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# THE BIG PICTURE: FINANCIAL MARKETS

Are you prepared for a conduct regulation regime?

March 2020

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# Introduction

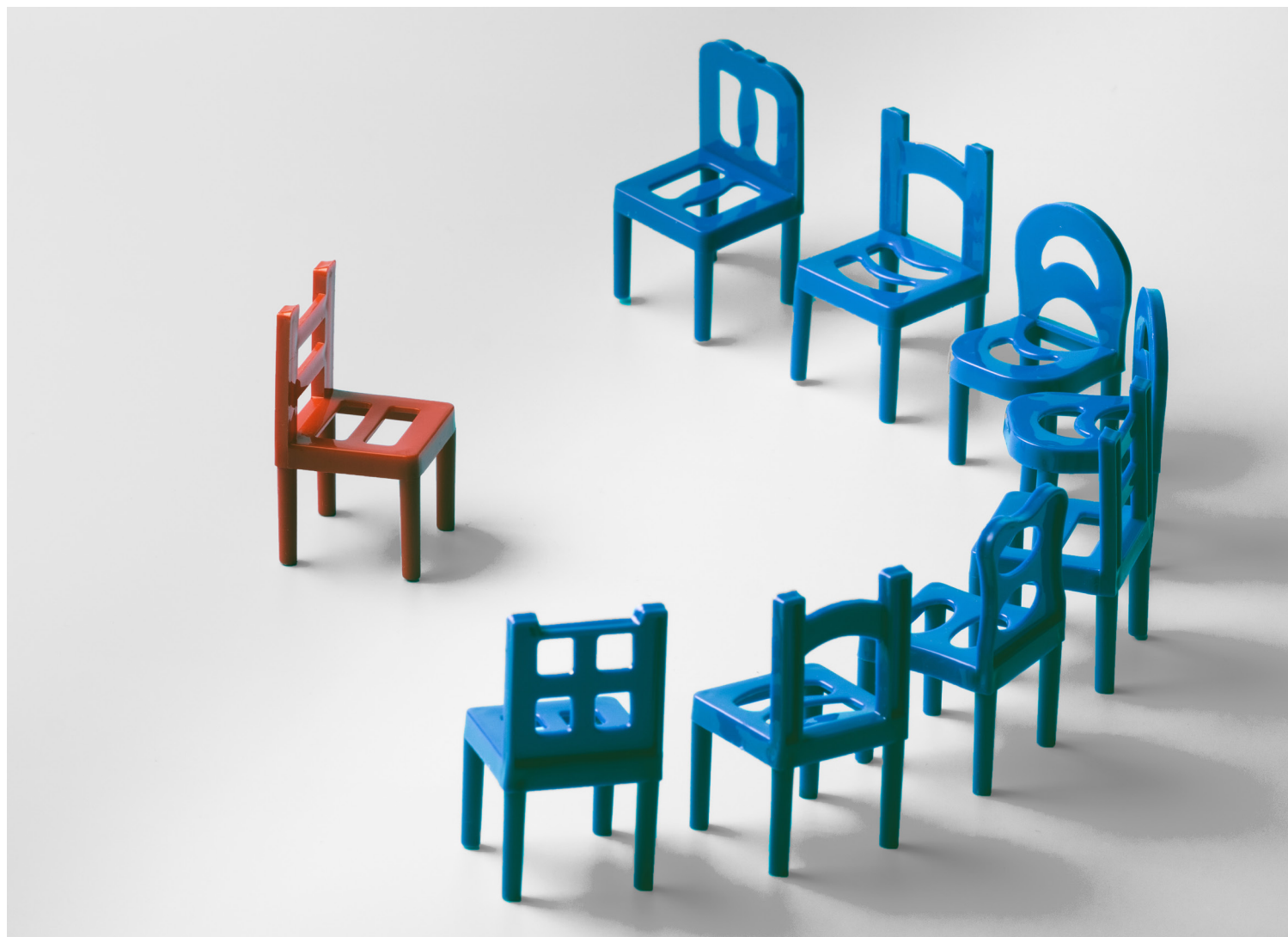
**F**inancial institutions will remain in the spotlight this year, following the first concrete indication of wide-ranging legislative reforms to the regulation of their conduct. The Financial Markets (Conduct of Institutions) Amendment Bill, which received its first reading in Parliament on 12 February 2020, proposes a new conduct regulation regime that will affect banks, insurers, non-bank deposit takers (NDTs) and intermediaries.

The Bill highlights a number of new areas that will now be subject to regulatory scrutiny. As introduced, the Bill proposes a far reaching set of new systems and controls requirements and flags the possibility of incentive compensation being subject to detailed regulatory restrictions. The legislation will not be the last word. Regulations will play a significant part in detailing many aspects of the regime.

**We take a look at the key features of the proposed regime and highlight the practical issues worth considering. We are also in the process of preparing our submission on the Bill (submissions close on 26 March 2020). Please contact a member of our conduct regulation team if you would like to discuss our insights on the Bill or the content of your own submission.**

## ★ PRACTICAL TIP

We highlight some practical tips to prepare for the new regime in blue boxes throughout the report.



# The fair conduct principle

**T**he new conduct regime will be built around a new 'fair conduct principle'. That is, financial institutions and intermediaries "must treat consumers fairly, including by paying due regard to their interests". The Bill does not provide any guidance as to what treating consumers fairly involves.

However, this language substantially replicates Principle 6 of the UK Financial Conduct Authority's Principles for Businesses. FCA guidance on this principle may be helpful to firms pending further clarity in New Zealand. [The FMA's Good Conduct Guide](#) and its examples of what customers care about will also be a helpful initial resource.

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 enforceable obligations.

### ★ PRACTICAL TIP

Consider the content of UK FCA Final Notices on Principle 6 for further detail of what treating customers fairly requires. Refer to the [Financial Conduct Authority's website](#).



# Who will be caught?

The new regime will apply to any registered bank, licensed insurer, or licensed non-bank deposit taker that acts as an insurer, creditor under a consumer credit contract or anyone in the business of providing one or more other relevant services to retail clients.

It will also apply to intermediaries involved in the provision of any of these services or any associated product<sup>1</sup> and are compensated by the financial institution (or another intermediary) that provides the product or service. The threshold for involvement is low. Almost any participation in the product or service life cycle will be captured, including the negotiation, solicitation or procurement of contracts, the carrying out of services in preparation for a contract, the giving of regulated financial advice and administering or performing the service or the terms and conditions of the associated product.

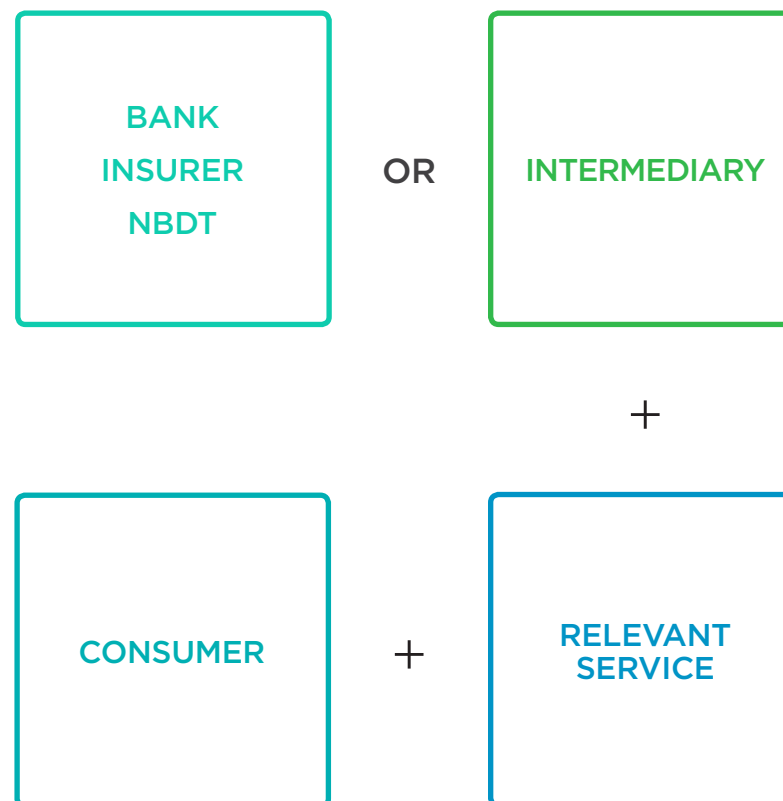
It will not be solely financial advisers and brokers that will be captured. Any person to whom a financial institution outsources an aspect of a relevant service or associated product (for example, claims handling,

complaints handling, underwriting or product design) is potentially within the scope of regulation.

A list of the relevant services can be found at Appendix 1.

### ★ PRACTICAL TIP

Identify the relevant services and/or financial advice products that you are likely to provide or be involved in providing to consumers (that is, current or prospective policyholders/beneficiaries under consumer insurance contracts, life insurance or health insurance, current or prospective debtors under consumer credit contracts, or current or prospective retail clients for all other relevant services). This will provide a good early indication of whether you are caught by the new regime and the potential scope and impact of regulation.



<sup>1</sup> A financial advice product that a consumer acquires under a relevant service. 'financial advice product' will be defined by amendments that the Financial Services Legislation Amendment Act 2019 will make to the Financial Markets Conduct Act 2013.



# Who will be caught?

## What are the obligations?

The intensity of regulation will vary according to the institution or person in question. Banks, insurers and NBDTs will be subject to more stringent regulation than intermediaries.

### Banks, Insurers and NBDTs

Will be required to:

- Obtain a market services licence under Part 6 of the Financial Markets Conduct Act 2013 to cover all relevant services that they provide.
- Establish, implement and maintain an effective fair conduct programme.
- Make their fair conduct programme and any material changes to the programme publicly available.
- Take reasonable steps to comply with their fair conduct programme.
- Take reasonable steps to ensure intermediaries comply with their fair conduct programme.
- Comply with regulations concerning incentives.

## Intermediaries

Will be required to:

- Take reasonable steps to comply with the fair conduct programme of any financial institution with whom they provide relevant services.
- Comply with regulations concerning incentives.

The Financial Markets Authority will be empowered to take enforcement action in response to breaches of these obligations. This could include seeking pecuniary penalties up to the maximums already laid out in the Financial Markets Conduct Act. Those maximum penalties are the greatest of the consideration of any transaction that constituted the breach, three times the amount of any readily ascertainable gain, or NZ\$1 million (for an individual) or NZ\$5 million (for a corporate).

### ★ PRACTICAL TIP

#### Banks, insurers and NBDTs:

Think about the intermediaries you engage with when acting as insurer, being a creditor under a consumer credit contract or providing other relevant services to retail clients. Consider whether to involve them in the development of your fair conduct programme and how you can ensure their compliance with your programme.

### ★ PRACTICAL TIP

#### Intermediaries:

Think about the banks, insurers and NBDTs that you work with on insurance, consumer credit contracts or other relevant services. Consider requesting involvement in the development of their fair conduct programme(s).

## OBLIGATIONS

	REGISTERED BANKS	LICENSED INSURERS	NBDTs	INTERMEDIARIES
Market services licence	✓	✓	✓	✗
Establish and maintain fair conduct programme	✓	✓	✓	✗
Publish fair conduct programme	✓	✓	✓	✗
Comply with fair conduct programme	✓	✓	✓	✓
Ensure intermediaries comply with fair conduct programme	✓	✓	✓	✗
Comply with incentives regulations	✓	✓	✓	✓

# Licensing

**B**anks, insurers and NBDTs 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. Part 6 of the Financial Markets Conduct Act 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.

For existing banks, insurers and NBDTs, obtaining a licence should be a mere formality. In effect, the Bill provides that the FMA must grant a license to registered banks, licensed insurers and licensed NBDTs unless the Reserve Bank considers that declining the application is necessary for maintaining a sound and efficient financial system or insurance sector. Regulations may defer the deadline for obtaining a market service licence.



# The fair conduct programme

The establishment and maintenance of a fair conduct programme is likely to be one of the most exacting requirements of the new regime. Every registered bank, licensed insurer and licensed NBDT will be under a statutory duty to establish and maintain one. Intermediaries will not have the same obligation. However, they will need to comply with the fair conduct programmes of the financial institutions they provide relevant services or associated products to. A single intermediary could have obligations under the fair conduct programmes of multiple institutions.

### 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 life cycle of relevant services or associated products including the design, offer and provision of any relevant services or associated products and any dealings with consumers in connection with those services or products. It is expected that regulations will impose prescriptive requirements for fair conduct programmes.

### What will a fair conduct programme need to address?

- 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,
- processes applicable to financial institution's employees, agents and intermediaries which support compliance with the fair conduct principle,
- any involvement that the financial institution has as an intermediary in the provision of relevant services or associated products by another financial institution,
- methods for regularly reviewing, and systematically identifying deficiencies in the effectiveness of the programme,
- how deficiencies will be promptly remedied,

- governance and management of conduct and culture risks,
- monitoring customer outcomes,
- the design of relevant services,
- handling of customer complaints,
- handling of insurance claims,
- communicating with customers,
- control and supervision over intermediaries,
- the design and management of incentives and other remuneration, and
- compliance with any regulations issued under the new regime.

The fair conduct programme and any material changes to that programme will have to be publicly available online. Financial institutions will also be required to notify the FMA of any material changes to the programme.

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 or ensure intermediaries comply with it. However, the FMA 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 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.

### ★ PRACTICAL TIP

Consider whether existing documented policies, processes, systems and controls address the above areas. Identify any potential gaps.



# Regulation of incentives

The Bill imposes a statutory duty on financial institutions and intermediaries to comply with regulations that will be made in relation to incentive compensation. The statutory requirement is strict and requires more than the taking of reasonable steps. The FMA will be able to take enforcement action for a breach of the regulations (and the statutory duty), including seeking a pecuniary penalty.

No details have been provided as to the content of the regulations. However, there are signs they could have far reaching effects:

- Firstly, “incentive” has been broadly defined such that a wide range of compensation measures are now likely to be regulated. In principle, any commission, benefit or other incentive that is determined by reference to the volume or value of relevant services or associated products will be caught, even if there are other criteria which determine the entitlement to, or value of, the incentive. This could have a profound effect on discretionary compensation and bonuses within banks, insurers, NBDTs and intermediaries. In principle, any bonus that depends even in part on the volume, value or number of

consumers to whom a relevant service or associated product was provided could be caught by the regulations.

- Secondly, the regulations may have a retrospective effect. The Bill provides that incentive regulations may apply to incentives paid or payable under agreements entered into before the commencement of the regulations or the enactment of the Bill. Compliance with the regulations may be a defence to a civil claim.

Subject to the final content of the regulations, alternative compensation arrangements may need to be agreed with affected employees and/or intermediaries.

## ★ PRACTICAL TIP

Identify compensation practices and arrangements (with employees and intermediaries) that might meet the definition of “incentives”.

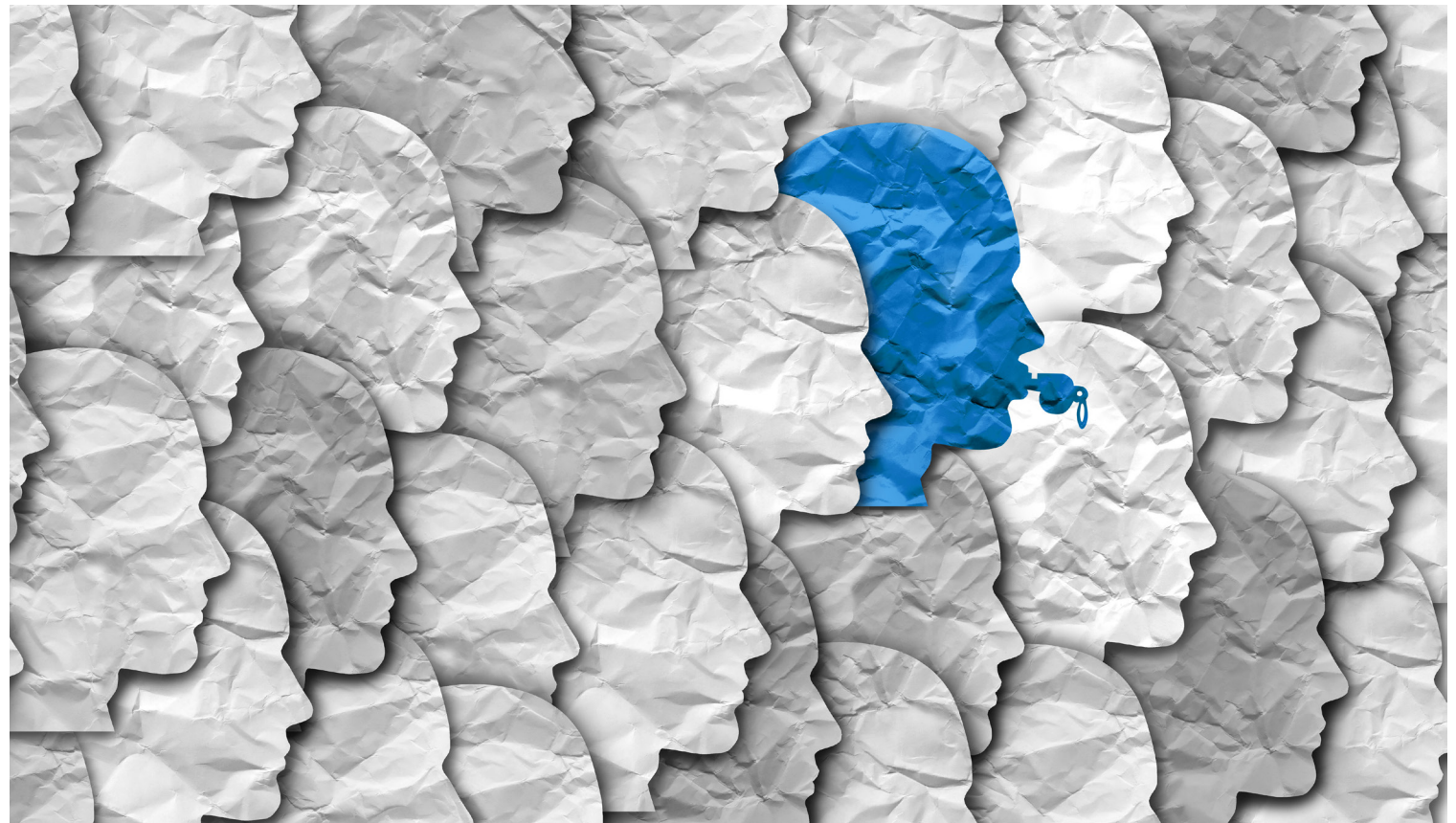
# Whistleblower protection

The Bill has introduced a limited whistleblower protection for employees or agents who report contraventions of the Financial Services Markets Act 2013 to the FMA in good faith. No civil, criminal or disciplinary proceedings can be brought against a person for making a report. Nor can their employment be terminated or an order be made in respect of their professional conduct.

By contrast, the Bill is silent on whistleblowers who report their concerns directly to their employer (whether a financial institution or intermediary) rather than the FMA. In these cases, the Protected Disclosures Act 2000 would be the only source of protection (although the government has recently signalled an intention to strengthen whistleblower protection).

### ★ PRACTICAL TIP

Review internal whistleblower policies against the Bill's proposals and the contents of the Protected Disclosures Act 2000.

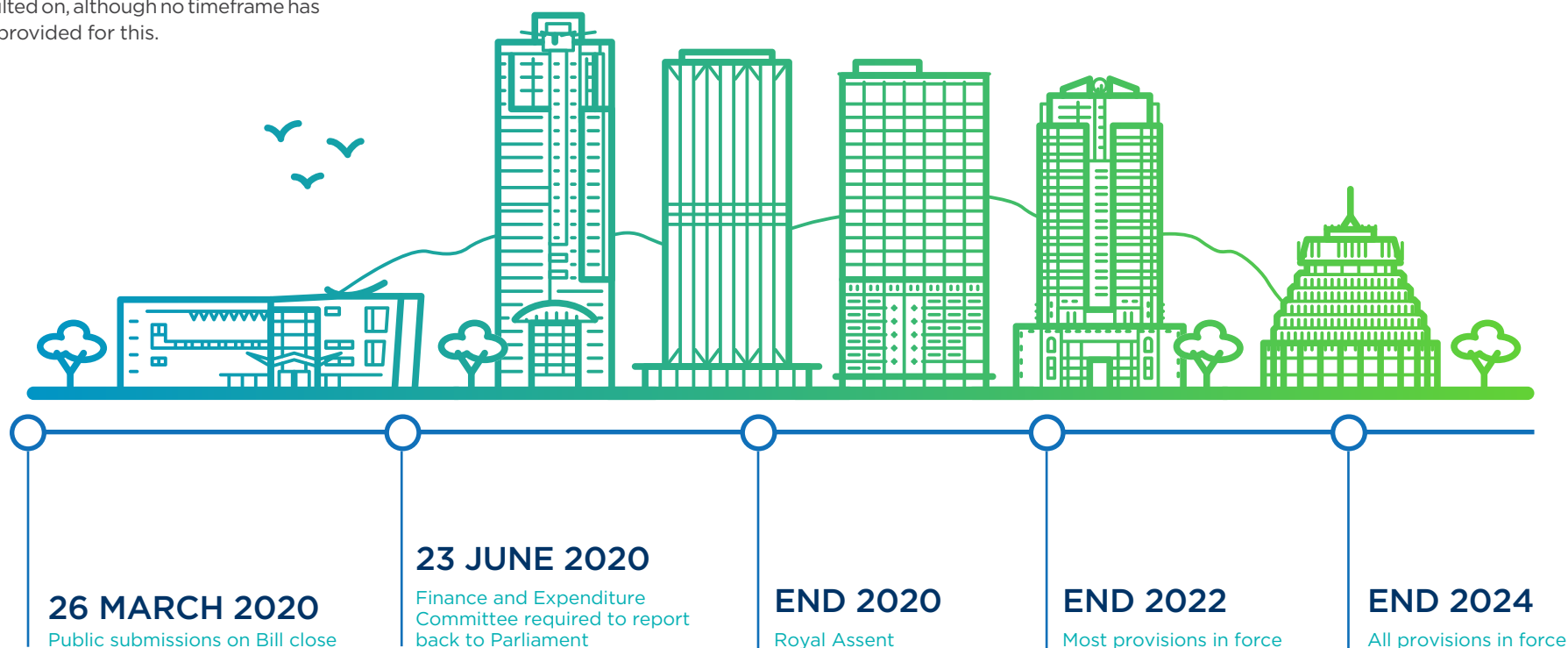




# Timeline

The Bill has now been referred to the Finance and Expenditure Committee which will report back to Parliament by 23 June 2020. The National Party has already stated that it does not support the Bill in its current form. The select committee stage will provide an opportunity for affected parties to provide submissions on the Bill. Submissions are currently open and close on 26 March 2020. Draft regulations will also be published and consulted on, although no timeframe has yet been provided for this.

The Minister for Commerce and Consumer Affairs has said that the Bill will be enacted by the end of the year. Most of the Bill will come into force within two years of the date of Royal Assent. 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 four years after Royal Assent).



# 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.

For further information about this report, please contact one of the team listed below or your usual Bell Gully adviser:



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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 an 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"> <li>a) a manager of a registered scheme (other than a restricted scheme)</li> <li>b) an independent trustee of a restricted scheme</li> <li>c) a provider of a discretionary investment management service</li> <li>d) a derivatives issuer</li> <li>e) a provider of prescribed intermediary services</li> </ul> <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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