

THE BIG PICTURE: FINANCIAL MARKETS

Greater detail on the conduct regulation regime

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Introduction

The Finance and Expenditure Select Committee of the last Parliament recommended changes to the Financial Markets (Conduct of Institutions) Amendment Bill that respond to a number of the industry's concerns about the Bill. These changes will have been welcomed by financial institutions. While we expect that most, if not all, of the recommendations will be adopted by the new Parliament, that will only be confirmed when the Bill has its second reading.

The Committee's proposed changes include greater detail on the fair conduct principle and fair conduct programme, narrower

regulation of intermediaries, and changes to the scope of consumer contracts. Greater constraints on regulating incentives and extended transition periods (including for licensing requirements) have also been proposed.

The Ministry of Business, Innovation and Employment has advised that draft regulations will also be published and consulted on, although no timeframe has yet been provided. The Minister for Commerce and Consumer Affairs had said that the Bill will be enacted by the end of 2020. However, it is now clear that this will not happen until 2021.



In this report, we look at the key recommendations from the Committee's report, and explain what financial institutions can expect from the proposed conduct regulation regime as it currently stands.



Greater detail on the fair conduct principle

The new conduct regime will be built around a new 'fair conduct principle', which requires financial institutions to treat consumers fairly.

Initially, the Bill did not contain any detail as to what treating consumers fairly requires. The Select Committee has recommended the provision of additional guidance in this area. It has proposed that "fairness" is defined by reference to five factors:



This list is non-exhaustive, with the Committee saying that the principle should "reflect changing societal norms, and be sufficiently flexible to incorporate changes to products and services, as well as industry practices".

The fair conduct principle does not itself impose any directly enforceable duties. Rather, it is the overriding objective the conduct regime seeks to meet. Other aspects of the new regime provide the key obligations: the requirement for an institution to establish, maintain and comply with a fair conduct programme, and the regulation of incentives.

Greater detail on the fair conduct programme

The central requirement of the new regime is the obligation to establish and maintain a “fair conduct programme”. Every registered bank, licensed insurer and licensed non-bank deposit taker will be under a statutory duty to establish and maintain such a programme.

Intermediaries are not required to have a fair conduct programme. The Select Committee has also recommended the removal of the duty on intermediaries to comply with the fair conduct programmes

of the financial institutions to which they provide services or products. For an intermediary, fair conduct obligations will be a function of its negotiated contractual obligations to the financial institution.

What is a fair conduct programme?

A fair conduct programme is a set of documented policies, processes, systems and controls designed to ensure a financial institution’s compliance with the fair conduct principle, and the compliance of

any related intermediaries. The scope of any such programme will be broad.

The Bill provides that the programme should address the entire lifecycle of relevant services or associated products including the design, offer and provision of the services and products, including any dealings with consumers.

What will a fair programme need to address?

As introduced, the Bill contained limited detail of the expected requirements of a

fair conduct programme. It was originally expected that regulations would impose the detailed requirements for fair conduct programmes.

In response to concerns from the industry, the Committee observed that leaving details of the requirements to regulations “would not provide certainty”. It has recommended that the Bill contain the high level requirements for these programmes together with a regulation-making power to add additional requirements, but only to the extent that they are “necessary”.



Greater detail on the fair conduct programme

AREAS A FAIR CONDUCT PROGRAMME WILL NEED TO COVER WITHIN BILL

-  **How the financial institution will meet all of its legal obligations** under the Financial Markets Conduct Act 2013, the Fair Trading Act 1986, the Credit Contracts and Consumer Finance Act 2003, the Consumer Guarantees Act 1993, and the Financial Service Providers (Registration and Dispute Resolution) Act 2008.
-  **Designing and managing the provision of relevant services and associated products**, regularly reviewing whether they meet the requirements and objectives of consumers and making enhancements.
-  **Identifying, monitoring and managing risks** of conduct that does not comply with the fair conduct principle.
-  **Having clearly defined roles, responsibilities, and accountability arrangements** for identifying, monitoring and managing risks of non-compliance with the fair conduct principle.
-  **Maintaining records** that are sufficient to allow an assessment to be made of the financial institution's compliance with the fair conduct principle.
-  **Regular and comprehensive reporting** about risks and incidents of non-compliance with the fair conduct principle, to the board or other governing body of the financial institution.
-  **Identifying conduct that fails to comply with the fair conduct principle** and taking reasonable steps to mitigate any actual or potential adverse effects of the failure.
-  **Processes and procedures** applicable to the financial institution's employees, agents and intermediaries to support compliance with the fair conduct principle.
-  **Initial and regular ongoing training** for employees, agents and intermediaries on the relevant services or associated products and applicable processes and policies.
-  **Checking that employees, agents and intermediaries have completed and have a reasonable understanding of that training.**
-  **Managing and supervising** employees, agents and intermediaries to ensure that they are supporting the financial institution's compliance with the fair conduct principle.
-  **Obtaining assurances** that employees, agents and intermediaries are competent, fit and proper.
-  **Monitoring** whether employees, agents and intermediaries are complying with the fair conduct principle.
-  **Designing and managing incentives** to mitigate or avoid adverse effects of incentives on the interests of consumers, so far as is reasonably practicable.
-  **Communicating clearly, concisely and effectively** with consumers about the financial institution's relevant services or associated products.
-  **Regularly reviewing**, and systematically identifying deficiencies in, the effectiveness of the programme.
-  **Promptly remediating identified deficiencies** in the fair conduct programme.
-  **Complying** with any regulations under the new regime.

AREAS A FAIR CONDUCT PROGRAMME WILL NEED TO COVER WITHIN SCOPE OF FUTURE REGULATION

-  **Monitoring**
monitoring customer outcomes.
-  **Design and management**
of relevant services.
-  **Customer complaints**
handling of customer complaints.
-  **Insurance**
handling of insurance claims.
-  **Communicating**
with customers.
-  **Control and supervision**
over intermediaries.
-  **Design and management**
of incentives.

Greater detail on the fair conduct programme

Proportionality will be relevant

The Committee has recognised that a fair conduct programme is not a “one size fits all” set of processes and procedures, and that financial institutions should not be held to an identical regulatory standard.

It has proposed that a financial institution’s fair conduct programme should reflect the nature, size and complexity of its business, its relevant services and associated products, the methods by which it provides them to consumers, the types of consumers it deals with, the intermediaries it works with, and any other matters as may be prescribed by regulations.

Publication of fair conduct programmes

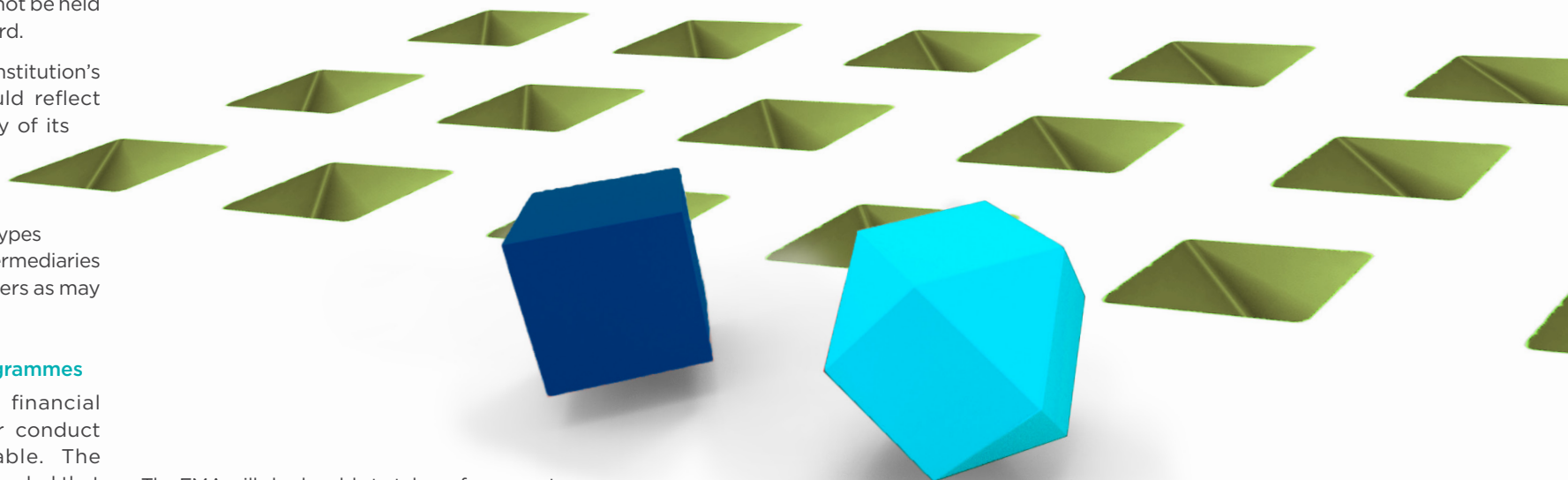
The Bill originally required financial institutions to make their fair conduct programmes publicly available. The Committee has instead recommended that financial institutions make a summary of key aspects of the programme publicly available, and provide their full fair conduct programme to the Financial Markets Authority (FMA).

Enforcement

The FMA will be able to take enforcement action against a financial institution for not having an effective fair conduct programme, including any failure to meet the minimum requirements.

The FMA will also be able to take enforcement action where the financial institution fails to take reasonable steps to comply with its own programme. However, it will not be able to seek a pecuniary penalty for such non-compliance where it arises solely because of a breach of another provision of relevant legislation.

The FMA will not be able to take enforcement action against intermediaries, as they will be excluded from the requirement to comply with fair conduct obligations.



Who will be caught?

Narrower requirements on intermediaries

The new conduct regime will apply to registered banks, licensed insurers and non-bank deposit takers, and their intermediaries. The Committee has recommended narrowing the application of the regime to intermediaries. In particular, financial institutions will no longer have a duty to take “all reasonable steps” to ensure intermediaries comply with their fair conduct programme and intermediaries will not have a corresponding duty to take “all reasonable steps” to comply with the financial institution’s fair conduct programme.

Instead, the regulatory obligation will fall exclusively on the financial institution through the content of its fair conduct programme. Each financial institution will be required to make provision in its fair conduct programme for managing and supervising intermediaries (including training, obtaining assurances as to competence, fitness and propriety, setting conduct expectations and dealing with misconduct).

The only surviving duty on intermediaries will be to comply with incentive regulations. The Committee has recommended that these regulations will only apply to:

- intermediaries that offer or give incentives to their employees, agents or other intermediaries in connection with the provision of a financial institutions relevant services or associated products; and
- incentives offered to those who give regulated financial advice, are involved in negotiating, soliciting, or procuring contracts or carry out other services that are preparatory to the contract. Persons who assist in the administration or performance of relevant contract will not be subject to incentive regulation.



OR



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Changes to consumer contracts that are in scope

THE COMMITTEE HAS PROPOSED CHANGES TO THE CONSUMER CONTRACTS THAT WILL BE CAUGHT BY THE CONDUCT REGIME. IN PARTICULAR, THE COMMITTEE HAS RECOMMENDED:

1

Excluding credit contracts where the debtor is a trustee of a family trust. This is intended to reflect the position under the Credit Contracts and Consumer Finance Act regime (which does not impose obligations on loans to family trusts).

2

Amending the definition of a “consumer insurance contract” to capture situations where a bank is a master policyholder of a contract that provides general insurance for the benefit of consumers. This is intended to ensure that customers with group insurance policies receive the benefit of the conduct regime (and fair conduct obligations).

Regulation of incentives

The Bill imposes a statutory duty on financial institutions and intermediaries to comply with regulations concerning incentive compensation. However, an exposure draft of the regulations is not yet available.

The FMA will be able to take enforcement action for a breach of the statutory duty and regulations, including seeking a pecuniary penalty.

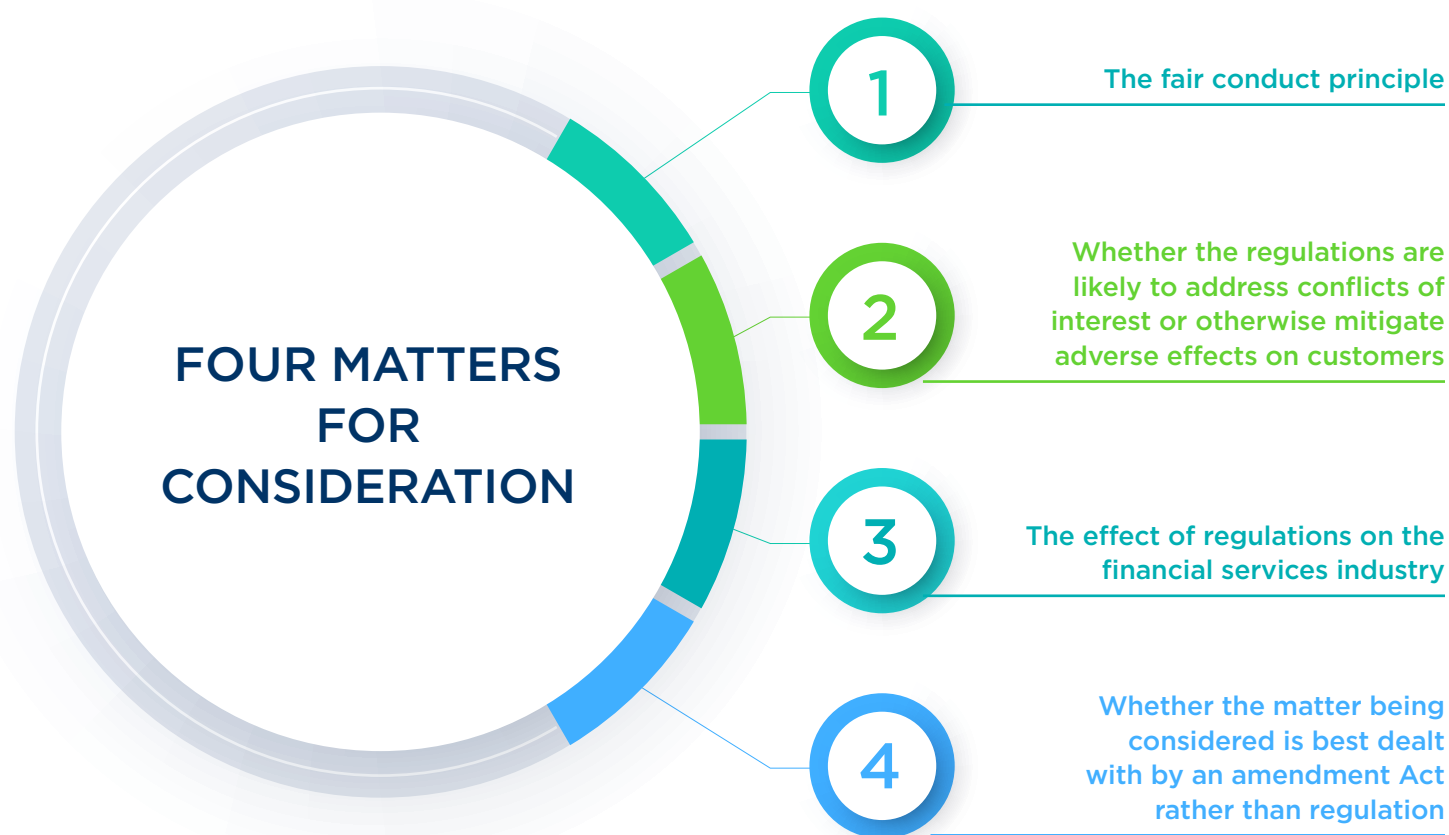
The Committee observed that the Bill is not intended to impose a total ban on incentives

and that regulations are required to provide the regime with flexibility. However, it has recommended that the responsible minister consider four matters before making incentive regulations.



Intermediaries

The duty to comply with incentive regulations is the only duty that will apply to intermediaries under the proposed regime. The Committee has also recommended that these regulations should only apply to intermediaries who give regulated financial advice and are involved in negotiating, soliciting, or procuring contracts or carry out other services that are preparatory to the contract. Intermediaries who assist in the administration or performance of relevant contracts (for example, claims management) will not be subject to incentive regulations.



Licensing remains - with a limited exception



Financial institutions will be required to obtain a market services licence for any relevant service or associated product they provide.

Licensing will enable the FMA to impose licence conditions that enable more focused regulation of conduct risks. Licensing may also provide the basis for additional systems and control requirements and obligations to self-report conduct breaches to the FMA.

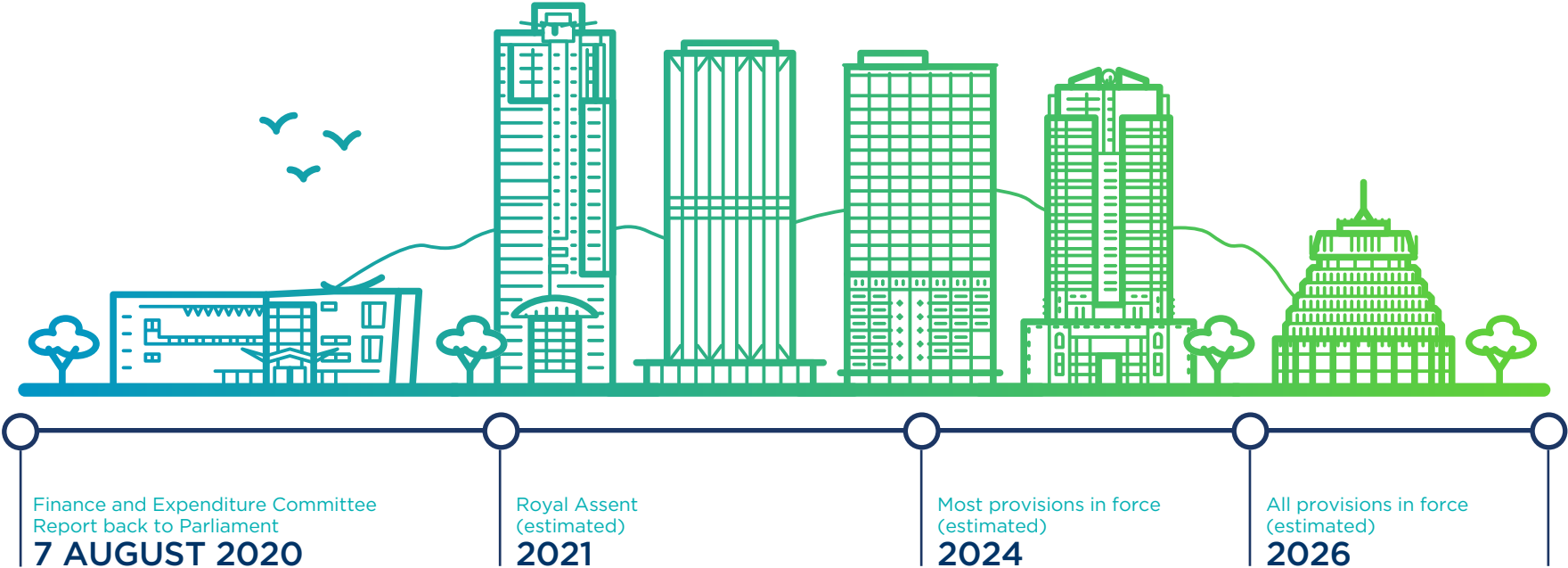
The licensing requirements will already be familiar to many financial institutions. Part 6 of the Financial Markets Conduct Act 2013 (**FMCA**) already requires licensees to have in place effective methods for monitoring compliance with their licence obligations and report material contraventions of licence obligations to the FMA.

The Committee has retained the licensing

requirement. However, it has observed that licensing may be an onerous, costly and unnecessary administrative burden for some financial institutions (for example, participants who are subject to the oversight of an umbrella organisation with a longstanding governance structure to address conduct and culture risks). The Committee has recommended a regulation-making power to exempt specified types of financial institutions from the requirement to hold a licence, similar to existing exemption powers under the FMCA.

For registered banks, licensed insurers and licensed non-bank deposit takers, the Bill provides that the FMA must grant them a licence unless the Reserve Bank considers that declining the application is necessary for maintaining a sound and efficient financial system or insurance sector.

Timeline



While we expect that most, if not all, of the Committee's recommendations will be adopted by the new Parliament, this will only be confirmed on the second reading of the Bill, for which no date has yet been set for that.

An exposure draft of the proposed regulations will also be published and consulted on,

although, again, no timeframe has yet been provided for this.

The Minister for Commerce and Consumer Affairs had said the Bill will be enacted by the end of the year. However, it is now clear that this will not happen until 2021.

The Committee has recommended extended

transitional periods for the introduction of the new regime. According to these recommendations, most of the Bill will come into force within three years of the date of Royal Assent, rather than two years as initially proposed. Regulations may provide for certain provisions in the Bill to come into force at a later date. However, that date

cannot be any later than five years after Royal Assent, rather than the four years as initially proposed.

The Committee has also recommended that the responsible Minister conduct a review of the effectiveness of the proposed conduct regime and report back to Parliament within five years of the Bill coming into force.

Bell Gully's conduct regulation team

Our team draws on local and international regulatory experience to offer practical advice on all aspects of these changes as they affect market participants. Our cross-practice group is closely monitoring the passage of the Bill (and the formulation of related regulations) and will continue to highlight key developments.

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Appendix 1

List of services that engage the new conduct regime

Financial Services Captured by the Bill	
1	Acting as an insurer.
2	Being a creditor under a consumer credit contract.
3	Providing a financial advice service.
4	Providing a regulated client money or property service (including a custodial service).
5	Keeping, investing, administering, or managing money, securities, or investment portfolios on behalf of other persons.
6	Operating a money or value transfer service.
7	Issuing or managing means of payment (for example, credit and debit cards, cheques, travellers' cheques, money orders, bankers' drafts, or electronic money).
8	Giving financial guarantees.
9	Acting as an offeror of financial products offered under a Financial Markets Conduct (FMC) offer.
10	Acting as an issuer, a supervisor or an investment manager, in respect of regulated products or financial products offered under an FMC offer.
11	<p>Acting as:</p> <ul style="list-style-type: none"> a) a manager of a registered scheme (other than a restricted scheme) b) an independent trustee of a restricted scheme c) a provider of a discretionary investment management service d) a derivatives issuer e) a provider of prescribed intermediary services <p>if the service is, or is required to be, provided under a market services licence (whether as a licence holder or as an authorised body).</p>
12	Acting as a custodian in respect of a registered scheme or a discretionary investment management service (DIMS) provided by a DIMS licensee.
13	Operating a financial product market.
14	Changing foreign currency.
15	Trading financial products or foreign exchange on behalf of other persons.
16	Providing forward foreign exchange contracts.

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