MINISTRY OF BUSINESS, INNOVATION & EMPLOYMENT
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Discussion document

Treatment of intermediaries under the new regime for the conduct of financial institutions

April 2021

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ISBN 978-1-99-001999-9 (online)

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The Ministry of Business, Innovation and Employment (MBIE) seeks written submissions on the issues raised in this document by 5pm on Friday 4 June 2021.

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List of Abbreviations

The Bill	Financial Markets (Conduct of Institutions) Amendment Bill
FMA	Financial Markets Authority
FMC Act	Financial Markets Conduct Act 2013
FSLAA	Financial Services Legislation Amendment Act 2019
MBIE	Ministry of Business, Innovation and Employment
RBNZ	Reserve Bank of New Zealand

1 Introduction

Purpose of this discussion document and context

1. The purpose of this discussion paper is to seek feedback on possible amendments to the Financial Markets (Conduct of Institutions) Amendment Bill (**the Bill**) regarding the treatment of intermediaries. These amendments would be made via Supplementary Order Paper at Committee of the Whole House stage later in 2021.

2. We note that a separate consultation document is currently also seeking feedback on potential regulations to support the operation of the Bill. Some of this other discussion document touches on issues relating to intermediaries. We acknowledge that it may not be possible to give considered feedback on possible regulations that relate to intermediaries until it is clear what the final form of the Bill will be. We therefore invite any relevant feedback on regulations relating to intermediaries either through this consultation document or through the other, where relevant.

2 Background and problem definition

The Bill's current treatment of intermediaries and history

3. The Bill establishes a fair conduct principle, which states that financial institutions must treat consumers fairly. The Bill also clarifies what this principle means in practice.

4. Financial institutions are also required to establish, implement, and maintain a fair conduct programme. A fair conduct programme would operationalise the fair conduct principle, and would involve financial institutions implementing the programme through effective policies, processes, systems, and controls. The programme would apply to all levels of the business, from governance level down to everyday interactions with consumers.

5. Intermediaries are not directly subject to the fair conduct principle or statutory obligations related to fair conduct programmes themselves under the Bill. However, they will be required in practice to meet the expectations of financial institutions set through fair conduct programmes to support the financial institution's compliance with the fair conduct principle.

6. This is achieved through clause 9, new section 446M of the Bill, which currently requires financial institutions to have effective policies, processes, systems and controls as part of their fair conduct programmes in relation to intermediaries.

7. Section 446M sets out a number of general processes etc.. that conduct programmes must include in relation to intermediaries, including processes:

    a. requiring intermediaries involved in the provision of the financial institution's relevant services or associated products to follow procedures and processes that are necessary or desirable to support the financial institution's compliance with the fair conduct principle – new section 446M(1)(b)(ii)

    b. managing or supervising each of those… intermediaries to ensure that they are supporting the financial institution's compliance with the fair conduct principle, and monitoring whether those persons are giving that support – new section 446M(1)(bd).

8. The latter requirement sets out certain specific requirements for fair conduct programmes in relation to all intermediaries including:

    a. conducting competence and "fit and proper" checks

    b. setting conduct expectations

    c. establishing procedures or processes for dealing with misconduct

    d. monitoring whether those intermediaries are treating consumers consistently with the fair conduct principle.

9. Clause 9, new section 446M(1A) provides that in considering what policies, processes etc. are effective, a financial institution must have regard to a range of factors, including the types of intermediaries that are involved in the provision of its relevant services and associated products and the nature of their involvement. This provision is intended to allow financial institutions to consider the range and nature of distribution channels and tailor their training and oversight processes accordingly. For example, it could allow a financial institution to consider what resources the intermediary has available to deliver the product training to their staff to ensure when offers are made to consumers they can make informed choices about the financial institution's products.

10. An "intermediary" is defined broadly in the Bill in clause 9, new section 446E. This generally covers any person who is "involved" in the provision of a financial institution's relevant service and is paid or provided commission for their involvement by the financial institution or another intermediary. The scope of this definition is very broad and captures sales and distribution activities, as well as administrative, advisory and fulfilment services that support the provision of the financial institution's relevant services (e.g. claims management companies, lawyers, and panel beaters in relation to motor vehicle insurance respectively).

11. At Select Committee stage, the Finance and Expenditure Committee made a number of amendments to the Bill relating to intermediaries. These included removing the duty for intermediaries to comply with fair conduct programmes, and the duty for financial institutions to ensure intermediaries comply with their fair conduct programmes.

Interaction between the Bill and new financial advice regime

12. As noted above, the Bill will regulate financial institutions (banks, insurers and non-bank deposit takers) in respect of all aspects of their conduct towards consumers. It sets a principle that financial institutions must treat their consumers fairly and have programmes in their

business that comprise effective processes, policies, systems and controls that are designed to ensure they comply with this fair conduct principle.

13. In March 2021, a new regime for the regulation of financial advice came into force – the Financial Services Legislation Amendment Act 2019 (**FSLAA**). It will require anyone providing financial advice to a retail client to either hold a Financial Advice Provider licence, or be engaged to operate under a Financial Advice Provider's licence as a financial adviser, or nominated representative.

14. There is a high degree of interaction between the conduct regime and the incoming financial advice regime. For example, some financial institutions (e.g. banks) will also be licensed as Financial Advice Providers and engage financial advisers and nominated representatives to provide financial advice when they offer and provide products to customers. All financial institutions (including insurers and non-bank deposit takers) are also likely to distribute their products through intermediaries who are financial advisers or Financial Advice Providers (e.g. specialist insurance brokers, mortgage brokers, or general financial advisers).

15. This latter interaction between the conduct and financial advice regimes creates the potential for some overlap in responsibilities to consumers. This is because the conduct regime (through this Bill) imposes obligations on financial institutions to take responsibility for the fair treatment of consumers even when products are distributed through intermediaries. It therefore imposes obligations on financial institutions to monitor and set expectations around the conduct of intermediaries. FSLAA, however, already places obligations on the conduct of these intermediaries when giving financial advice to retail clients (consumers). These obligations are designed to achieve many of the same objectives of the conduct regime. One of the questions in this discussion document seeks to resolve therefore is how these two sets of obligations should fit together to achieve the best outcomes for consumers.

Concerns related to intermediaries obligations

16. We have heard concerns raised by a wide number of stakeholders, particularly in the financial advice sector, regarding the requirements that apply in respect of intermediaries. In particular, we have heard that the requirements in the Bill:

    a. are too broad

    b. are unclear

    c. overlap with or duplicate the regulation of financial advice under FSLAA (and are therefore unnecessary)

    d. would require compliance in practice by intermediaries with multiple compliance programmes, despite the changes made at Select Committee

    e. would require financial institutions to control the conduct of independent third parties over whom they have little or no control (or who in fact sometimes have greater market power than financial institutions themselves and can dictate key parts of relevant services to financial institutions e.g. large insurance brokers who design the terms of insurance products and approach insurers to underwrite them)

17. Stakeholders have noted that as a result of these issues:

a. The obligations will require significant resourcing and time commitment from both financial institutions and intermediaries to comply (e.g. through agency agreements), particularly intermediaries dealing with multiple institutions' conduct programmes.

b. Financial institutions may be doing more than is necessary or appropriate with respect to training, supervising and managing intermediaries. This could lead to undesirable structural changes in the market. Examples of this have already been seen including financial institutions requiring annual audits of every intermediary to quality and conduct standards by an independent third party, rather than doing conduct assessments on a risk-based basis.

c. There may be a gap in the regulatory framework around the likes of large insurance brokers designing the terms of products but where this activity is not directly covered by the Bill or FSLAA.

18. Stakeholders have noted that if these impacts continue, intermediaries could reduce the number of institutions they work with, which could reduce product choice for consumers and competition.

Concerns related to "intermediary" definition

19. We have also heard concerns regarding the definition of an "intermediary". In particular, we have heard that the scope is too broad and captures a very wide range of third parties who have little direct involvement with consumers, or with whom financial institutions have no contractual arrangements and therefore imposing oversight requirements would impose significant compliance costs.

3 Proposals

Objectives

Overview

20. The overall objectives of the intermediaries obligations are to ensure that consumers are being treated fairly, and that financial institutions are meeting their responsibility to consumers under the fair conduct principle, regardless of distribution channel. It is also the objective to minimise compliance costs and potential duplication of regulation.

21. Underlying these objectives is that one of the key issues identified in the FMA and RBNZ reviews was that some financial institutions were not taking adequate responsibility for customer outcomes that are influenced by the conduct of intermediaries, and make little effort to maintain visibility of customer outcomes where an intermediary is involved. In some

cases, it was also found that intermediaries were keeping consumers at arm's length from the financial institutions.

22. It is therefore the objective for institutions to take appropriate responsibility and care for whether or not customers are experiencing good outcomes from their products, including where this occurs through an intermediary. However, it is also the objective for intermediaries to be open with financial institutions about consumers' experiences, and for good conduct towards consumers to be a shared responsibility.

Summary

23. Ultimately, ensuring good customer outcomes is a shared responsibility between the financial institution and intermediary. Each party should have different obligations that reflect their different roles. However, it is also possible that these obligations and responsibilities to consumers will overlap somewhat. Examples of this might include ensuring connected communications with consumers, or ensuring consumers are in the right product. It is the intention that any obligations that sit on either party should be compatible and mutually reinforcing to achieve the best outcomes for consumers. It is therefore the intention of this discussion document to seek feedback on how best to achieve these objectives.

Proposals

Overview

24. We propose two main amendments to the Bill to address the concerns raised , while achieving the objectives outlined above, as follows:

    a. Amend the current definition of "intermediary" in the Bill to capture only persons involved in the sale or distribution of a financial institution's relevant service or associated products, and

    b. Narrow the obligations that apply to financial institutions in respect of "intermediaries" to minimise compliance cost and duplication of regulation while still ensuring financial institutions take appropriate responsibility for consumer outcomes.

25. A table providing an overview of all the Options discussed is included below at **Annex 1**.

Part 1: Definitions

26. The general purpose of revisiting the definitions in the Bill is to ensure that financial institutions are taking a level of oversight of people involved in the provision of their relevant services and associated products that is appropriate for the nature and extent of their involvement.

27. The proposals below should also have the benefit of avoiding requiring financial institutions to oversee a wide range of service providers who are only involved in the provision of relevant services or associated products in a generalised way, rather than involved in the provision of specific services or products to individual consumers.

28. We note for context that Parts 2 and 3 discuss the obligations that would apply to intermediaries, employees and agents.

Option 1: Amend definition of intermediary to focus on sales and distribution

29. Under this option, the definition of an intermediary would be amended to capture sales and distribution activities only, but also to ensure all of sales and distribution activities are comprehensively captured. The definition would capture persons providing non-advised sales (e.g. travel agents, retailers selling add-on insurance/credit, car dealers, comparison websites) as well as intermediaries providing regulated financial advice in relation to associated products who are regulated under FSLAA (e.g. financial advice providers such as insurance brokers, or mortgage brokers). The intention is also to continue to capture dealer groups (see example 1 in new section 446E).

30. The intention of focusing the definition of an intermediary on sales and distribution is to reflect that sales and distribution is a conceptually and practically distinct type of involvement in the provision of a financial institution's relevant services or associated products. This is because sales and distribution involve direct facilitation or promotion of a service or product to consumers. These activities raise specific risks and conduct and communication interests for consumers, such as the need to assist consumers to make informed decisions about services or products. These activities should therefore be treated differently from other types of involvement.

31. Under this option, people involved in "services that are preparatory to a contract being entered into" and administration and performance of a service or terms and conditions of a product would no longer be considered "intermediaries". This would include the likes of lawyers, plain English writers, claims management services, and claims fulfilment providers. (However, note discussion below on coverage of these activities through the concept of an "agent").

32. We propose to keep the regulation-making powers in the Bill in clause 6, new section 446E(4) to exclude prescribed occupations and activities from the definition of "involved".

1	Do you have any comments on Option 1: 'Amend definition of intermediary to focus on sales and distribution'?
2	Do you think the scope of the proposed definition of an intermediary is comprehensive enough to capture the variety of sales and distribution methods and to avoid gaps and risks of arbitrage?

Option 2: Refine scope of who is covered as an agent

33. Under Option 1 discussed above, financial institutions would be required to have certain processes etc. in relation to a narrower set of "intermediaries". This option, however, would not amend the obligations that financial institutions have in respect of "employees" and "agents" under section 446M.

Who is an agent?

34. The concept of an agent is broad and would cover any person acting within the actual or apparent authority of the financial institution.

35. Actual authority can be:

    a. "express", which is when authority is given by express words, or

    b. "implied", which is when authority might be necessary to carry out the role, when it is usual for the particular undertaking, when it is customary in the trade or profession, or when the circumstances indicate that authority ought to be implied.

36. Apparent authority is when there is no actual authority, but the financial institution makes an express or implied representation that the agent has authority to bind the financial institution. Note that the representation must be by the financial institution, not by the agent.

37. Agents, for example, could include

    a. Parties involved in assisting with insurance claims handling or settlement, such as:

        i. Claims management companies

        ii. Loss assessors or adjustors acting on behalf of the insurer

        iii. Claims fulfilment providers acting on behalf of the insurer (e.g. under a preferred provider arrangement with authority to assess loss or determine a claim).

    b. Parties acting on behalf of lenders, such as third party debt collection or repossession businesses.

38. More generally, we consider that the definition of an "agent" would largely cover the activity of assisting in the administration or performance of a service or terms and conditions of a contract (current section 446M(3)(d) but not proposed to be covered by the new definition of "intermediary"). As discussed below in Part 3, we consider that these activities should still be appropriately monitored by the financial institution if the activity is performed on the financial institution's behalf as these activities can be fundamental to the functioning or performance of relevant services and products and therefore the financial wellbeing of consumers.

39. We note, however, that the concept of "agent" is not linked or restricted to agents who have a direct or specific involvement in the provision of a financial institution's specific services or products to individual consumers. This could mean that a wide range of agents are potentially captured by the concept, including advisory services (e.g. lawyers, accountants) or other

preparatory services that only involve very generalised involvement in the provision of relevant services or associated products.

Option

40. A further option being considered is therefore to further carve out from the scope of financial institutions' responsibilities persons who are only involved in a very generalised way in the provision of relevant services or associated products, rather than involved in the provision of any specific relevant services or products to individual consumers.

41. The purpose of this option is to avoid capturing the likes of advisory or other "preparatory" services (e.g. lawyers, accountants) and other service providers to the financial institution, who may be acting as agents for the financial institution, but who are not involved, directly or indirectly, in providing any part of the financial institution's relevant service or associated products to particular consumers.[1]

42. This option could be achieved with specific amendments to definitions in the Bill, or through exclusions in regulations (or both).

3	Do you have any comments on Option 2?
4	Do you think Option 2 would adequately exclude advisory services (e.g. lawyers, accountants) and other service providers to the financial institution who are not involved, directly or indirectly, in providing any part of the financial institution's relevant service or associated products to consumers?
5	Do you think any explicit exclusions are needed for particular occupations or activities? If so, which ones, and why?

Part 2: Obligations in relation to intermediaries

Objectives

43. The objectives of the proposals below are to:

    a. ensure that financial institutions are taking appropriate responsibility for the fair treatment of consumers in all circumstances, including where their services and products are distributed and serviced through intermediaries

    b. minimise uncertainty and unnecessary duplication of regulatory obligations.

44. To achieves these objectives, two key questions are:

    a. How far should a financial institution's responsibilities for an intermediary extend, and

    b. How should the interaction with FSLAA obligations be managed.

[1] We understand that lawyers are sometimes used by banks in conveyancing transactions as a means of fulfilling some of their obligations under the Credit Contracts and Consumer Finance Act (e.g. assisting borrowers and guarantors to make informed decisions by fulfilling some disclosure requirements around contract terms).

45. The three options presented below represent different degrees of oversight of intermediaries and different approaches to those intermediaries that are regulated under FSLAA.

How far should a financial institution's responsibility for an intermediary extend?

46. As product providers, banks, insurers and non-bank deposit takers have a particular responsibility (captured under the fair conduct principle in section 446B of the Bill) to ensure that their products are likely to meet the requirements and objectives of consumers. This means that financial institutions have a responsibility to monitor and manage the distribution of their products and the ongoing performance of those products.

47. In relation to intermediaries, this means that financial institutions should ensure intermediaries have adequate knowledge about their services and products, but also that the institution has processes for monitoring whether the services and product are meeting the interests, requirements and objectives of consumers over time.

48. More broadly, financial institutions have a responsibility for all aspects of conduct that may conflict with their obligations to consumers under the fair conduct principle. This is because product suitability and performance is only one part of the fair treatment of consumers.

49. In relation to intermediaries, this means that financial institutions have a responsibility for monitoring whether an intermediary is acting generally in a manner that supports the institution's own obligations under, and compliance with, the fair conduct principle. This goes beyond immediate product distribution to ongoing product servicing or dealings with a customer about a product or service, especially for products with a long lifecycle. This could include ensuring clear, regular communication to customers about products during a claim or complaint, monitoring how vulnerable consumers are treated, or avoiding undue pressure or influence on consumers.

Interaction with financial advice obligations

50. As noted above, many intermediaries are regulated as financial advice providers under FSLAA. The intention of requiring financial institutions to oversee these intermediaries is not to interfere with the sales or advice interaction or to duplicate the FSLAA obligations. It is also not the responsibility of a financial institution to monitor or manage an intermediary's compliance with its own (the intermediary's) obligations under FSLAA or other enactments. However, as noted, a financial institution's responsibility may necessarily include some degree of monitoring the conduct of the intermediary and taking appropriate action in response to misconduct.

51. An example of this may be:

    a. carrying out an assessment of the intermediary to determine the level of risk and appropriate processes for that intermediary

    b. monitoring (amongst other things) whether the intermediary is communicating clearly, concisely and effectively with consumers about the institution's products

    c. taking appropriate action in light of any issues or misconduct identified (e.g. training requirements, increased oversight, action plan, suspension or termination of agency agreement).

52. The relevant question becomes how far the responsibility of a financial institution should extend to ensure the fair treatment of consumers where this objective is partly achieved through other regulation (FSLAA), and how the two sets of responsibilities should fit together.

6	Do you have any comments on the objectives regarding the treatment of intermediaries?

Option 3: Minimal changes to intermediaries obligations (remove 446M(1)(b) only)

53. One of the key concerns that has been raised by stakeholders is that the current obligations in the Bill are too broad and unclear in relation to independent third parties that financial institutions have ability to little control. Particular concerns have been raised that section 446M(1)(b) is unclear and too broad.

54. This option would therefore remove the requirement in section 446M(1)(b) for financial institutions to require intermediaries to "follow the procedures or processes that are necessary or desirable to support the financial institution's compliance with the fair conduct principle."

55. All other requirements in section 446M(1) that apply in relation to intermediaries would remain under this Option. This means, for example, that financial institutions would still have to have effective processes etc.. in relation to:

    a. requiring training for intermediaries on the financial institution's relevant services, products and conduct programme

    b. checking that the intermediary had completed that training and had a reasonable understanding of the matters covered by that training

    c. managing or supervising their intermediaries to ensure they are supporting the financial institution's compliance with the fair conduct principle and monitor whether those persons are giving that support.

56. The advantage of this option is that it would likely reduce some of the breadth of obligations and uncertainty about what this requirement requires in practice in relation to intermediaries. This could reduce the issue of financial institutions implementing unnecessarily broad requirements on intermediaries in order to reduce their liability.

57. The potential disadvantage of this option is that it would still require financial institutions to exert a strong degree of control over their intermediaries through the requirement to "*manage or supervise* the intermediaries to ensure they are supporting the financial institution's compliance with the fair conduct principle". Multiple stakeholders have noted that they are not in a position to control the conduct of their intermediaries, so a requirement to "manage or supervise" may be inappropriate and not reflect the nature of the relationship between financial institutions and intermediaries. Such an obligation may also imply that a greater degree of interference with the activities or service of the intermediary is necessary in order to "ensure [the intermediary] is supporting the financial institution's compliance with the fair conduct principle. In practice, there is concern that such interference by financial institutions could duplicate the purpose and function of the financial advice regime, which is already supervised by the FMA.

58. Overall, therefore, while this option could ensure financial institutions are taking greater responsibility for consumer outcomes through intermediaries, and may reduce some uncertainty, it may not achieve the objective of reducing compliance burden or duplication of regulatory obligations.

7	Do you have any comments on Option 3: 'Minimal changes to intermediaries obligations'?
8	If Option 3 were pursued, do you think any other obligations in section 446M(1)(bb), (bc), (bd) or (bf) would need clarifying or amending? Why/why not?

Option 4: More significant changes to intermediaries obligations

59. This option would remove a greater number of the current obligations in section 446M(1) that apply to financial institutions in relation to intermediaries.

60. The purpose of this option is to attempt to minimise the potential duplication of responsibilities/activities between what is covered under the conduct regime (ie this Bill) and under the new financial advice regime in FSLAA.

61. To achieve this, this option would remove the requirements in section 446M(1) for financial institutions to have effective processes etc. for:

    a. requiring intermediaries to follow procedures or processes that are necessary or desirable to support FI's compliance with the fair conduct principle (446M(1)(b))

    b. requiring training for the intermediary on the FI's fair conduct programme and "procedures and processes" (446M(1)(bb)(ii))

    c. checking that intermediary has completed training and has a reasonable understanding of it (446M(1)(bc))

    d. managing or supervising intermediaries to ensure they are supporting the financial institution's compliance with the fair conduct principle (446M(1)(bd) – first part).

62. Instead, this option would only require financial institutions to have effective processes etc. for:

    a. requiring training for each intermediary in the financial institution's relevant services and associated products (to the extent relevant to the intermediary's involvement in the provision of the financial institution's services and products)

    b. setting conduct expectations of intermediaries

    c. monitoring intermediaries to ensure they are supporting the financial institution's compliance with the fair conduct principle (rather than "managing or supervising…")

    d. establishing robust and transparent processes for dealing with misconduct.

63. To be clear, this option would remove the obligation on financial institutions to "manage or supervise…" intermediaries and only require them to "monitor" and establish and apply transparent processes for dealing with misconduct. This is intended to be a lower standard of oversight to reflect that financial institutions are not in relationship of influence or control over

independent third party intermediaries, with whom they are likely only have contractual relationships. A lower standard of oversight (rather than active "management") is also generally appropriate because many intermediaries will be regulated under FSLAA, subject to conduct duties to clients and monitored by the FMA. It is therefore not necessary to require financial institutions to "manage" the conduct intermediaries to ensure it supports the institution's compliance with the fair conduct principle.

64. The advantage of this option is that it would remove a number of the current provisions in the Bill that have the potential to duplicate the function and purpose of FSLAA.

65. However, we also note that this option does not distinguish between intermediaries that are regulated under FSLAA and those that are not. The potential disadvantage of this option is that while it may address the issue regarding duplication of FSLAA, it may set too low a standard of oversight in respect of non-FSLAA intermediaries, who are not independently regulated. This option would also rely on its general provisions and section 446M(1A) to allow financial institutions to distinguish between FSLAA intermediaries and non-FSLAA intermediaries.

9	Do you have any comments on Option 4: 'More significant changes to intermediaries obligations'?
10	What do you think the level of responsibility should be for financial institutions' oversight of intermediaries? For example, "*managing or supervising* the intermediary to ensure they support the financial institutions compliance with the fair conduct principle", or "*monitoring* whether the intermediary is supporting the financial institution's compliance with the fair conduct principle", or something else?
11	What standard do you think financial institutions should have to oversee their intermediaries to?

Option 5: Distinguish between FSLAA and non-FSLAA intermediaries

66. A further option is to explicitly distinguish between intermediaries that are regulated under FSLAA (ie licensed financial advice providers) and those that are not regulated under FSLAA (e.g. car dealers, travel agents, or retailers selling add-on finance/insurance, or product comparison websites). This option would apply on an entity level and not distinguish between the regulated financial advice and non-regulated financial advice (e.g. execution-only sales) provided by the FSLAA intermediary.

67. The purpose of this option is to recognise that financial advice providers are already subject to a form of conduct regulation under FSLAA that is intended to achieve largely the same objective as the conduct regime (ie the fair treatment of consumers) albeit in a specific context – the provision of financial advice. This option would rely on FSLAA to a greater degree and its supervision, monitoring and enforcement by the FMA to ensure good outcomes for, and the fair treatment of consumers, rather than require financial institutions to monitor and verify all aspects of the conduct of intermediaries to achieve this objective. However, we do consider that some degree of oversight of FSLAA intermediaries is appropriate as financial institutions should understand whether consumers are experiencing good outcomes from their relevant services and products.

68. We note for context that clause 7 of the Bill amends section 403 of the FMC Act to permit the FMA to impose conditions on financial advice provider licences acting as intermediaries of financial institutions to ensure consumers are treated fairly. This power could be used to reinforce the Bill's objectives.

69. Under this option, in respect of non-FSLAA intermediaries, financial institutions would have a greater degree of responsibility to not only monitor but also to verify the general conduct of those intermediaries in line with the fair conduct principle. This is because these intermediaries are not subject to separate conduct regulation and oversight (apart from Part 2 of the FMC Act and the Fair Trading Act 1986). Financial institutions themselves (rather than the FMA in relation to FSLAA intermediaries) should therefore be expected to take more oversight of the sales and distribution conduct of intermediaries to ensure consumers are experiencing good outcomes from the financial institution's services and products.

FSLAA intermediaries

70. To achieve the above, this option would impose a more limited range of requirements on financial institutions in relation to intermediaries that are licensed financial advice providers. In particular, financial institutions would be required to have effective processes etc. for:

    a. requiring training for each intermediary in the financial institution's relevant services and associated products (to the extent relevant to the intermediary's involvement in the provision of the financial institution's services and products)

    b. setting conduct expectations of intermediaries

    c. monitoring whether each of their intermediaries is supporting the financial institution's compliance with the fair conduct principle

    d. dealing with misconduct by intermediaries.

71. This option could also focus the responsibilities of the financial institution to be more about monitoring product performance and related outcomes for consumers, rather than general monitoring of the overall conduct of the intermediary. This is to reflect that these intermediaries are already subject to duties to comply with a client interest duty and code of conduct under FSLAA.

Non-FSLAA intermediaries

72. In relation to all other intermediaries, financial institutions would be required to have effective processes etc.. for:

    a. requiring training for each intermediary in the financial institution's relevant services and associated products (to the extent relevant to the intermediary's involvement in the provision of the financial institution's services and products)

    b. checking that intermediaries have completed training and have knowledge of matters covered

    c. obtaining assurance that intermediaries are competent and fit and proper to conduct work engaged for

d. setting conduct expectations of intermediaries

e. monitoring whether each of their intermediaries is supporting the financial institution's compliance with the fair conduct principle

f. dealing with misconduct by intermediaries.

12	Do you have any comments on Option 5: 'Distinguish between FSLAA and non-FSLAA intermediaries'?
13	How far do you think financial institutions' oversight of FSLAA intermediaries under Option 5 should extend? For example, should it cover the general conduct of the intermediaries, or more narrowly on product performance and related consumer outcomes (or something else)?

Part 3: Obligations in relation to employees and agents

73. We do not propose major amendments to the Bill in relation to financial institutions' obligations over employees and agents.

74. This means that that fair conduct programmes must include the following processes etc.. in respect of employees and agents:

    a. requiring training for each employee and agent on the relevant services, products, and conduct programmes (ie processes, polices systems and controls) where relevant to their involvement in the provision of relevant services or associated products - 446M(1)(bb)(i)

    b. checking that those employees and agents have completed that training and have a reasonable understanding of the matters contained in it - 446M(1)(bc)

    c. managing or supervising each of those employees and agents to ensure that they are supporting the financial institution's compliance with the fair conduct principle, and monitoring whether those persons are providing that support, including by:

        i. obtaining reasonable assurance that each employee and agent is competent and otherwise fit and proper to carry out the range of work for which they are engaged

        ii. setting conduct expectations

        iii. establishing processes for dealing with misconduct

        iv. monitoring whether consumers have been treated by employees and agents consistent with the fair conduct principle.

75. We consider that these are reasonable requirements for financial institutions to have in place in respect of employees and agents. This is because any employee or agent acting on a financial institution's behalf and within their authority is effectively acting as the financial institution itself. The financial institution should therefore be responsible for the conduct of that employee or agent when providing services or products to consumers, and monitor and manage that conduct appropriately.

76. We note these obligations are generally similar to those that apply to lenders in relation to their agents under the Responsible Lending Code (the Code).[2] The Code, for example, requires lenders to require agents acting on their behalf to comply with policies and processes relevant to their role, monitor compliance by agents with those policies and processes and addresses any breaches, and have processes to ensure the compliance of agents with the relevant law. The commentary in the Code notes lenders are responsible for the conduct of their agents, and that agents can include a wide range of third parties, including third party debt collection or repossession businesses, or retailers or motor vehicle dealers that facilitate access to credit at the point of sale.

77. As discussed above, the current intention is that these obligations would only apply to employees and agents who are acting on their behalf in relation to the provision of specific relevant services or products to individual consumers. This is to avoid capturing the likes of advisory services (e.g. lawyers, accountants).

14	Do you have any comments on the proposals regarding obligations in relation to employees and agents?
15	Do you think there should be a distinction drawn between employees and agents? Why/why not?
16	Do you think any amendments should be made to the obligations in 446M(1) that would apply to employees and agents?
17	Do you have any other comments or viable proposals?

4 Other options considered

78. In the course of recent engagement of these issues, stakeholders have submitted several options to resolve their concerns.

79. We have considered these carefully but do not believe they are workable for the reasons set out below.

Proposal for intermediaries to have their own fair conduct programmes

80. Some submitters have suggested that that intermediaries should be subject to a duty to establish, implement and maintain their own fair conduct programme, rather than be subject to oversight and conduct expectations indirectly through the fair conduct programmes of financial institutions. This was raised particularly by financial institutions in light of concerns about the inability to exert control over independent third parties and about large

[2] Responsible Lending Code, see section 2.2 – Ensuring Compliance and section 3.8 - Processes ***https://www.consumerprotection.govt.nz/assets/uploads/responsible-lending-code-june-2017.pdf***

intermediaries (e.g. insurance brokers) with significant market power to dictate the terms of products to financial institutions.

81. We acknowledge that many intermediaries provide financial services in their own right. We also acknowledge that large broking businesses often design the terms of products and provide contracts to insurers for underwriting. We accept there is an argument that all financial service providers providing the same or similar financial service should be subject to conduct regulation and the obligations of the Bill.

82. However, the focus of this particular Bill is to act swiftly to address conduct issues related to *financial institutions* (being banks, insurers and non-bank deposit takers). It is not the intention of this legislation to regulate the conduct of all financial service providers. This does not preclude conduct obligations being expanded in the future but the priority of the Bill is to address the identified issues and risks that exist particularly in financial institutions.

83. We also note that the Bill will create a new level playing field under which all financial institutions will be subject to statutory obligations to have conduct programmes that impose requirements on them in relation to intermediaries. It is therefore unlikely that intermediaries will be able to avoid compliance with conduct requirements or expectations imposed on them through conduct programmes (implemented through contracts / agency agreements), as they will only be able to negotiate conduct requirements so far without financial institutions being in breach of their statutory obligations.

84. In light of these reasons, we do not consider that this an appropriate option.

Proposal for intermediaries to be subject to duty to cooperate with financial institutions in relation to fair conduct programmes

85. Submitters have also suggested that intermediaries should be subject to an independent duty to cooperate and constructively engage with financial institutions. This was raised for the same reasons as the proposal above for intermediaries to be have their own conduct programmes.

86. Our views on this option are the same as for the above proposal. Our view therefore is that this is not an appropriate option.

Proposal to apply the fair conduct principle to intermediaries

87. Some submitters have suggested that the fair conduct principle should be applied directly to intermediaries so that they are subject to an obligation to treat consumers fairly in their own right, rather than through the fair conduct programmes of financial institutions.

88. The fair conduct principle in section 466B of the Bill is not an enforceable duty. It does not apply to financial institutions as a direct obligation with liability attached. It is operationalised in the Bill through the duty in section 446G for financial institutions to establish, implement and maintain a fair conduct programme. As noted above, we do not consider it appropriate for

intermediaries generally, nor those particularly involved in insurance distribution to have their own fair conduct programme of the type considered in section 446M. This solution is therefore not feasible.

Recap of questions

Option 1: Amend definition of intermediary to focus on sales and distribution	
1	Do you have any comments on Option 1: 'Amend definition of intermediary to focus on sales and distribution'?
2	Do you think the scope of the proposed definition of an intermediary is comprehensive enough to capture the variety of sales and distribution methods and to avoid gaps and risks of arbitrage?
Option 2: Refine scope of who is covered as an agent	
3	Do you have any comments on Option 2?
4	Do you think Option 2 would adequately exclude advisory services (e.g. lawyers, accountants) and other service providers to the financial institution who are not involved, directly or indirectly, in providing any part of the financial institution's relevant service or associated products to consumers?
5	Do you think any explicit exclusions are needed for particular occupations or activities? If so, which ones, and why?
Objectives	
6	Do you have any comments on the objectives regarding the treatment of intermediaries?
Option 3: Minimal changes to intermediaries obligations (remove 446M(1)(b) only)	
7	Do you have any comments on Option 3: 'Minimal changes to intermediaries obligations'?
8	If Option 3 were pursued, do you think any other obligations in section 446M(1)(bb), (bc), (bd) or (bf) would need clarifying or amending? Why/why not?
Option 4: More significant changes to intermediaries obligations	
9	Do you have any comments on Option 4: 'More significant changes to intermediaries obligations'?
10	What do you think the level of responsibility should be for financial institutions' oversight of intermediaries? For example, "*managing or supervising* the intermediary to ensure they support the financial institutions compliance with the fair conduct principle", or "*monitoring* whether the intermediary is supporting the financial institution's compliance with the fair conduct principle", or something else?
11	What standard do you think financial institutions should have to oversee their intermediaries to?

Option 5: Distinguish between FSLAA and non-FSLAA intermediaries	
12	Do you have any comments on Option 5: 'Distinguish between FSLAA and non-FSLAA intermediaries'?
13	How far do you think financial institutions' oversight of FSLAA intermediaries under Option 4 should extend? For example, should it cover the general conduct of the intermediaries, or more narrowly on product performance and related consumer outcomes (or something else)?
Obligations in relation to employees and agents	
14	Do you have any comments on the proposals regarding obligations in relation to employees and agents?
15	Do you think there should be a distinction drawn between employees and agents? Why/why not?
16	Do you think any amendments should be made to the obligations in 446M(1) that would apply to employees and agents?
17	Do you have any other comments or viable proposals?

Annex – Overview of options

Definitions		Obligations		
Option 1	**Option 2**	**Option 3**	**Option 4**	**Option 5**
Narrow definition of "intermediary" to focus on persons involved in sale and distribution of FI's relevant services or assoc. product. Keep current concepts of employee and agent.	Carve out from the scope of financial institutions' responsibilities through amendments to the Bill and/or exclusions in regulations persons who are only involved in a generalised way in the provision of relevant services or associated products, rather than involved in the provision of any specific relevant services or products to individual consumers.	<u>For intermediaries</u> FI must have effective processes etc. for: - requiring training for each intermediary in the FI's relevant services, associated products, and conduct programme to the extent relevant to the intermediary's involvement in the provision of the FI's services and products - checking that intermediaries have completed training and have knowledge of matters covered - managing or supervising whether each of their intermediaries is supporting the financial institution's compliance with the fair conduct principle, and monitoring whether they are giving that support - obtaining assurance that intermediaries are competent and fit and proper to conduct work engaged for - setting conduct expectations	<u>For intermediaries</u> FI must have effective processes etc. for: - requiring training for each intermediary in the FI's relevant services, associated products to the extent relevant to the intermediary's involvement in the provision of the FI's services and products - setting conduct expectations of intermediaries - monitoring whether each of their intermediaries is supporting the financial institution's compliance with the fair conduct principle (rather than "*managing or supervising…")* - dealing with misconduct by intermediaries. Remove requirements for FI to: - require intermediaries to follow procedures or processes that are necessary or desirable to support FI's compliance with the fair conduct principle (446M(1)(b))	<u>For FSLAA intermediaries</u> FI must have effective processes etc. for: - requiring training for each intermediary in the FI's relevant services, associated products to the extent relevant to the intermediary's involvement in the provision of the FI's services and products - setting conduct expectations of intermediaries - monitoring whether each of their intermediaries is supporting the financial institution's compliance with the fair conduct principle (rather than "*managing or supervising…")* - dealing with misconduct by intermediaries. <u>For non-FSLAA intermediaries</u> FI must have effective processes etc. for: - requiring training for each intermediary in the FI's relevant services, associated products to

		- dealing with misconduct by intermediaries - monitoring whether consumers treated consistently with fair conduct principle. Remove requirement in 446M(1)(b) for FI to require intermediaries to follow procedures and processes that are necessary or desirable to support FI's compliance with the fair conduct principle. Do not distinguish between FSLAA intermediaries and non-FSLAA intermediaries. <u>For employees and agents</u> Keep current requirements in 446M.	- require training for the intermediary on the FI's fair conduct programme and "procedures and processes" (446M(1)(bb)(ii)) - check that intermediary has completed training and has an understand of it (446M(1)(bc)) - monitor or supervise intermediaries to ensure they are supporting FI's compliance with the fair conduct principle - obtain assurance that intermediaries are competent and fit and proper to carry out work for which they are/will be engaged - monitor whether consumers are being treated by intermediaries in a manner that is consistent with the fair conduct principle. Do not distinguish between FSLAA intermediaries and non-FSLAA intermediaries. <u>For employees and agents</u> Keep current requirements in 446M.	the extent relevant to the intermediary's involvement in the provision of the FI's services and products - checking that intermediaries have completed training and have knowledge of matters covered - obtaining assurance that intermediaries are competent and fit and proper to conduct work engaged for - setting conduct expectations of intermediaries - monitoring whether each of their intermediaries is supporting the financial institution's compliance with the fair conduct principle (rather than "*managing or supervising…")* - dealing with misconduct by intermediaries. <u>For employees and agents</u> Keep current requirements in 446M.