0082 Minute	Cabinet Office
24 May 2023	Regulatory Impact Statement: Financial Markets (Conduct of Institutions) Amendment Act: Regulations for market services licences	MBIE

Information redacted

NO

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In Confidence

Office of the Minister of Commerce and Consumer Affairs

Cabinet Legislation Committee

Regulations and commencement order to support the Financial Markets (Conduct of Institutions) Amendment Act 2022: Authorisation for submission to the Executive Council

Proposal

- 1 I seek Cabinet's authorisation to submit to the Executive Council the following regulations and commencement order required to support the Financial Markets (Conduct of Institutions) Amendment Act 2022 (**the Act**):
 - 1.1 The Financial Markets Conduct (Fees) Amendment Regulations 2023 (**Fees Amendment Regulations**)
 - 1.2 The Financial Markets Conduct (Conduct of Institutions) Amendment Regulations 2023 (**Conduct Regulations**)
 - 1.3 The Financial Markets (Conduct of Financial Institutions) Amendment Act 2022 Commencement Order 2023 (**Commencement Order**).
- 2 I am also seeking Cabinet's agreement to the policy decision to impose licensing fees on financial institution licence applicants through the Fees Amendment Regulations, and to a limited exclusion from a previously approved prohibition on certain kinds of sales incentives in the Conduct Regulations.

Executive summary

- 3 The Act introduces a new licensing regime for banks, insurers and non-bank deposit takers (collectively **financial institutions**), which will require them to treat consumers fairly. This paper seeks agreement to make regulations that are necessary to implement the regime.
- 4 Firstly, the Fees Amendment Regulations set licensing fees that enable the Financial Markets Authority (**FMA**) to recover the costs for processing licensing applications. It is appropriate that these costs be recovered from applicants as they will receive the benefit of holding a licence. Having considered the feedback received in consultation I am confident that the proposed fees are fair, reasonable and proportionate.
- 5 The fee model is composed of a flat application fee and an hourly rate that will only apply when the FMA is dealing with more complex and time-consuming applications. I expect that the majority of applicants will only pay the flat fee, but the FMA will have the ability to recover costs if extra time is required to process applications.

- 6 Secondly, the Conduct Regulations give effect to Cabinet's previous policy decision to prohibit financial institutions and intermediaries from offering sales incentives based on volume or value targets to their employees (except senior managers and executives), agents and intermediaries [DEV-22-MIN-0003 refers]. Public consultation was undertaken on an exposure draft of the regulations relating to incentives and changes have been made in response to submission feedback to ensure clarity and certainty. I also propose to introduce a limited exclusion for financial advice provider intermediaries in relation to a remuneration model that I understand is used in the sector.
- 7 The Conduct Regulations will also include regulations to give effect to other policy decisions made by Cabinet and ensure that the regime works as intended, including provisions to ensure that the regime works for the Lloyd's insurance market.
- 8 Finally, the Commencement Order will bring some technical provisions of the Act into effect on 25 July 2023 in order that the FMA can consider licensing applications from that date. It will bring the remaining provisions of the Act (including the substantive obligations on financial institutions and obligation to hold a licence) into effect on 31 March 2025.

Background

- 9 Under the Act, which received royal assent on 29 June 2022, financial institutions will be required to treat consumers fairly, and must establish, implement and maintain effective fair conduct programmes to ensure that they do so. Financial institutions will be required to hold a licence issued by the FMA in respect of their conduct towards consumers. The FMA will monitor and enforce the regime.
- 10 The FMA plans to begin accepting applications for financial institution licences on 25 July 2023, subject to necessary technical provisions being brought into force by the Commencement Order. Financial institutions are getting ready for licensing and have begun developing their fair conduct programmes in preparation for making licence applications. Cabinet has previously been advised that the regime is planned to commence in early 2025.
- 11 In February 2022, Cabinet made policy decisions on proposed regulations under the Act relating to sales incentives and to the Lloyd's insurance market and authorised the Minister to issue drafting instructions to Parliamentary Counsel Office (**PCO**) to give effect to these recommendations [DEV-22-MIN-0003]. In September 2022, Cabinet agreed to the release of a discussion document on the licensing fee to apply under the Act and the release of an exposure draft of regulations relating to sales incentives and authorised the Minister to make minor and technical changes [DEV-22-MIN-0221].

Fees Amendment Regulations

- 12 Licensing allows the FMA to assess whether a financial institution is able to meet the statutory licensing criteria under the Financial Markets Conduct Act 2013 (**FMC Act**), including whether it is capable of effectively performing the

licensed service. It also improves the FMA's ability to monitor the conduct of licensed financial institutions towards consumers and take enforcement action where necessary.

- 13 Under the FMC Act and the Financial Markets Authority Act 2011, the FMA is able to recover the costs incurred in considering a licence application if the fees are prescribed in regulations. I consider that charging a fee to applicants is consistent with the best practice guidelines published by the Office of the Auditor-General and by Treasury. The proposed fee model in the Fees Amendment Regulations is set out in the table below:

Financial institution licensing fee (all costs inclusive of GST)	
Basic licensing fee for all applicants (based on an estimated time to assess a standard application of 5.75 hours) ¹	\$1,024.93
+ Hourly rate charges that may apply for applications where the FMA's staff time to assess exceeds 6.75 hours ²	\$178.25/hour , or part-hour pro rata, of work carried out
+ Fee for each authorised body included in the licence (based on an estimated time to assess a standard application of 3.45 hours)	\$614.95
+ Other variations to licence conditions ³	\$115 plus \$178.25/hour , or part-hour pro rata, of work carried out

- 14 The hourly rate component of the fee will allow the FMA to recover the costs it incurs in considering more time-consuming applications (including incomplete applications). This is consistent with the approach used for other categories of licences processed by the FMA. This approach will keep the fees charged to most applicants relatively low.
- 15 The hourly rate aspect of the charging model was questioned by some industry submitters, as they felt it might increase uncertainty about the fee level. However, it is my expectation that most applicants will only pay the flat application fee. The regulations also provide that the FMA will only charge an additional hourly rate after notifying the applicant of the additional charge and the reasons for it. I expect the FMA to continue to be an efficient and effective regulator and to apply the hourly rate appropriately.
- 16 Some submitters questioned why different licence classes with different fees were not set (for example, based on the size or type of financial institution). I understand that assessment time is not expected to differ based on the type

¹ The fee is calculated based on the FMA hourly rate of of \$178.25/hour set by the Financial Markets Conduct (Fees) Regulations 2014.

² As with the existing financial advice provider licensing fee, which also uses an automated application system to process applications and consists of only a few hours of staff time for assessing a [standard] application, a small margin of 1 hour over the estimated average time is proposed before the hourly fee may be charged. I understand it has been rare for FMA to charge for additional hours for financial advice provider licences.

³ This fee reflects the FMA's existing licence variation fee in the Fees Regulations of \$115 plus \$178.25/hour of work carried out.

of institution. The circumstances that are likely to increase the complexity of an application (and therefore assessment time) include where, for example, the applicant submits an incomplete application that is missing required information or documents, or where the applicant has not followed the application guidance.

- 17 Having considered feedback from submitters I consider the proposed fee model of a flat fee (with additional hourly rates where necessary) is appropriate because:
- 17.1 it should allow the FMA to fully recover, but not over-recover, anticipated staff costs of assessing licence applications;
 - 17.2 it minimises cross-subsidy between different applicants by allowing additional fees to be charged for more complex applications;
 - 17.3 it will provide certainty to most applicants, while allowing the FMA to recover additional costs of assessing more complex applications;
 - 17.4 it will encourage the FMA to deliver licensing services to fee payers in an efficient and effective manner, by setting the base fee at a level that appropriately recovers costs in most cases and by requiring the FMA to notify applicants and explain the reason for charging an additional hourly rate in more complex cases;
 - 17.5 it is simple to administer and aligns with the approach taken to most other FMC Act licensing fees.

Conduct Regulations – sales incentives

- 18 The Government decided to take action on sales incentives following the FMA and Reserve Bank’s reviews of the conduct and culture of banks and life insurers and the FMA’s review of bank incentives. It was found through these reviews that incentives were driving poor conduct in financial institutions. Target-based incentives are particularly problematic because a recipient’s personal interest in making a sale grows stronger as they approach the target.
- 19 Accordingly, in February 2022, Cabinet agreed that regulations will prohibit financial institutions and intermediaries from offering sales incentives based on volume or value targets to their employees (excluding senior managers and executives), agents and intermediaries [DEV-22-MIN-0003 refers]. In September 2022, Cabinet agreed to the release of an exposure draft of regulations relating to sales incentives [DEV-22-MIN-0221].
- 20 The following minor amendments have been made to the exposure draft version of the regulations.
- 21 Firstly, the prohibition now applies only to incentives that are determined or calculated by reference in any way “directly” to a target or other threshold that relates to the volume or value of the services and products. The exposure draft definition captured incentives that were determined or calculated in any way by reference “directly or indirectly” to a target or other threshold. The use

of “indirectly” reflected the definition in the Act, which is intentionally broad, but in this context it may have resulted in the unintended capture of measures like market share or profit which are causally linked to the volume or value of services and products provided.

- 22 Secondly, the prohibition now applies only to customer-facing employees and their immediate managers or supervisors. In practice, customer-facing employees and their immediate managers or supervisors are most likely to be offered incentives based on volume or value targets of products or services. This change is intended to avoid uncertainty and gives effect to Cabinet’s policy decision not to capture senior managers and executives.
- 23 Thirdly, the regulations now include a transitional provision to confirm that they will apply to prohibited incentives that are offered, given or payable after the regulations commence, even if they are offered, given or payable under an agreement entered into before the commencement date. For clarity, incentives earned before the commencement date, but paid after, will not be caught. The purpose of this transitional provision is to provide certainty about the application of the prohibition.
- 24 Finally, other minor and technical changes have been made to improve the drafting and clarity of the regulations, including expressly excluding linear incentives (i.e. incentives calculated on a per product or per service basis) from the scope of the prohibition.
- 25 I also propose a limited exclusion from the prohibition that will apply to financial advice provider intermediaries (who are not financial institutions). They may remunerate employed financial advisers with a fixed base salary plus (once a certain level of sales is reached) linear commissions. This is sometimes called a ‘salary plus’ or ‘gateway’ model. I understand these models were introduced to replace purely commission-based structures in the financial advice sector, and feedback from the industry suggests they deliver positive outcomes for consumers by relieving pressure on new financial advisers to make sales to earn a living. I am mindful that the application of the prohibition to these models could have the unintended consequence of discouraging new advisers from entering the industry. I am concerned that a blanket prohibition would have a disproportionate impact on the provision of these financial services. However, if in the future these models are used in a way that does give rise to consumer harm, I will consider whether the exclusion remains appropriate.
- 26 Section 546(4) of the FMC Act sets out a number of factors that I must have regard to before making a recommendation to make regulations relating to prohibiting incentives. I have had regard to these factors as follows:
- 26.1 The proposed regulations are consistent with the purposes of the FMC Act and the fair conduct principle, including by promoting the confident and informed participation of consumers in financial markets.
- 26.2 They will appropriately manage conflicts of interest between the interests of consumers and recipients. Incentives with a target

component can lead to recipients prioritising making sales over consumer interests, particularly when they are close to the target.

- 26.3 I do not expect that the proposed regulations will significantly impact the availability of financial advice, services and products, or the financial services industry. I acknowledge that there will be some compliance costs for industry from having to change remuneration structures. However, incentives other than volume or value targets will still be permitted (such as linear incentives). I am also aware that some financial institutions have already responded to the FMA and Reserve Bank conduct and culture reviews by removing these types of incentives, particularly in the banking and life insurance space.
- 26.4 I am satisfied that the subject of the regulations is not more appropriately dealt with in an Act. The regulations do not prohibit all incentives; they prohibit a specific type of incentive provided to a specific class of people. Regulations allow more flexibility for the specifics of the prohibitions to be adjusted in the future if necessary to address risks to consumers that come to light.

Conduct Regulations – Other provisions

- 27 The Conduct Regulations also include provisions to ensure the regime works for the unique structure of the Lloyd's insurance market. The policy intent is to ensure consumers buying insurance policies from Lloyd's can expect the same level of fair treatment as they would from conventional insurers. To achieve this, these provisions [DEV-22-MIN-003]:
- 27.1 set out the detail of Lloyd's managing agents' fair conduct programme requirements (which differ to those applying to other financial institutions only to the extent necessary to ensure this is workable for the structure of the Lloyd's market);
- 27.2 set out the terms and conditions on which Lloyd's underwriting members will be exempt from the requirement to be licensed, which seek to reflect the obligations placed on other financial institutions through FMC Act licensing framework (e.g. reporting obligations);
- 27.3 prescribe how Lloyd's managing agents will make information about their fair conduct programme available to consumers.
- 28 The Conduct Regulations also give effect to Cabinet's decision to call-in contracts of insurance as financial products under the "fair dealing" provisions in Part 2 of the FMC Act [DEV-22-MIN-0003]. These fair dealing provisions already cover the service of 'acting as an insurer', which means the FMA acts as leading regulator in this area, and the regulations ensure that insurance contracts as products are expressly covered.
- 29 Finally, the Conduct Regulations also deal with a technical matter that was identified during drafting. I understand that a small number of New Zealand banks provide services only to wholesale clients which may include some

wholesale corporate groups with controlled entities that meet the legislative definition of “retail client”. I consider that these controlled entities do not need the protections of the conduct regime.

- 30 Therefore, I propose to exclude services offered to controlled entities of wholesale clients from the Act, using the power in section 546(1)(ob) of the FMC Act to prescribe excluded classes of service. I consider that the statutory prerequisites in section 550 are met because:
- 30.1 The proposed regulations give effect to the purposes of the FMC Act by promoting the development of efficient financial markets and avoiding unnecessary compliance costs.
- 30.2 The exclusion is narrowly targeted to cover only controlled entities and its extent is not broader than reasonably necessary to address the issues that give rise to the regulations.
- 30.3 I have consulted with the FMA who agree with this proposal.

Commencement Order

- 31 As previously signalled to Cabinet, the FMA is planning to open licence applications in July 2023, and I intend to commence the regime early in 2025. The attached Commencement Order:
- 31.1 brings some technical provisions of the Act into effect on 25 July 2023 to enable the FMA to consider licence applications from that date
- 31.2 brings the remaining provisions of the Act (including the substantive obligations on financial institutions) into effect on 31 March 2025.
- 32 The above timeline has been well-signalled to industry and takes into account the importance of giving financial institutions plenty of time to develop their fair conduct programmes and obtain their licences before the full regime comes into effect. The FMA has been consulted on the proposed timeline.

Timing and 28-day rule

- 33 Subject to Cabinet’s agreement, the proposed regulations and Commencement Order will be submitted to the Executive Council for signature on 6 June, and are expected to be notified in the Gazette on 8 June and come into effect:
- 33.1 for the Fees Amendment Regulations, on 25 July 2023;
- 33.2 for the Conduct Regulations, on 31 March 2025;
- 33.3 for the Commencement Order, on 25 July 2023.
- 34 The proposed timing complies with the 28-day rule.

Compliance

- 35 The proposed regulations and Commencement Order comply with:
- 35.1 the principles of the Treaty of Waitangi;
 - 35.2 the rights and freedoms contained in the New Zealand Bill of Rights Act 1990 and the Human Rights Act 1993;
 - 35.3 the principles and guidelines set out in the Privacy Act 2020;
 - 35.4 relevant international standards and obligations; and
 - 35.5 the Legislation Guidelines (2021 edition), which are maintained by the Legislation Design and Advisory Committee.
- 36 As outlined above at paragraphs 26 and 30, statutory prerequisites for the making of the regulations have been met. I have consulted the FMA about the proposed regulations where required by section 549 of the FMC Act 2013.

Financial implications

- 37 There are no financial implications from this paper, as the proposed regulations will ensure that the FMA can recover licensing costs in the new regime from applicants.

Regulations Review Committee

- 38 I am not aware of any grounds for the Regulations Review Committee to draw the regulations to the attention of the House of Representatives.

Certification by Parliamentary Counsel

- 39 The draft regulations have been certified by PCO as being in order for submission to Cabinet.

Impact analysis

- 40 A Regulatory Impact Statement in respect of the proposed licensing fees is attached as **Appendix 1** and has been reviewed by MBIE's Regulatory Impact Analysis Review Panel. The panel considers that the information and analysis summarised in the Regulatory Impact Statement **meets** the criteria necessary for Ministers to make informed decisions on the proposals in this paper.
- 41 A Regulatory Impact Statement in relation to the prohibition on incentives based on volume or value targets was submitted at the time Cabinet made policy decisions in relation to the Act [DEV-19-MIN-0237].⁴ A Regulatory Impact Statement in relation to the approach to the Lloyd's insurance market

⁴ <https://www.mbie.govt.nz/dmsdocument/7372-regulatory-impact-statement-regulatory-regime-to-govern-the-conduct-of-financial-institutions-december-2019-pdf>

was submitted at the time Cabinet made the relevant policy decisions [DEV-22-MIN-0003].⁵

Publicity

- 42 The regulations will be published on PCO's 'New Zealand Legislation' website.

Proactive Release

- 43 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.

Consultation

- 44 The FMA were consulted on the development of the proposals outlined in this paper, and the Office of the Auditor-General's *Guidelines to Costing and Charging for Public Sector Goods and Services* have been considered. The Treasury, RBNZ, Commerce Commission have been consulted on this paper, and Cabinet (Policy Advisory Group) has been informed.
- 45 MBIE officials undertook consultation with the public on the licensing fees discussion document (for four weeks) and the exposure draft incentive regulations (for six weeks), in accordance with Cabinet's previous policy decisions [DEV-22-MIN-0221].
- 46 Five submissions from industry organisations were received on the licensing fees discussion document. Submitters' views on the proposed approach to licensing fees have been taken into account and are discussed above at paragraphs 15 to 17 and in the attached Regulatory Impact Statement. 21 submissions were received on the exposure draft incentives regulations, including from industry organisations, insurers, banks and financial advice providers. The submissions were helpful in identifying areas of the draft regulations that could be improved, and feedback has been taken into account in the amendments outlined at paragraphs 20 to 25 above.
- 47 In addition, MBIE officials undertook targeted consultation with Lloyd's representatives on the regulations relating to Lloyd's, in order to ensure they would work for the Lloyd's market. Feedback has been taken into account in the final regulations.

Recommendations

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

- 1 **note** that the Financial Markets (Conduct of Institutions) Amendment Act 2022 introduces a new regulatory regime for the conduct of financial institutions;

⁵ <https://www.mbie.govt.nz/dmsdocument/19335-financial-markets-conduct-of-institutions-amendment-bill-further-policy-decisions-regulatory-impact-statement-proactiverelease-pdf>

Fees Amendment Regulations

- 2 **note** that under the Financial Markets Conduct Act 2013 and the Financial Markets Authority Act 2011, regulations can be made requiring applicants for a financial institution licence under the new regulatory regime to pay a fee to the Financial Markets Authority;
- 3 **note** that in September 2022, Cabinet agreed to the release of a discussion document on the licensing fee to apply under the Act [DEV-22-MIN-0221];
- 4 **note** that, as proposed in the discussion document, the Financial Markets Conduct (Fees) Amendment Regulations 2023 impose a fee of \$1,024.93 for standard applications, with an hourly fee of \$178.25 applying for applications which require more assessment time;
- 5 **agree** to introduce licensing fees on a cost-recovery basis as outlined in the Financial Markets Conduct (Fees) Amendment Regulations 2023;

Conduct Regulations

- 6 **note** that in February 2022, Cabinet made policy decisions in relation to proposed regulations under the Act and authorised the Minister to issue drafting instructions to Parliamentary Counsel Office to give effect to these decisions [DEV-22-MIN-0003];
- 7 **note** that in September 2022, Cabinet agreed to the release of an exposure draft of regulations relating to sales incentives [DEV-22-MIN-0221];
- 8 **note** that the Financial Markets Conduct (Conduct of Institutions) Amendment Regulations 2023 give effect to the policy decisions referred to in paragraph 6 above by prohibiting financial institutions and intermediaries from offering incentives based on volume or value targets to customer-facing employees and their managers, agents and intermediaries;
- 9 **agree** to a limited exclusion for financial advice provider intermediaries (who are not financial institutions) to allow them to remunerate employed financial advisers through a fixed base salary, plus (once a certain level of sales is reached) linear commissions;
- 10 **note** the advice of the Minister of Commerce and Consumer Affairs that the statutory prerequisites in section 546(4) of the Financial Markets Conduct Act are met in relation to regulations prohibiting incentives;
- 11 **note** that the Financial Markets Conduct (Conduct of Institutions) Amendment Regulations 2023 also address a technical issue by excluding services provided to retail clients controlled by wholesale clients from the regime;
- 12 **note** the advice of the Minister of Commerce and Consumer Affairs that the statutory prerequisites in section 550 of the Financial Markets Conduct Act are met in relation to the proposed exclusion in paragraph 11 above;

Commencement Order

- 13 **note** that the Financial Markets (Conduct of Financial Institutions) Amendment Act 2022 Commencement Order 2023 provides that:
- 13.1 some technical provisions of the Financial Markets (Conduct of Institutions) Amendment Act 2022 will come into effect on 25 July 2023 to enable the Financial Markets Authority to consider licence applications from that date;
- 13.2 the remaining provisions will come into effect on 31 March 2025;

Authorisation of submission

- 14 **authorise** the submission to the Executive Council of the Financial Markets Conduct (Fees) Amendment Regulations 2023, the Financial Markets Conduct (Conduct of Institutions) Amendment Regulations 2023 and the Financial Markets (Conduct of Financial Institutions) Amendment Act 2022 Commencement Order 2023;
- 15 **note** that the Financial Markets Conduct (Fees) Amendment Regulations 2023 will come into force on 25 July 2023 and that the Financial Markets Conduct (Conduct of Institutions) Amendment Regulations 2023 will come into force on 31 March 2025.

Authorised for lodgement

Hon Dr Duncan Webb
Minister of Commerce and Consumer Affairs