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DLA Piper submission: Fit for purpose financial services conduct regulation

1 This is DLA Piper's submission on the Ministry of Business, Innovation and Employment's (**MBIE**) *Fit for purpose financial services conduct regulation* consultation (**Consultation**). DLA Piper is a global business law firm with offices in over 40 countries. In New Zealand, DLA Piper operates out of Wellington and Auckland. Contributing authors were Rachel Taylor, Emma Moran, Tom Barnes, Cameron McCracken, Boston Flanagan-Connors and Tessa Keenan.

2 Our submission is confined to the following proposals contained in Part 2 of the Consultation's discussion document:

2.1 To introduce a requirement for the Financial Markets Authority (**FMA**) to approve changes in control of licensed firms; and

2.2 To introduce without-notice warrantless on-site inspection powers for the FMA,

(together, the **Proposals**).

3 Thank you for the opportunity to submit on the Consultation. We would welcome the opportunity to discuss our submission with MBIE. For this purpose, we can be contacted at Privacy of natural persons

General comments

4 We have reservations about whether the Proposals are demonstrably justified. While we agree with the discussion document that "[t]here are benefits to ensuring that the FMA has effective tools to monitor the compliance of regulated firms",[1] we are not aware of any evidence to suggest that FMA's existing tools are ineffective. Even if they are, it is not clear from the discussion document *how* the Proposals would remedy such deficiencies. In the absence of that evidence and analysis, we submit there is an insufficient basis to proceed with the Proposals.

5 For example:

5.1 In respect of the proposal to require FMA consent to changes in control of licensed firms, the discussion document points to a concern that changes in control could affect the treatment of customers because a new owner might "prioritise financial gain".[2] In our view, that risk applies *regardless* of whether there is a change in control. In any

[1] Paragraph 88.
[2] Paragraph 94.

event, the FMA has a suite of existing tools to address that risk — from investigation and information gathering, to conditioning and cancelling licences.

5.2 In respect of the proposal to introduce without-notice warrantless on-site inspection powers for the FMA, the discussion document describes this power as being "consistent with standard international expectations for financial markets conduct regulators like the FMA."[3] Alignment with international practice is not — by itself — a justification to introduce such an extensive power. While overseas policy settings are relevant, it must first be established how such practice is justified and appropriate in the New Zealand context.

6 We are concerned this leaves market participants in the unique position of having the burden of proving why the FMA *should not* have these broad additional powers, rather than the discussion document positively establishing why the additional powers are *necessary and justified.*

7 There is also a risk that without appropriate guardrails the Proposals (if implemented) could be abused. The ability to conduct without-notice searches of regulated firms should be limited to the most egregious conduct, where urgent enforcement action is required. It should not be used for standard supervisory practice. In our view, the FMA's existing powers — including the ability to conduct without-notice *but warranted* searches — are sufficient to deal with those egregious and urgent cases.[4]

8 The Proposals have the potential to be a drag on the efficiency of financial markets without any demonstrable justification and run contrary to a stated purpose of the ongoing financial services reforms, being to reduce the compliance burden.

Responses to Consultation questions

E. Ensuring the FMA has effective tools

Option E1. Introduce change in control approval 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.

9 No.

10 We think the current notification process works well. Licensed firms are already required to notify the FMA, as soon as practicable, of any changes in their control.[5] In our experience, where a change of control is proposed, all relevant participants (typically, buyer and seller) work together to notify the FMA at an early stage of a transaction, and transaction documents usually record this. We are not aware of any material issues being raised by the FMA.

11 The discussion document points to a concern that changes in control could affect the treatment of customers because a new owner might "prioritise financial gain"[6] but that risk exists *whether or not* there is a change in control.

[3] Paragraph 106.
[4] Financial Markets Authority Act 2011, section 29.
[5] Financial Markets Conduct Regulations 2014, regulation 191.
[6] Paragraph 94.

12 In any event, the FMA's existing powers — such as the ability to issue interim stop orders[7] and "section 25" notices[8], and the FMA's powers under the Corporations (Investigation and Management) Act 1989[9] — are sufficient to deal with changes in control which lead to breaches, or potential breaches, of law.

13 While this power is similar to the requirement that the Reserve Bank of New Zealand (**RBNZ**) approves changes in control of banks, non-bank deposit takers and licensed insurers,[10] the FMA has a fundamentally different regulatory remit from that of the RBNZ.

14 The RBNZ is responsible for prudential regulation. Requiring the RBNZ to approve changes in control of systemically important entities involves necessary and justifiable considerations of governance and financial strength.

15 In contrast, the FMA is responsible for conduct regulation. We do not consider that the stated risk that a restructure "may impact on the interests of consumers and the firm's ability to treat consumers fairly"[11] justifies a departure from the current notification regime.

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?

16 No.

17 While this proposal would achieve the stated aim of aligning the regulatory powers of the FMA with the RBNZ's, we question the utility of this. This would appear to result in dual-regulated firms being required to obtain two consents to a change in control, risking significantly increasing the compliance burden and further slowing an approval process which can already take months.

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

18 Requiring the FMA to consent to changes in control would likely unnecessarily slow transactions in the financial services sector. The current requirement for the RBNZ to approve changes in control of prudentially-regulated firms can take months. A similar requirement, or an *additional* requirement for dual-regulated firms, risks causing significant and unnecessary delays. This would undermine efficiency in the market for licensed firms.

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.

19 No.

20 We agree it is necessary to ensure the FMA has effective tools to monitor the compliance of regulated firms. However, we are concerned that expanding the FMA's onsite inspection powers to include warrantless searches is not a reasonable and proportionate device.

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[7] Financial Markets Conduct Act 2013, section 465.
[8] Financial Markets Authority Act 2011, section 25.
[9] Corporations (Investigation and Management) Act 1989, Part 2.
[10] Under the Reserve Bank of New Zealand Act 2021, Non-bank Deposit Takers Act 2013 and Insurance (Prudential Supervision) Act 2010 respectively.
[11] Discussion document, paragraph 93.b..

21 The FMA already has expansive powers to enter and search premises without notice, subject to first obtaining a warrant from an issuing officer.[12]

22 The discussion document does not identify any reason that would justify a departure from the safeguards afforded by this well-established practice.

23 We also have some concerns that the introduction of such an apparently draconian power would create an adversarial atmosphere between regulated firms and regulators, dissuading collaboration and ultimately undermining the regulatory regime's ability to respond to problems effectively.

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?

24 We do not consider this should apply to any regulated firms.

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

25 The FMA's existing expansive powers to enter and search premises without notice subject to first obtaining a warrant from an issuing officer create sufficient safeguards for both regulators and regulated firms. The effect of warrantless search powers is the removal of these safeguards.

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

26 N/A.

Yours sincerely

DLA Piper New Zealand

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[12] Financial Markets Authority Act 2011, section 29.