



## COVERSHEET

<b>Minister</b>	Hon Andrew Bayly	<b>Portfolio</b>	Commerce and Consumer Affairs
<b>Title of Cabinet paper</b>	Proposals to review the Financial Markets (Conduct of Institutions) Amendment Act 2022 and the Credit Contracts and Consumer Finance Act 2003	<b>Date to be published</b>	13 March 2024

### List of documents that have been proactively released

<b>Date</b>	<b>Title</b>	<b>Author</b>
January 2024	Proposals to review the Financial Markets (Conduct of Institutions) Amendment Act 2022 and the Credit Contracts and Consumer Finance Act 2003	Office of the Minister of Commerce and Consumer Affairs
25 January 2024	Proposals to Review the Financial Markets (Conduct of Institutions) Amendment Act 2022 and the Credit Contracts and Consumer Finance Act 2003  CBC-24-MIN-0013 Minute	Cabinet Office

### Information redacted

**YES**

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Some information has been withheld for the reason of confidential advice to government.

## In Confidence

Office of the Minister of Commerce and Consumer Affairs

Cabinet Business Committee

## Proposals to review the Financial Markets (Conduct of Institutions) Amendment Act 2022 and the Credit Contracts and Consumer Finance Act 2003

### Proposal

- 1 This paper outlines my thinking on reviewing regulation of some financial services, and the timing for Cabinet considerations of the policy options and decisions. I plan to make a public announcement on my broad policy direction at the Financial Services Council conference on 31 January.

### Relation to government priorities

- 2 These proposals respond to the specific commitments to financial services deregulation in the National Party's 100-point plan for *Rebuilding the Economy* [CAB-23-MIN-0464 refers]. The changes I plan to advance will also give effect to the Government's commitment to cut red tape to make it easier to invest and grow.

### Executive Summary

- 3 The Financial Markets (Conduct of Institutions) Amendment Act 2022 (CoFI) and Credit Contracts and Consumer Finance Act 2003 (the CCCFA) were both recently passed or reformed by the previous Government.
- 4 After the CCCFA changes in December 2019, banks estimated around 6-7% of applicants who would have previously qualified for a mortgage had to be turned down. This means vulnerable consumers are not able to access a wide range of suitable financial products. Furthermore, CoFI adds another layer to an already complex financial regulatory landscape.
- 5 My officials and I have engaged a range of industry operators on the issues with both these pieces of legislation and have determined an acceptable way forward. Industry is seeking certainty as to what revised arrangements we intend to implement.
- 6 I am proposing to review CoFI to ensure financial institutions can implement its requirements more easily and that they result in 'fair market' policies that are fit for purpose and proportionate. I propose to explore three areas of reform to financial markets conduct regulation relating to the relationship between the Financial Markets Authority (FMA) and the Reserve Bank of New Zealand (RBNZ), the conduct licensing requirements, and the CoFI obligations.

- 7 I propose to review CCCFA in two phases, with Phase 1 removing prescriptive affordability regulations for lower-risk lending or lenders (which can be done through secondary legislation), and Phase 2 taking a longer-term review of CCCFA and its relationship with CoFI.
- 8 I propose to announce these planned reviews at an industry event on 31 January 2024. The key next steps will be:
- 8.1 Officials and I will undertake further consultation with stakeholders and consumer representatives to inform development of policy decisions and instructions to Parliamentary Counsel Office.
- 8.2 I expect to return to Cabinet in February to seek policy decisions in relation to the Phase 1 CCCFA review, and mid-year in relation to CoFI and Phase 2 of the CCCFA review.
- 8.3 The reviews of CoFI and Phase 2 of the CCCFA review are likely to result in recommendations to Cabinet to make legislative changes. These will proceed in parallel. Legislative bids are being submitted, and both are seeking a priority Confidential advice to Government

## Background

- 9 Since the significant reform of the financial services sector led primarily by Hon Simon Power in the fifth National Government, which resulted in the establishment of the FMA in 2011, there have been a succession of legislation and regulations passed to further improve conduct by financial institutions. Unfortunately, this proliferation has led to:
- 9.1 Duplication of the roles of the regulatory bodies leading to additional costs on industry. For example, RBNZ and FMA may both have interests in the governance activities of firms from independent prudential and conduct perspectives. Separately, the Commerce Commission has prime responsibility for monitoring conduct under the CCCFA. In essence, our 'twin peaks' regulatory model (that is common in overseas jurisdictions) has become increasingly complex between regulators, imposing costs on firms.
- 9.2 A need to hold multiple licences from both the FMA and the RBNZ. For example, a large, diversified financial institution may have to hold up to five licences from the FMA (e.g., financial advice provider, discretionary investment management services, managed investment schemes).
- 10 The introduction of CoFI in 2022 has further compounded the issue by requiring yet another licence requirement and imposing significant compliance costs on financial institutions to comprehensively document their 'fair conduct programmes'. Many financial institutions believe that the requirements are an overreach and do not adequately allow for a proportionate approach to be taken.

- 11 In addition, the Commerce Commission has responsibility for monitoring and enforcing consumer credit regulation through the CCCFA. This means some entities (in particular, deposit takers) are regulated by three different institutions. I see benefit to bringing together responsibility for financial markets conduct and the CCCFA into a single regulator.

### **Reviewing the ‘twin peaks’ regulatory arrangements in conduct regulation**

- 12 The ‘twin peaks’ model was initially implemented in Australia and has been widely adopted internationally, including by the UK following the Global Financial Crisis. As noted, New Zealand has adopted a similar approach, but this has become blurred over time, particularly with the Commerce Commission’s role in monitoring conduct in relation to the CCCFA.
- 13 In my view the model is the correct approach, but I also consider there are opportunities for better coordination and cooperation between the regulators. In essence, this means:
- 13.1 I propose to reinforce a ‘twin peaks’ model where the RBNZ is the prudential regulator and the FMA is the conduct regulator.
- 13.2 I propose responsibility for the CCCFA would transfer from the Commerce Commission to the FMA, as the conduct regulator.
- 13.3 Removing duplication of licensing requirements between the conduct and prudential regimes. By way of example, initial fit-and-proper person assessments required by both regulators and both entities requiring firms to report separately on cyber resilience.

### **Reviewing the FMA’s conduct licence requirements**

- 14 Many entities hold multiple conduct licences from the FMA (e.g., licences to provide financial advice or provide managed funds, in addition to the need to obtain a new licence under CoFI). This can impose significant compliance and administrative costs on institutions.
- 15 I propose to review existing conduct licensing requirements with the objective of consolidation and simplification. In particular, I propose to review how to consolidate the different licences into a single licence for conduct. The FMA is of a view that this would be a logical and practical change.
- 16 There may also be opportunities for operational improvements and streamlining in prudential licensing, which is the responsibility of RBNZ, although I understand financial institutions do not hold multiple prudential licences.

### **Review of CoFI requirements**

- 17 The CoFI regime applies to banks, insurers and non-bank deposit takers (financial institutions). These financial institutions are also subject to general conduct requirements across their business to support all aspects of engagement with consumers. CoFI requires these institutions to develop

systems and policies in their businesses (“fair conduct programmes”) to ensure they are supporting good outcomes for customers, and to hold a licence from the FMA.

- 18 I am proposing to review aspects of the CoFI regime. Having discussed CoFI with industry stakeholders, they have told me they are not looking for fundamental change at this stage, but they remain concerned about the extent of the policy development required by the FMA to meet their application requirements.
- 19 The current framework of CoFI has some important conduct requirements but these may be able to be simplified to ensure greater clarity and flexibility and discretion for financial institutions to meet their obligations.
- 20 By way of example, it is essential that all financial institutions have in place documented procedures that cover the following aspects of their businesses:
  - 20.1 How they engage appropriately with their clients and customers;
  - 20.2 How they develop new policies to ensure they are fit for purpose and meet legislative and regulatory requirements;
  - 20.3 Fee arrangements and, if relevant, management of their intermediaries’ charging arrangements; and
  - 20.4 Adequate complaints dispute procedures.
- 21 I intend to undertake a targeted review of the CoFI requirements, which have been added to the Financial Markets Conduct Act 2013 (FMC Act), to ensure good conduct obligations are proportionate and fit-for-purpose. It is my intention to allow greater discretion for institutions to determine what conduct programme they need to put in place. Secondly, to support smaller institutions, I expect the FMA to issue guidance as to minimum requirements that must be met (such as policies relating to customer engagement, handling complaints, etc). I am also interested to review the coherence and structure of the FMC Act, especially given recent changes in respect of CoFI.
- 22 Financial institutions are required to have a CoFI licence in place by 31 March 2025, with the first applicants now lodging their documentation. I intend to inform the sector that financial institutions should continue to apply for a CoFI licence and that there will be appropriate transitional arrangements in place. This might include ‘grandfathering’ of institutions into any new licence regime where they already hold a licence. I am keen to avoid unnecessary uncertainty and speculation.
- 23 The FMA has confirmed it recognises the importance of a proportionate approach by institutions in designing their fair conduct programmes. Furthermore, the FMA agrees that the prime responsibility for a programme lies with the financial institution.

## CCCFA review

- 24 The CCCFA regulates credit that is available to consumers for personal, domestic, or household purposes. A number of changes have been made to the CCCFA over recent years, increasing its prescriptiveness and establishing one-size-fits-all regulations to almost all consumer lending.
- 25 Whilst the intent of these changes was to protect vulnerable New Zealanders from unscrupulous lending practices, including from high-cost lenders, unfortunately the changes have contributed to declines in lending (both in traditional lending, such as mortgages, but also short-term lending for those looking for finance expenses, such as car repairs). I believe that this has led these vulnerable borrowers to turn to alternative unregulated high-cost sources, i.e. some of the very people the changes were seeking to protect them from.
- 26 To improve the workability and effectiveness of the CCCFA, I propose two phases of review to the CCCFA, which can proceed in parallel with the above work on CoFI.
- 27 Phase 1 is to remove prescriptive affordability requirements for lower-risk lending or lenders as a matter of priority. I intend to consider the following options for exclusion:
- 27.1 registered banks and non-bank deposit takers, who are already regulated by RBNZ and the FMA;
  - 27.2 lending below a specified annual interest rate (e.g. 30 percent), as interest rates are often an indicator of the risk the loan may be unaffordable; and
  - 27.3 types of credit that have low default rates, such as mortgages.
- 28 Phase 2 is to undertake a more substantive review of the CCCFA legislation. This review will:
- 28.1 explore longer-term solutions to the problems already identified, particularly with the CCCFA's liability settings;
  - 28.2 address any other areas of under-performance; and
  - 28.3 consider whether efficiencies would be possible by rationalising the CCCFA's relationship with CoFI, including the prospect of changing institutional arrangements.
- 29 My objectives guiding this review are:
- 29.1 removing the compliance burden for consumers and lenders;
  - 29.2 supporting consumers to access credit that meets their needs;

- 29.3 ensuring regulation is proportionate to the risk of harm to consumers;
- 29.4 ensuring regulatory obligations and the institutional arrangements supporting them are clear for lenders and the regulator; and
- 29.5 making sure that regulatory obligations provide a level playing field for lenders.

### **Cost-of-living Implications**

- 30 This paper does not include any policy proposals that would impact on New Zealanders' cost-of-living, but the CCCFA reform may lead to policy proposals that could have an impact. This will depend on the extent to which lenders make changes to their affordability processes as a result of the CCCFA regulatory changes.

### **Financial Implications**

- 31 This paper contains no proposals that have financial implications. There are likely to be financial implications of future proposals arising out of reviews, which I expect can largely be dealt with through existing baselines. If institutional arrangements for consumer credit regulation are changed, this may require institutional funding to be reviewed.

### **Legislative Implications**

- 32 This paper contains no proposals that have legislative implications, but the reviews are likely to result in recommendations to Cabinet to make legislative changes. In this respect:
  - 32.1 Amendments to the CoFI regime may require amendment legislation, and I expect to submit a legislative bid in this respect;
  - 32.2 Phase 1 of the CCCFA reforms is expected to result in amendments to the Credit Contracts and Consumer Finance Regulations 2004;
  - 32.3 Phase 2 of the CCCFA reforms may require amendment legislation, and I expect to submit a legislative bid in this respect.

### **Impact Analysis**

#### **Regulatory Impact Statement**

- 33 Regulatory impact analysis has not yet been undertaken on the proposals in this paper but will be completed when policy decisions are sought.

#### **Climate Implications of Policy Assessment**

- 34 This paper does not seek policy decisions and therefore there are no climate implications.

### Population Implications

35 This paper does not seek policy decisions and therefore there are no population implications.

### Human Rights

36 This paper does not seek policy decisions and therefore there are no human rights implications.

### Use of External Resources

37 No external resources such as contractors or consultants have been engaged and remunerated in relation to the proposals contained in this paper or the policy development process.

### Consultation

38 I have undertaken initial consultation with a range of industry leaders and Ministerial colleagues, including with coalition partners and with the Minister of Finance and the Minister for Regulation. This initial consultation has assisted me in identifying areas for review.

39 I have also discussed the key themes of the proposed changes with the FMA and they are in agreement with them.

40 Officials will undertake wider consultation with stakeholders prior to seeking policy decisions from Cabinet to ensure that all interested parties have had an opportunity to contribute.

41 Consultation on the matters outlined in this paper has also been undertaken with the Treasury, the FMA, RBNZ and the Commerce Commission. The Department of Prime Minister and Cabinet (Policy Advisory Group) has been informed.

### Communications

42 It is proposed that I will outline the direction of travel in a speech to the Financial Services Council conference on 31 January. The CEO of the FMA is speaking directly after me at the conference and there is a process in place to align the speeches to ensure a united and clear direction is given to the sector.

43 I am expecting stakeholders to react very positively to the announcement to review the legislative architecture governing the financial services sector and, particularly, provide greater clarity as to the roles of the regulatory authorities and a move to a simplified licencing regime.

44 In relation to the CoFI regime, I expect stakeholders to welcome an announcement setting out the planned direction of travel, but there is a risk that consumer groups might perceive the change will result in a lessening of



conduct obligations. The most likely organisations who might express this view have been engaged directly to reduce this possibility.

- 45 I am expecting stakeholders to react largely positively to the announcement in relation to the CCCFA. Again, there may be some concerns from consumer groups if they perceive these changes to be a watering down of requirements. However, there is wide agreement that the current arrangements are leading to perverse lending outcomes.
- 46 I will be mindful in public communications of the need to avoid unnecessary uncertainty and will note that appropriate timelines and transitional arrangements will be put in place.

### **Proactive Release**

- 47 I intend to proactively release this paper within 30 days of decisions being confirmed by Cabinet.

### **Recommendations**

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

#### **CoFI review**

- 1 **note** that the Financial Markets (Conduct of Institutions) Amendment Act 2022 introduced a new regulatory regime for the conduct of financial institutions which is due to commence on 31 March 2025;
- 2 **note** that the National party's 100-point plan for *Rebuilding the Economy* [CAB-23-MIN-0464 refers] had committed to repealing the Financial Markets (Conduct of Institutions) Amendment Act 2022;
- 3 **note** that in light of feedback from industry, there are opportunities to reform the Financial Markets (Conduct of Institutions) Amendment Act 2022 and related conduct regulation in order to streamline regulatory requirements and reduce compliance costs for industry;
- 4 **agree** that the Minister of Commerce and Consumer Affairs will review the following aspects of financial markets conduct regulation:
  - a. reviewing how the conduct regime interacts with the prudential regime;
  - b. reducing the compliance and administrative costs of multiple conduct licenses; and
  - c. simplifying substantive obligations in the legislation to ensure clarity and flexibility for institutions and to ensure conduct obligations are proportionate and fit-for-purpose.

#### **CCCFA review**

- 5 **note** that following the recent Credit Contracts and Consumer Finance Act 2003 and the Credit Contracts and Consumer Finance Regulations 2004 reforms, consumer credit legislation remains inflexible, prescriptive and results in high compliance costs and in borrowers being denied access to affordable credit;
- 6 **note** that to address the identified unintended impacts, the review of the Credit Contracts and Consumer Finance Act 2003 and of the Credit Contracts and Consumer Finance Regulations 2004 will be carried out in two phases:
  - a. Phase 1 will examine removing prescriptive affordability requirements for lower-risk lending or lenders;
  - b. Phase 2 will involve a more substantive review of the CCCFA including longer-term solutions to the identified problems.

### **Legislative implications and report back**

- 7 **note** that the reviews are likely to result in recommendations to Cabinet to make legislative changes;
- 8 **invite** the Minister of Commerce and Consumer Affairs to report back to Cabinet on the outcome of consultation on these matters and submit recommendations on further policy decisions for Cabinet authorisation as soon as possible.

Authorised for lodgement

Hon Andrew Bayly  
Minister of Commerce and Consumer Affairs