NEW ZEALAND BANKERS ASSOCIATION

Submission

to the

Finance and Expenditure Committee

on the

Financial Markets (Conduct of Institutions) Amendment Bill

30 April 2020

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About NZBA

1. The New Zealand Bankers' Association (**NZBA**) is the voice of the banking industry. We work with our member banks on non-competitive issues to tell the industry's story and develop and promote policy outcomes that deliver for New Zealanders.

2. The following seventeen registered banks in New Zealand are members of NZBA:
   - ANZ Bank New Zealand Limited
   - ASB Bank Limited
   - Bank of China (NZ) Limited
   - Bank of New Zealand
   - China Construction Bank
   - Citibank N.A.
   - The Co-operative Bank Limited
   - Heartland Bank Limited
   - The Hongkong and Shanghai Banking Corporation Limited
   - Industrial and Commercial Bank of China (New Zealand) Limited
   - JPMorgan Chase Bank N.A.
   - Kiwibank Limited
   - MUFG Bank Ltd
   - Rabobank New Zealand Limited
   - SBS Bank
   - TSB Bank Limited
   - Westpac New Zealand Limited

Introduction

3. NZBA welcomes the opportunity to provide feedback to the Finance and Expenditure Committee (**Committee**) on the Financial Markets (Conduct of Institutions) Amendment Bill (**Bill**).

4. NZBA supports the policy goal underpinning the Bill – to treat consumers fairly through the lifecycle of financial products and services. This policy is consistent with NZBA members' own values and statements of corporate intent and with NZBA's Code of Banking Practice. It is also particularly front of mind at the moment as the banks and their staff support unprecedented numbers of customers impacted by the effects of Covid-19 on the economy.

5. While NZBA supports the underpinning policy goal of the Bill, the Bill itself needs significant refinement to ensure that a clear, certain and sustainable framework is established. This is important not just for financial institutions and intermediaries, but also for the Financial Markets Authority (**FMA**) and consumers. At present:

   (a) The intended scope of some of the obligations in the Bill, and to whom those obligations apply, is unclear and/or requires further refinement and policy work.

   (b) There are a number of aspects in the Bill where the substance of obligations is to be developed in regulations; or where it is intended that exemptions or limitations in respect of the application of the Bill will be developed in regulations regarding particular persons, entities or activities.

NZBA considers that this policy work should occur now so that detail can be included in the Bill itself, rather than key aspects being developed through regulation.[1]

(c) The drafting and layout of the Bill itself is complicated, including given the use of many defined terms. It should be simplified to improve usability.

6. Key areas where substantially more work is required are in relation to:

(a) The scope and definitions of financial institutions and intermediaries, including to ensure that an appropriate pool of customers do benefit from the regime and to address the potential anti-competitive element if some entities, but not others, have higher standards applied to them for the distribution of similar products and services.

(b) The substance of the fair conduct principle and of the obligations imposed regarding fair conduct programmes.

(c) The intended policy settings in respect of incentive prohibitions.

7. We anticipate that NZBA's concerns about the state of readiness of the Bill will not be a surprise. The Regulatory Impact Statement for the Bill itself highlights: (a) the significant time constraints faced and so the lack of usual extensive consultation, (b) an expectation that there may need to be further refinement through consultation and during the legislative process; and (c) that the details of the proposed framework will need to be fleshed out over time, through regulations and potentially legislative changes, once there has been opportunity for further policy thinking.[2]

8. The implementation of a new conduct regime in New Zealand is an important development. It is critical to allow the time to ensure that the legislation and regulations are workable and proportionately address the identified issues, and that financial institutions and their intermediaries have sufficient time to ensure compliance with whatever is set as the final regime.

9. Given the additional work required, NZBA suggests that this may be a Bill that the Committee could recommend be moved to a slower track and/or not proceed at this stage but be referred back to officials for further development. In either event, NZBA is very willing to work with officials to assist in the refinement of the Bill but we do ask that the timeframes set take into account:

(a) Pressures on banks and their representatives at this time as we manage other Covid-19 issues (and the similar pressures on Parliament, MBIE and the FMA).

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1 In this regard, NZBA notes the Legislation Design and Advisory Committee Legislation Guidelines (2018 Edition) at pages 69-77, which provide that matters of significant policy and principle should be included in an Act and that secondary legislation should generally deal with minor or technical matters of implementation and the operation of the Act. The guidelines note that it is *not* appropriate to empower secondary legislation to fill any gaps in an Act that may have occurred as a result of rushed or unfinished policy development processes.

2 Regulatory Impact Statement: Regulatory regime to govern the conduct of financial institutions (9 December 2019) at pages 5 and 22.

(b) The timeline of other regulatory reform and change within the financial services sector that is underway which is relevant both to the banks' ability to engage with additional law reform and to when banks may realistically have windows available to implement any required changes.

For example, the industry is currently in the process of making and embedding changes in order to comply with (i) the Financial Services Legislation Amendment Act 2019 (**FSLAA**) (which are currently scheduled to come into effect in March 2021 at the earliest (delayed from June 2020)) and for which key regulations are yet to be finalised; and (ii) the recent amendments to the Credit Contracts and Consumer Finance Act 2003 (**CCCFA**) (the most substantive of which are currently scheduled to come into effect on 1 October 2021 (delayed from April 2021)) and for which key regulations are yet to be finalised.

(c) The prospect that a pause may allow the opportunity for additional time to consider whether the overall regulatory framework makes sense for regulators and the industry.[3]

10. To the extent that the Committee may be concerned about whether or not there is a need for urgent reform which may impact on decision making regarding timing, our view is that timing pressure should not be at the expense of getting the law right:

(a) The banking industry is progressing well on enhancing its management of conduct risk and is currently reporting six monthly to the FMA and Reserve Bank of New Zealand (**RBNZ**) on action plans developed (albeit due to current Covid-19 pressures some extensions have been sought and granted to these reporting timeframes).

(b) All banks have removed sales incentives (as defined by the FMA) for front line staff and their managers.

(c) Banks are currently dealing closely with the regulators and customers in a positive way to help with COVID-19 related issues. They are especially focused on those who need help most, and are working with the Banking Ombudsman Scheme (**BOS**) and other organisations to support people in vulnerable situations.

(d) There may be options for staged implementation of aspects of the proposed framework which would allow more time to develop the detail of other aspects of the regime.

11. NZBA would welcome the opportunity to speak to the Committee and answer any questions. The submission that follows is divided into two parts: Part 1 addresses overarching points; and Part 2 comments more specifically on the substance of the Bill.

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[3] Noting that the Council of Financial Regulators in November 2019 set as a work priority for 2020 a review of the "Regulatory System Charter" to promote active stewardship of the financial markets regulatory system, taking into account proposed changes to the responsibilities of the different CoFR agencies. The current version of the Charter can be found here: https://www.mbie.govt.nz/assets/7c4f545d08/regulatory-charter-financial-markets.pdf

Part 1: Overarching Points

Scope/Perimeter

12. The Bill applies only to banks, insurers and non-bank deposit takers (**NBDTs**) (and their intermediaries). It, does not currently apply to the wider financial services industry, including non-NBDT finance companies or managed investment scheme (**MIS**) providers despite these entities offering products that are the same as, or substantially similar to, products offered by banks[4] (sometimes via intermediaries).

13. There should be an even playing field in any legislation in that there should not be higher standards applied to one sector of the industry for what are similar products.

14. In relation to this, further consideration is required, at a policy level, to what entities within the financial services landscape in New Zealand ought to be subject to the fair conduct principle and regime (including incentive regulations) – in order to protect consumers and to avoid anti-competitive results. In this respect:

    (a) NZBA is concerned that any new obligations regarding CCCFA products should apply to all lenders (and their intermediaries) – not just banks and NBDTs. In this regard, the further consultation paper released on Phase 2 of the Reserve Bank Act Review in March 2020 contains a helpful discussion of lenders (wholesale funded lenders) not currently caught by the definition of NBDT and the potential for some of those entities to be brought within the perimeter of the planned Deposit Takers Bill.[5] A similar consideration of the proper treatment of lenders (and their intermediaries) for the purposes of this conduct regime is required. This should bear in mind that the factors for inclusion within a prudential versus a conduct regime may be different given the different objectives of protecting consumers versus financial stability. A wider regulatory perimeter may be appropriate in a conduct regime.

    (b) As discussed at paragraphs 23-29 below, the current drafting of the Bill requires reconsideration in order to clarify the policy intent regarding the distribution of non-bank or non-insurance products and services. In particular:

        (i) whether the intention is to capture only when a bank, insurer or NBDT is *providing* a product or service in the sense of the bank, insurer or NBDT being the product or service manufacturer; or

        (ii) whether the intention is to capture within the regime when a bank, insurer or NBDT is involved in sale, distribution or support activities relating to products and services of non-financial institutions (eg KiwiSaver providers).

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4 For example, motor vehicle finance, personal loans and KiwiSaver.

5 Safeguarding the future of our financial system: Further consultation on the prudential framework for deposit takers and depositor protection (March 2020) at chapter 3.

Regulatory Overlap

15. NZBA appreciates the efforts by officials to date to try and avoid or manage regulatory overlap in the drafting of the Bill. However, as we discuss further below, additional refinements are required on this aspect, in particular regarding the CCCFA. Such refinements may help reduce the complexity of the Bill.

16. More broadly, NZBA submits that consideration should be given to the current and developing financial services landscape in New Zealand:

    (a) It is important to ensure that the regime fits with new and foreshadowed duties on directors and senior managers. For example, in the CCCFA, the Deposit Takers Bill and in any separate executive accountability regime. In regard to the latter, we note that the March 2020 consultation paper on Phase 2 of the Reserve Bank Act Review which provides an update on the proposed development of an executive accountability regime in New Zealand.[6] The consultation paper explains that officials will be mindful of developments in Australia (where the Australian Treasury is currently working on expanding the Bank Executive Accountability Regime (**BEAR**) to create an integrated prudential-conduct executive accountability regime covering deposit takers, insurers, superannuation funds, and potentially other financial service providers).

    (b) The opportunity should be taken to consider wider structural issues in relation to oversight and supervision of financial services regulation (with the aim being to simplify the landscape). In particular, if the regime continues to include CCCFA products, we submit that further consideration should be given to jurisdiction for the oversight and supervision of the CCCFA moving from the Commerce Commission to the FMA.

    (c) Existing industry infrastructure and initiatives should also be acknowledged, such as the BOS complaints dashboard and NZBA's Code of Banking Practice.

Legislative reform and transition timeline

17. This Bill has been placed on a fast-track. However, we consider that its timing should be re-assessed in the light of current Covid-19 related pressures on Parliament, government agencies, regulators and banks (and their staff and systems).

18. Consideration of timing going forward should take into account (a) the new activities and pressures that have emerged; (b) the consequential effect on this regime due to the deferral of other law reform projects;[7] and (c) other new law and regulation reform in the pipeline.[8] In relation to (b), we note that some of those law reform

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6 Pages 79–80.

7 For example, regarding FSLAA and the CCCFA.

8 For example, for banks, regulatory reforms relating to the Capital Review, Phase 2 of the Reserve Bank Act review, the signalled executive accountability regime and the Fair Trading Amendment Bill. Insurers are also, separately, facing other proposed reforms including in relation to Cabinet

projects themselves are not yet complete either, for example key FSLAA and CCCFA regulations are yet to be finalised, and that the deferral of other regimes impacts on the implementation window for the conduct regime reforms.

19. At present the Bill allows for a two year backstop after the date of Royal Assent. NZBA stresses, however, that the regulations are crucial to the operationalisation of this legislation and that sufficient time would be needed to review and provide feedback on these. Once the regulations are confirmed, banks will also need appropriate time to implement and make changes where necessary. In considering this transition time, the need for financial institutions to potentially re-negotiate contractual arrangements with third parties should be taken into account as this may take a significant amount of time.

Proportionality to address gaps

20. The Bill proposes a new multi-faceted framework is introduced to sit within the Financial Markets Conduct Act 2013 (**FMCA**). If the Bill is to proceed, NZBA asks that the Committee considers whether all aspects of it are required or are required immediately (for example, both a licensing obligation and a fair conduct programme obligation) and reconsiders the extent to which persons other than the FMA receive the rights of enforcement currently envisaged in the Bill.

21. In considering the appropriateness of this framework, we ask that the Committee again takes into account the wider conduct regulation landscape. The gaps identified by the FMA and RBNZ in the Bank Conduct and Culture Review released in November 2018 will be relevant here. Those identified gaps, for the most part, focussed on regulatory oversight gaps, rather than a need to provide consumers themselves with the ability to bring wide ranging claims against financial institutions and intermediaries (including in regard to fair conduct programmes and their compliance in respect of incentive programmes).[9]

22. In summary, in terms of its multi-faceted nature, the framework proposed includes:

    (a) A new *requirement for financial institutions (banks, insurers and NBDTs) to be licensed* if undertaking particular activities involving consumers. This will require a licensing process, in which we anticipate financial institutions will need to demonstrate to the FMA plans for compliance with the fair conduct principle, and will allow the FMA to impose licence conditions on financial institutions and intermediaries who are financial advice providers in that process. Once licensed, licensees would need to provide any prescribed reports to the FMA and ensure that they have in place effective methods for monitoring compliance with their licensing conditions and identifying material changes in circumstances. The FMA would have powers to censure the licensee, require the licensee to submit an action plan, give other directions and suspend or cancel licences.

    (b) A new *ability for the FMA to insert into licences for a financial advice service, where the licensee is an intermediary, requirements to ensure*

decisions made following MBIE's Insurance Contracts review and in relation to a proposed review of the Insurance Prudential Supervision Act 2010.

9 Bank Conduct and Culture Review report (November 2018) at page 31.

consumers are treated fairly. These requirements can relate to any aspect of the intermediary's involvement in the provision of the relevant services or products, regardless of whether those aspects involve giving financial advice. The FMA would have the same powers as described in (a) above in respect of these licence requirements.

(c) A new *fair conduct principle* which applies when financial institutions and intermediaries undertake particular activities involving consumers. The intended extent of this principle is currently unclear from the Bill. Including whether a breach of this principle itself (unrelated to a breach of the fair conduct programme duty described below) is possible and, thus, can give rise to any stand-alone enforcement consequences or whether the principle acts as a guiding principle for the new regime only. If intended as a stand-alone duty, it appears that a breach would be able to be treated as a breach of the law and give rise to civil consequences under the FMCA. In this regard, civil proceedings would be able to be brought by the FMA or any other person: (i) against a person who contravenes those provisions (ie the financial institution and intermediaries who may be entities or individuals); and (ii) against any person involved in the contravention.

(d) A new *duty for financial institutions to establish, implement and maintain and (together with their intermediaries) adhere to fair conduct programmes*. These programmes would need to comprise policies, processes, systems and controls to meet the fair conduct principle. A breach of any of the obligations relating to fair conduct programmes, including a failure to follow a fair conduct programme, would be able to be treated as a breach of the law and give rise to civil consequences under the FMCA. Again, civil proceedings would be able to be brought by the FMA or any other person: (i) against a person who contravenes those provisions (ie the financial institution and intermediaries who may be entities or individuals); and (ii) against any person involved in the contravention.

(e) A new *duty to comply with incentives regulations* which would include the detail of what types of incentives are prohibited. If financial institutions or intermediaries breach these regulations, this could again lead to civil penalties under the FMCA with proceedings being able to be brought by the FMA or any other person (i) against a person who contravenes those provisions (ie financial institution and intermediary entities and intermediaries who may be individuals) and (ii) against any person involved in the contravention.

Part two: comments on drafting of the bill

Scope of the Bill/Key definitions

Financial Institutions & Relevant Service Definitions

23. Financial institutions are defined in the Bill as registered banks, licensed insurers and licensed NBDTs in the business of "providing 1 or more relevant services"[10] (proposed section 446D). "Relevant service" is then defined in proposed section 446F.

24. NZBA considers that these definitions should be reconsidered in order to clarify which activities are intended to be caught when banks, insurers and NDBTs act as intermediaries. This should take into account the broader perimeter policy issues discussed at paragraphs 12-14 above.

25. As the Bill is currently drafted, the key issue is: (a) whether the intention is to capture only when a bank, insurer or NBDT is *providing* a product or service in the sense of the bank, insurer or NBDT being the product or service manufacturer; or (b) whether the intention is for these definitions to also capture when a bank, insurer or NBDT is involved in sale and distribution activities relating to products and services and/or performing aspects of the product or service for the product or service manufacturer.

26. In this regard, there is ambiguity in the word "providing" within section 446D and within section 446F(1)(a)(iv). In respect of the latter, section 446F(1)(a) lists four categories of "relevant service":

    (a) acting as an insurer (section 446F(1)(a)(i));[11]

    (b) being a creditor under a consumer credit contract (section 446F(1)(a)(ii));[12]

    (c) any financial service referred to in the specified sections of the Financial Service Providers (Registration and Dispute Resolution) Act 2008 (**FSP Act**) where that service is a "retail service" (section 446F(1)(a)(iii)); and

    (d) acting as an intermediary for any services referred to in (a)-(c) above (section 446F(1)(a)(iv)).

27. In terms of the ambiguity within section 446F(1)(a)(iv), unlike elsewhere in the Bill, there is no mention of "associated products" in section 446F(1)(a)(iv) (ie compare section 446E where the phrase "involved in the provision of a relevant service or an associated product" is defined). We query, therefore, if the intention in the drafting is to only capture when a financial institution is involved in the administering or

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[10] We note that "relevant services" here should not be plural, ie "relevant service".

[11] Unlike the other service descriptions at section 446F(1)(a)(ii) and (iii), this does not include a qualifier to limit the service to consumer/retail related insurance. See our submission at paragraph 38 below, in which we suggest that this approach could be better for each of the other limbs of this definition too.

[12] As discussed further at paragraph 39(a) below, the definition here of consumer credit contract has been expanded from that in the CCCFA about which we have separate concerns.

performing of the service (ie similar to within section 446E(3)(d)) in section 446F(1)(a)(iv).

28. To improve clarity, the definition of "relevant service" should be re-drafted so that it (a) focuses on *providing* a product or service in sense of the financial institution being the product or service manufacturer; and (b) excludes intermediary activities. The position of financial institutions when acting as intermediaries should then be dealt with elsewhere in the Bill as a separate concept.

    (a) This could include through the use of the general definition of intermediary in the Bill which would capture when a financial institution is acting as an intermediary for another financial institution (for example, the distribution by a bank of an insurance product).

    (b) It could also include either:

        (i) the use of a new term, if what is intended is to capture when a financial institution is distributing (on a non-advised basis) a service or product offered by an entity other than another financial institution (ie "a financial institution acting as a distributor of a non-financial institution service or product"); or

        (ii) further consideration could be given as to whether such "non-financial institutions" themselves (and all of their related intermediaries) should be brought within the definition of "financial institution".

29. Finally, in relation to the definition of "relevant service", we note the exemption power in section 446F(1)(b) under which regulations can exclude a service of a particular class. We submit that these powers should not be used unless necessary and that principles of good policy design require fulsome consideration now of what services fall inside and outside of the regime – rather than this policy work occurring in the course of preparing the regulations. That said, NZBA is not opposed to some regulation-making power being maintained to enable flexibility in due course.

Intermediaries Definition

30. There are three requirements that need to be met for a person to be defined as an intermediary, we address each of these limbs below.

First limb of the intermediary definition

31. The first limb is that the person must be "involved in the provision of a relevant service or an associated product to a consumer" (section 446E(1)(a)). In the Bill a product is defined as an "associated product" if it is a financial advice product that a consumer acquires under the service (section 446F(2)). Further, under section 446E(3), a person is "involved in the provision of a relevant service or an associated product" if the person does one or more of the following:

    (a) negotiates, solicits, or procures a contract for the service or the acquisition of the product:

(b) carries out other services that are preparatory to that contract being entered into:

(c) gives regulated financial advice in relation to the product:

(d) assists in administering or performing the service or the terms or conditions of the associated product.

32. Section 446E(4) provides, however, that a person is not "involved in the provision of a relevant service or an associated product" merely because the person carries out 1 or more of the following activities:

(a) distributing an advertisement or other promotional material:

(b) carrying on a prescribed occupation and acting in relation to the service or product in the ordinary course of carrying on that occupation:

(c) carrying out a prescribed activity.

33. While we recognise that section 446E(4)(b) and (c) anticipate regulations will be made to prescribe certain occupations and activities out of the definition of intermediaries (and corresponding regulation making powers are to be at section 546(1)(oc) of the FMCA), our view is that ideally the intermediary definition would be further refined in the Bill. For example:

(a) Related to our broader policy comments about the Bill, make section 446E(1)(a) clear that to be an intermediary, the person needs to be involved in the provision of a relevant service or an associated product *by a financial institution* to a consumer. This appears to be reflected already in section 446E(1)(c) but should be included within in 446E(1)(a) as well.

(b) In relation to section 446E(3)(a) and (b), it could be made clearer that the contracts referred to are to be with "consumers", rather than, for example, any contract "for the service".

(c) In relation to section 446E(3)(b) and (d), further consideration should be undertaken of what categories of intermediaries are intended to be caught which could lead to the definition being better particularised. This is in circumstances, for example, where "other services that are preparatory to the service or the acquisition of the product" is very broad and would cover a range of entities such as agencies involved in plain English reviews of customer documents, entities who undertake printing services, and solicitors involved in the review of customer documents.

Second and third limbs of the intermediary definition

34. The second and third limbs of the intermediary definition at section 446E(1)(b)-(c) provide, in addition to meeting the first limb that a person will be an intermediary if:

(b) the person is paid or provided a commission or other consideration in connection with that involvement; and

(c) the commission or consideration is paid or provided, directly or indirectly, by or on behalf of any of the following:

(i) the financial institution that provides the service or products:

(ii) another person who is an intermediary in relation to the service or products.

35. However, the Bill provides that a person is not an intermediary if involved only as: (a) an employee of a financial institution; or (b) an employee of an intermediary (section 446E(2)).

36. In relation to these provisions, NZBA submits:

(a) further thought should be given to section 446E(2) in order to include not just employees but also contractors who are natural persons engaged either directly or through a recruitment/resourcing agency; and

(b) as discussed further at paragraph 62 below in relation to section 446L, it may be that it is not appropriate in all circumstances for financial institutions to have obligations in respect of persons who are "intermediaries of intermediaries".

Consumer Definition

37. At present, the "consumer" definition is located at section 446S "Other definitions used in subpart". NZBA submits that the definition of "consumer" is, however, a key definition and should be moved to sit under the key definitions heading in the Bill (with the definitions of financial institution, intermediary and relevant service). Alternatively, further thought could be given to whether all definitions used in this sub-part should be grouped together at the start of the subpart in order to assist in usability and comprehension.

38. In relation to the definition of "consumer", as drafted the Bill is unnecessarily complex, given the "relevant service" definition also includes qualifiers based on customer-type. For example, the use of "consumer credit contract" in section 446F(1)(ii) and the use of "retail services" in section 446F(1)(iii) with corresponding detail at section 446F(3) that "a service is a retail service if that service is or will be received by: (a) a retail client; or (b) a class of persons where there is at least 1 retail client in that class". This double-up is confusing. We suggest that further thought is given to whether this is the best approach or whether the Bill could be simplified so that the consumer definition provides all of the detail regarding the types of consumers to whom the obligation is owed. The preference being that, to the extent possible, the consumer definition aligns with definitions in existing regimes.

39. In terms of the current definition of "consumer", we note two points:

(a) Insofar as the definition of consumer relates to "the relevant service of acting as a creditor under a consumer credit contract or an associated product", the Bill has altered the definition of "consumer credit contract"

such that it includes two categories of contracts that are not classed as consumer credit contracts under the CCCFA.

The first of these relates to situations in which a customer has a transactional account and which then goes into overdraft. This is uncontroversial. Rather, we are concerned about the effect of the second of these classes of contract being "a credit contract under which the debtor is a trustee acting in his or her capacity as a trustee of a family trust". While in principle we have no objection to treating customers in this class fairly, we query the intended substance of this obligation. For example, whether the expectation is the obligations akin to those in the CCCFA should apply, including in relation to the disclosure and responsible lending regime. If so, we are concerned that this amendment is in effect, bringing family trusts within the CCCFA for bank and NBDT lenders, but not for other lenders. Any such change requires further policy development and analysis and potentially should occur as an amendment to the CCCFA, rather than through a conduct regime.

(b) In relation to the definition of consumer as it relates to the "relevant service of acting as an insurer or an associated product", as drafted the Bill does not appear to cover the situation in which a bank is the master policyholder of an insurance contract (eg a travel insurance policy) under which certain of the bank's eligible customers may become entitled to cover. This is an aspect that the Committee may wish to consider further

Licensing

40. As described above, the Bill provides that any person acting as a financial institution must be licensed (section 6 of the Bill) and also allows the FMA the ability to insert new requirements into licences for a financial advice service (section 7 of the Bill).

41. Consistent with our comments about the definition of financial institutions above, clarification is required on what a licence concerning "acting as a financial institution" is to cover, versus where a bank may be acting as an intermediary such that conditions could be included instead within existing financial advice service licences. We note and support the ability for the FMA, through the operation of the existing FMCA provisions, to structure licences on the basis that they may cover one or more market service (section 395(2) of the FMCA). This may allow for streamlining of the licensing process, rather than the banks (and others) needing to hold multiple licences.

The fair conduct principle

42. As foreshadowed at paragraph 22(c) above, there is currently ambiguity in the Bill as to the intended scope of the fair conduct principle, its relationship with the "fundamental duties in the Bill" and whether it is intended to give rise to a separately enforceable obligation itself (ie such that a failure to comply with the fair conduct principle could give rise to separate civil consequences under the FMCA in addition to breaches of the duties in the Bill). In this regard:

(a) The Overview at section 446A of the Bill describes that the new sub-part 6A to be inserted into the FMCA "provides for certain financial institutions

and intermediaries to treat consumers fairly (including paying due regard to their interests) by:

(i) requiring financial institutions to establish, implement and maintain an effective fair conduct programme;

(ii) requiring financial institutions and their intermediaries to comply with the programme; and

(iii) requiring financial institutions and intermediaries to comply with regulations that regulate incentives."

(b) The Bill itself describes, under a heading "what is the fair conduct principle", that "[t]he fair conduct principle is that a financial institution (and any intermediary) must treat consumers fairly, including by paying due regard to their interests" (section 446B). Sections 446C(1) and (2) then set out "when the fair conduct principle applies" to financial institutions and intermediaries. The sections of the Bill that address the matters at paragraph 42(a)(i)-(iii) above follow under a heading in the Bill entitled "Fundamental duties to meet fair conduct principle".

43. In reconsidering this aspect of the Bill, thought could be given to structuring the explanation of the fair conduct principle provisions in a way that is either consistent with (or deliberately inconsistent with) the articulation of the lender responsibility principles in the CCCFA (section 9C).[13]

44. While not wholly opposed to a general duty to treat customers fairly, we support what appears to be the approach of grounding the principle in other obligations (eg the need for a fair conduct programme and/or licensing obligations). We consider that this will assist in mitigating some of the uncertainty that can arise from an open-ended and enforceable duty to treat customers fairly.

45. In any event, it would be helpful for there to be further refinement of the principle in the Bill or in guidance or guidelines to be issued by the FMA. For example, (a) as to whether paying due regard to consumers' interests is at an individual consumer level (which would raise significant implementation issues) or whether an objective consumer standard is intended; and (b) as to what are the "interests" of a consumer.

46. If the "fair conduct principle" is intended to be an enforceable obligation, the references to it to intermediaries will also need to be given additional thought. That is to confirm the extent of an intermediary's independent obligations in respect of that obligation.

47. In terms of the drafting of the fair conduct principle, consistent with our comments relating to intermediaries above, we also suggest that 446C(2) is amended as follows: "The fair conduct principle also applies when an intermediary is involved in

[13] In comparison, the CCCFA, includes a clear positive obligation that the lender must comply with the lender responsibility principles (section 9C(1). The lender responsibility principles are then described in section 9C(2) to include both a general duty to exercise the care, diligence and skill of a responsible lender and a requirement to comply with all the lender responsibilities in section 9C(3).

the provision *by a financial institution* of any relevant service or any associated product to a consumer."

Fair conduct programmes

48. While in theory NZBA supports a requirement for financial institutions to have in place a fair conduct programme, further work is required to refine the actual requirements of this. This is in order to make what is proposed workable for both financial institutions and intermediaries. NZBA and its members are happy to discuss this aspect further with the Committee or officials, including to help give context and explain the fundamental elements and documents that make up a best practice compliance programme for a bank.

Definition and intended contents of fair conduct programme

49. A "fair conduct programme" is very broadly defined as "policies, processes, systems, and controls that are designed to ensure the financial institution's (and any intermediary's) compliance with the fair conduct principle" (section 446G).

50. This definition, especially the reference to "systems", is potentially uncertain and may need further definition.[14] We submit too that consideration should be given to aligning the definition with the definition of "compliance programme" within the CCCFA (set out below). That definition, through its terms, ensures the inclusion of policies, procedures, systems and controls, and also ensures the evolution of programmes as deficiencies are identified:

> **84 Compliance programmes**
>
> For the purposes of this Part, a creditor or lessor has a **compliance programme** if the creditor or lessor—
>
> (a) requires its employees and agents to follow procedures, or has implemented automated procedures, that are designed to ensure compliance with this Act and the regulations; and
>
> (b) ensures that there are in place methods for systematically identifying deficiencies in the effectiveness of the programme; and
>
> (c) promptly remedies any deficiencies discovered.

51. In relation to the content of fair conduct programmes, it is presently unclear from section 446G(1) and (2) whether: (a) the fair conduct programme is only required to comply with section 446M and any other regulations made relating to the required content of the programme, as otherwise prescribed; or (b) if financial institutions may have obligations over and above this to ascertain potentially relevant elements to include in their fair conduct programmes. To ensure certainty, it should be the former only.

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[14] We note that the Anti-Money Laundering and Counter Financing of Terrorism Act 2009 (**AML/CFT Act**) includes a requirement to "*establish, implement and maintain a compliance programme that includes internal procedures, policies and controls*" at section 56.

52. It would also be helpful to better understand officials' vision of what a fair conduct programme would look like and entails – as it appears that there may be a disconnect between what the industry understands from the wording of the Bill and what officials intend. In this respect, based on the content of sections 446G and 446M of the Bill, the policies, processes, systems and controls once committed to writing would be voluminous, technical and potentially commercially sensitive. This does not fit with the duty in section 446H to make fair conduct programmes publicly available.

53. In addition to commercial sensitivity issues, the publication of all policies, processes, systems and controls would be unhelpful for consumers, albeit it may be that publication of some key elements of each bank's fair conduct programme could be helpful (eg regarding the complaints handling process). For completeness, we note that this issue should be resolved in the Bill itself, rather than being an aspect left to be addressed in regulations.

54. In considering what fair conduct programmes are to entail, careful thought should also be given to the need for financial institutions to draft these with an eye to the fact that a breach by the financial institution or one of its intermediaries of what is described could also amount to a breach of the law with potential actions being able to be brought (as currently drafted in the Bill) by both the FMA and consumers. (By comparison, in the AML/CFT Act, proceedings in relation to "compliance programme" breaches can only be brought by AML Supervisors.) Given this, the preparation of these documents is likely to require legal review beyond what is usually required when implementing a compliance programme. This may have the unintended consequence of narrowing programmes away from the underpinning policy – a customer-centric approach.

55. In order to aid understanding of the requirements of what a fair conduct programme is to comprise, we suggest that some of the content of section 446M and from the regulation making power in section 546(1)(oa) (set out below) is incorporated and potentially prescribed within the obligation to establish, implement and maintain an effective fair conduct programme in section 446G.

56. In terms of the content of section 446M, we also query whether it is right that the first stated minimum requirement of a fair conduct programme is to comply with other existing legislation and, indeed, whether this is appropriate to include at all. This is in circumstances where:

    (a) it would be helpful for the Bill to first articulate what new obligations arise from the regime;

    (b) the FMA and Reserve Bank reviews did not make findings about failures to have in place compliance programmes for existing legislative regimes; and

    (c) conceptually, it may be more appropriate for the other pieces of legislation referred to, to be amended to include new compliance requirements (ie as is currently in place within the CCCFA and could be incorporated within the Fair Trading Act and Consumer Guarantees Act).

57. These provisions could require that all sectors, not just financial institutions, are required to put in place compliance programmes for those regimes.

Application of fair conduct programmes to intermediaries

58. We submit that further thought is required as to how the requirement that fair conduct programmes are to cover intermediary conduct would operate in practice. In particular, we note that some intermediaries may act for multiple financial institutions. This may result in difficulty for them in terms of ensuring compliance with multiple fair conduct programmes – in circumstances where breaching any one of those fair conduct programmes could put them in breach of the FMCA.

Changes to fair conduct programmes

59. Our comments on section 446H (the duty to make fair conduct programme available) are that, in addition to comments at paragraph 52 above, the phrase "material change" needs to be defined. In practice, there could be many changes to a fair conduct programme if it comprised a large number of policies, processes, systems and controls.

Duties to comply with fair conduct programmes

60. Our comments on the duty to comply with fair conduct programme in section 446I are:

    (a) Section 446I(1)(b)(ii), states that only every intermediary who is involved in the provision of the financial institution's relevant services or associated products and who "knows or ought reasonably to know, that they have obligations under the financial institution's fair conduct programme" must take all reasonable steps to comply with a financial institution's fair conduct programme. The definition of intermediary itself should be limited, rather than this type of provision being included to rule out those not intended to be captured.

    (b) Section 446I(2) states that financial institutions and intermediaries must comply with the duty "in the prescribed manner". It is not clear, however, what the corresponding regulation-making power is to provide for this prescription, nor is there any detail of what types of matters may be prescribed.

    (c) Section 446I(3) states that a financial institution or intermediary will contravene section 446I "even if a failure to comply relates only to 1 consumer." This provision seems overly punitive and NZBA submits that it should either be removed entirely or amended to incorporate a materiality threshold.

    (d) In relation to the example used following section 446I, we query the usefulness of this example and suggest that another is used. This is in circumstances where the conduct described (a failure to take reasonable steps when lending money to a particular consumer) is likely to also be a breach of the CCCFA. Banks and NBDTs are already familiar with the CCCFA provisions and the conduct described would quite possibly ultimately not be pursued as a breach under the new FMCA provisions but under the CCCFA.

61. Our comments on the duty to ensure that intermediaries comply with fair conduct programme in sections 446K are:

(a) Section 446K requires that every financial institution must take all reasonable steps to ensure that every intermediary (a) complies with the duties imposed on intermediaries under the financial institution's fair conduct programme; and (b) otherwise acts in a manner that supports the financial institution's compliance with the fair conduct principle. The content of (b) links with what is the intended status of the fair conduct principle (ie guiding principle or duty in itself). NZBA submits that (b) should be removed and the focus, consistent with the rest of the regime, should only be on compliance with the fair conduct programme (ie (a)).

(b) In terms of taking all reasonable steps in regard to ensuring an intermediary's compliance, while section 446K(2) provides that financial institutions must comply with that duty in the prescribed manner, again we note that no clear regulation making power is attached to this, nor any detail of what types of matters may be prescribed. NZBA submits further that this content as to what reasonable steps involved, or, at least further detail, should be included in the Bill itself.

Carve out for intermediaries who are financial advice providers

62. Our comment on section 446L is that, while we support the carve out that financial institutions do not need to ensure that intermediaries who are financial advice providers follow the financial institutions fair conduct programme, the scope of this carve out needs further thought. This is against the background of how the FSLAA licensing system is working in practice. In this respect, some Head Groups are registered with the FMA as financial advice providers, rather than all the brokers that fall under the Head Group. This structure could become less favourable to banks and NBDTs on the current wording of section 446L with a detrimental impact on those who have adopted this structure. One solution could be for section 446L to include intermediaries "associated with" or "aligned to" a financial advice provider.

Incentives

63. The Bill gives potentially very wide regulation making powers in relation to incentives with the term "incentive" being drafted broadly. As drafted, the power has the ability to lead to regulation in a range of situations, including intra-group payments/payments between independent entities and payments to individuals. NZBA submits that more granular policy development is required in this area, rather than such broad regulation powers being passed, and that significant policy of this nature is more appropriately dealt with in primary legislation. For example, regulations made under the powers in the Bill as drafted could create substantial change in the broker industry and so care should be taken to understand the overall implications, rather than pushing this important aspect to be developed in regulations.[15]

64. In the meantime:

[15] See again the LDAC Legislation Guidelines as referred to in footnote 1 at pages 68–69.

(a) we note that the banks have themselves removed all sales incentives (as defined by the FMA) to frontline staff and their managers; and

(b) NZBA would support, in the first instance, regulation of incentives through, for example, a new licence requirement relating to the design and management of incentives.

Whistleblowing

65. In principle, NZBA has no objection to whistleblowers having protection when reporting matters to the FMA as proposed at section 446T and we note the similarities in wording here with the whistleblowing provision that FSLAA is introducing into the FMCA for financial advice providers. We note, however, the work that has occurred and is underway at the banks to encourage, develop and embed speak up cultures and the use of informal and formal concern escalation, including through independent whistleblowing schemes. The messaging around section 446T should, therefore, be handled carefully so as not to undermine those efforts and/or the trust of staff and the public of the veracity of those initiatives.

Contact details

66. If you would like to discuss any aspect of this submission, or to arrange a time for oral submissions to the Committee, please contact:

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