



Licensing overview report 2017

What we found and what you need to
know to meet your licence obligations.



This copyright work is licensed under the Creative Commons Attribution 3.0 New Zealand licence. You are free to copy, distribute and adapt the work, as long as you attribute the work to the Financial Markets Authority and abide by the licence terms. To view a copy of this licence, visit <http://creativecommons.org/licenses/by/3.0/nz/>. Please note that the Financial Markets Authority logo may not be used in any way which infringes any provision of the Flags, Emblems, and Names Protection Act 1981. <http://www.legislation.govt.nz/act/public/1981/0047/latest/DLM51358.html> Attribution to the Financial Markets Authority should be in written form, not by reproduction of the Financial Markets Authority logo.

Contents

Key summary	2
The purpose of this report	2
Understanding our approach	2
Summary of applications	5
Applying for a licence	6
Eligibility criteria	6
Minimum standards	7
Gaps in understanding the licensing requirements	7
Our process	8
Minimum standards	9
The importance of conduct	10
Fit and Proper	11
Capability	12
Operational infrastructure	13
Financial resources	15
Governance	18
Culture	21
Compliance	22
Future focus for monitoring	24
Additional resources	25
Applying for a licence under the FMC Act	25
Sector specific case studies	27

Key summary

Over 250 financial services providers applied for a licence under the [FMC Act 2013](#) between 1 April 2014 and 30 November 2016. By the end of last year, 201 of these, in six different categories, successfully obtained a licence.

Introducing a licensing regime was a core part of the FMC Act. Assessing applications has been a major part of our work over the last two to three years. Any licensing regime must challenge applicants to demonstrate appropriate governance structures and control and compliance processes. For many applicants navigating the new licensing regime required significant engagement from us.

We know this was a challenge. However, we think a direct approach to encourage a close dialogue with applicants during their application process worked really well. We want to continue to foster the collaborative and engaged nature of these relationships post licensing as we construct our monitoring framework for licence holders.

The purpose of this report

This report aims to:

- Outline how we applied a flexible approach to applications.
- Explain how the minimum standards and FMC Act eligibility criteria fit together.
- Show the linkage between our view of good conduct and the minimum standards in our licensing guides.
- Signal our future focus for monitoring to current licence holders.
- Clarify the ongoing legal obligations for licence holders.

Understanding our approach

We also want to highlight where we improved our own processes to make licensing faster and more efficient for applicants. Part of this process is more frequent engagement with applicants, including face-to-face meetings early on in the application process.

Face-to-face engagement

When we met applicants face-to-face it was very beneficial for us. Applicants had the opportunity to describe their unique business model, structure and way of operating. It also allowed applicants to give explanations to our questions, face-to-face. This reduced our information requests, and we became comfortable that the applicant was knowledgeable and experienced after asking the right questions.

We recommend all future applicants meet face-to-face with us. Applicants should consider who would be the best person to attend this meeting. It may be your CEO, compliance manager, a director, or the person who prepared the licence application.

Why conduct matters

A good culture encourages all staff within an organisation to look after its customers. We do not prescribe or enforce culture for financial service providers, as a regulator this is not part of our role. We believe boards and senior management teams need to lead their company culture. This means

that across any organisation, from the leadership team down, a shared understanding exists of desired business outcomes and how they align with achieving the best outcomes for customers.

It is helpful to read this report alongside the [guide to the FMA's view of conduct](#), published earlier this year. Together, these documents give a good indication of our areas of future focus, our overall approach to monitoring; and what we expect of licensed providers of financial products and services.

Flexible approach to applications

The guidance and minimum standards contained in [our licensing guides](#) do not prescribe how firms should meet the FMC Act eligibility criteria. Each applicant must demonstrate how their business model meets the legal requirements for eligibility. The legislation was designed, specifically, to cater for all types of business models and sizes.

Our licensing assessment is flexible and allows firms to take more than just one set approach to meet the criteria suited to their business model and size.

Some examples of this flexible approach are:

Meeting governance standards with no independent directors

We received a significant number of applications from very small businesses where the appointment of an independent director was not sustainable for their business.

We expected to see a simple governance process that shows:

- A simple charter or terms of reference for governance meetings that detailed standing agenda items.
- Evidence of formal, regular meetings to work 'on' the business, not in the business.
- A formal process to sign off annual accounts.
- How operational risks are assessed.
- A register of legal compliance obligations.
- How reports received from the compliance assurance programme are assessed.
- How directors maintain sufficient continuing professional development appropriate to their duties.

In these cases, independent challenge to the oversight of the business was provided by a business adviser, advisory board or other professional.

Out-source model firms

We assessed several applications from businesses with a highly outsourced business model. While a licensed business can outsource a function, it cannot outsource the obligation. Sometimes this was a challenge for applicants to show how they meet the eligibility criteria.

When we assessed highly outsourced models, we engaged with the applicant to understand how they ensured their outsourced functions were adequate, effective and compliant with their licensee obligations.

We expected to understand the level of oversight they had of the outsourced service provider, the types of agreements in place (including service level agreements for performance expectations).

We also expected to see how the performance monitoring programme for the outsourced provider aligned with the overall compliance assurance programme.

Summary of applications (as at 30 November 2016)

We summarise the types of license applications received and whether they were successful, withdrawn or declined.

253 TOTAL APPLICATIONS	11 UNSUCCESSFUL	41 WITHDRAWN	TOTAL APPROVED 201
72	0	6	Managed investment scheme 66
12	1	2	Crowdfunding 9
61	1	7	Discretionary investment management service 53
17	0	7	Personalised discretionary investment management service 10
32	1	0	Licensed independent trustee (individual) 31
3	0	0	Licensed independent trustee (corporate) 3
10	0	3	Peer-to-peer 7
46	8	16	Derivative issuers 22

Applying for a licence

This section aims to clarify the eligibility criteria and how they link to the minimum standards set out in our licensing guides.

Any business or individual applying for a licence must meet the FMC Act eligibility criteria before we can grant them a licence to offer financial products and/or services.

If an applicant receives a licence, it means we are satisfied that they meet the eligibility criteria. When they get a licence, there are ongoing obligations on the licence holder to maintain these criteria. Licensees must meet all of the relevant requirements of the FMC Act and its accompanying regulations for the entire licence period. This is where we saw some confusion amongst applicants about the ongoing obligations in the licence conditions.

Eligibility criteria

The legal requirements or 'eligibility criteria' under the FMC Act which all licence applicants must meet are:

- The applicant's directors and senior managers are fit and proper persons to hold their position.
- The applicant can perform the service effectively (considering the proposed conditions of licence).
- The applicant is not expected to contravene their obligations as a licensee.
- The applicant is, or will be, a registered financial services provider, under New Zealand law.
- Managed Investment Scheme (MIS) managers or Discretionary Investment Management Services (DIMS) have no provisions in their constitution meaning their directors could act other than in the applicant's best interest.

See the [Who needs a licence?](#) section on our website. This sets out the specific eligibility requirements for each type of financial product and service.

Minimum standards

The minimum standards set out in our licensing guides are intended to help applicants understand what we are looking for when we assess a licence application against the legal eligibility criteria outlined on page 6.

We imposed extra licence conditions on applicants on a case-by-case basis. Transitional conditions were also imposed on some applicants, which reflected the significant 'step up' needed for some businesses to meet the criteria.

We also allowed exemptions to approve some non-standard products and services. Examples of this were small forestry partnerships, property syndicates being actively wound up, and racing syndicates.

See the section *Minimum standards* on page 9 for more detailed information on each section of the standards. This outlines what a good application should demonstrate under each key area; as well as the key themes we identified during the pre-FMC Act licensing process in 2016.

Gaps in understanding of licensing requirements

We received some applications that did not meet the legal eligibility criteria and/or minimum standards. These applications showed a lack of understanding of one or more obligations. In these cases, we could not grant a licence, unless an applicant made necessary changes.

The most common reasons why an application was not successful were:

Lack of understanding of NZ law

We received many licence applications from businesses located offshore. We have no issue, in general, with an organisation based outside of New Zealand applying for a licence, as long as the business can demonstrate that it will be carrying out activities, in this country, that fit the purpose and requirements of the licence it is applying for.

However, some applicants did not understand the obligations for licence holders under New Zealand law. We were concerned some applicants had no real operations in New Zealand. It seemed as if these applicants wanted a licence, primarily, to suggest to clients offshore they were regulated and licensed in New Zealand.

Over-reliance on consultants

Some applications were prepared by consultants. When we spoke to the applicants, sometimes they could not describe their business operations and the operation of their key processes. We felt many applicants use of consultants replaced, rather than supplemented, the understanding of their business structure.

We also saw several applications which shared identical financial information, and were prepared by the same consultant.

Lack of understanding of regulatory requirements

Occasionally, we uncovered information on our applicants' websites and in other advertising materials that did not meet the regulatory requirements. Applicants should regularly review all printed and online marketing materials to make sure all statements meet the legal requirements and are not misleading.

Unclear business models

A few applicants applied when their business was going through change. This meant they were unable to clearly explain their business model, structure, governance and compliance arrangements. Applicants

need to be able to fully explain how their business will operate when licensed.

Start-up businesses

A newly-formed or not yet operational business is often hard to describe accurately in a licence application. We were sympathetic to the challenge, but we still need evidence that the business understands what the operational structure will look like. We encourage these types of applicants to engage with us early.

Likely to contravene their market services licence

We will not grant a licence where we believe the applicant is likely to contravene their licence conditions after it is granted. We had a few applications where the applicant:

- Lacked the financial and human resources required to conduct a licensed service.
- Could not provide the additional information or explanations we asked for during the assessment process.

Our process

When an application was unsuccessful, we followed these principles:

- The decision was necessary or desirable to promote one or more of the main purposes of the FMC Act, and
- The FMA should not restrict businesses or individuals becoming licensed without good reason.

Part of our process is to send the unsuccessful applicant a letter outlining the areas where they did not meet the licence eligibility criteria. Then, an applicant has a minimum of 10 working days to make a written submission before we make our final decision.

Our experience over the last three years is that a number of applicants withdraw their applications at this stage.

Applicants reapply once they have made changes to their business models.

We do not take pleasure in declining or challenging licence applications. With that top of mind, we are determined to work with businesses to help them meet the necessary legal requirements to get a licence. Whenever an applicant applies for a licence for a second time, we consider it as a new application.

Minimum standards

This section summarises our observations under the main sections of the minimum standards set out in our licensing guides. We set out examples of the good practice we've seen in many applications, and where we see room for improvement.

The minimum standards do not change or limit the legal eligibility criteria licence applicants have to meet in the FMC Act.

As a regulator, it is our job to ensure an applicant has met legal eligibility criteria before they receive a licence. Licence holders must meet the requirements of the FMC Act and Regulations in all cases, at the time of licensing and for the entire licence period.

There are similar minimum standards for the different licence types. They fall into these main categories:

Minimum standard	Requirement
Fit and proper	Your directors and senior managers must be fit and proper persons to hold their respective positions.
Capability	Your organisation must have the right mix of people with the right skills and experience, in the right roles, to monitor your licensed business properly and effectively.
Operational infrastructure	Each licence type has its own specific requirements for operational infrastructure. There are common requirements for all applicants. You need to demonstrate you have the policies, processes and procedures in place, supported by effective controls; and you meet the minimum standards.
Financial resources	You must have adequate financial resources to effectively perform the licensed service at all times.
Governance	You must have a high-level body responsible for overseeing compliance with your market services licence obligations – and ensure appropriate risk management.
Culture	You have governance and compliance arrangements that promote a customer-focused culture with your obligations as a licensee, and ensure appropriate risk management and fair treatment of investors.
Compliance	You must have adequate and effective arrangements for challenging and testing your own compliance, its compliance framework and the outcomes.

We expected all applicants to explain how their approach was appropriate to the size and nature of their business. If an applicant believed a certain minimum standard was not relevant to the particular type(s) of products or services they would manage if granted a licence, we expected to see their rationale as to why they thought this. We also wanted to see a detailed description of how they still met the intent of the minimum standard, and how they would meet the eligibility criteria.

Out of the 253 applications we received, each applicant had a slightly different business model and approach to meeting the minimum standards. Some applicants had to strengthen certain aspects of their business structure, governance, reporting and compliance to meet the new legal requirements – however most applicants had appropriate and robust processes in place.

The importance of conduct

We apply a [conduct lens](#) to the work we do. Obtaining a licence for financial products or services is the first step on an applicant's conduct journey with us.

[Our Strategic Risk Outlook 2017 and guide to the FMA's view of conduct](#) contain more detail on this.

For each minimum standard, we use the following icons to signal our conduct expectations. These come from our guide to the FMA's view of conduct.



Fit and proper

Requirement: Your directors and senior managers must be fit and proper persons to hold their respective positions.



Our view of good practice:

- Good character – good checks and balances in place to make sure people in key positions meet the requirements for integrity, honesty, trustworthiness and reputation.
- Capability – people in key positions have the competence, skills and experience needed for their position. People can demonstrate how they meet professional standards of care and seek continuous improvement through training and development.

Key themes we saw:

The FMC Act requirements were extensive, so we expected applicants to understand the training and development needs to support their directors and senior managers to understand the changes. However, some applicants were not able to show us evidence of a detailed training schedule for senior management.

Most applicants could provide position descriptions customised to relevant roles, and explain how the appointed directors and senior managers were suitably qualified to perform their roles.

Several applicants had engaged a law firm to provide regular training to the directors and senior managers on the new FMC Act requirements. They provided a copy of the training schedule that included future ongoing training already booked in. We thought this showed clear commitment to meeting the fit and proper aspect of the minimum standards.

We encourage directors and senior managers to regularly undertake professional development to keep skills and knowledge current; and to ensure standards continue to be maintained.

Suggestions for new applicants

We expect applicants to think about which positions in their organisation would be a 'senior manager', as defined in the FMC Act. Usually, this term covers anyone who has a significant influence over the management or administration of the licensed business – so it can include a number of roles.

Capability

Requirement: Your organisation must have the right mix of people with the right skills and experience, in the right roles, to monitor your licensed business properly and effectively.



Our view of good practice:

- People have the skills and experience to provide the right products and services.
- Professional standards of care are met.
- People seek continuous improvement through training.

Our licensing guides recommend that applications include an organisational chart of the applicant's business. This can be very helpful during the licensing assessment, as it helps us to understand the structure of the business, the make-up of the management team and which services (if any) are outsourced.

Where directors and senior managers are based overseas, we want to see an explanation of their knowledge of New Zealand legislation, particularly with the FMC Act.

In smaller organisations, we are keen to understand how oversight and compliance functions are separated from areas such as sales and operations. We recommend the person who designs and implements any of these key processes is different from the person who checks them.

Key themes we saw:

Applicants from larger organisations were generally well-resourced and had no difficulty meeting the minimum standards for capability.

Some applicants presented position descriptions for staff with split-functions that did not provide a robust control environment. For example, the person responsible for developing the operational processes was also responsible for checking the same processes were effective.

We saw several small businesses that had effective compliance models showing segregation of duties and internal checks. They were also able to show how they achieved independent testing and monitoring.

A number of larger organisations provided a high-level overview of their management structure, focusing on the key roles that would implement or oversee the licensed products or services and how reporting lines ensure effective compliance is in place.

Some very small businesses outsourced compliance testing and monitoring to ensure regular independent checks were in place. Others worked with their accountant or a business mentor to formalise their strategic thinking and business planning. It also offered an independent challenge to their processes.

Operational infrastructure

Requirement: Each licence type has its own specific requirements for operational infrastructure. There are common requirements for all applicants. They needed to demonstrate they had policies, processes and procedures in place which were supported by effective controls; and met the minimum standards.



Our view of good practice:

- Businesses maintain systems which support good conduct.
- People seek out continuous improvement.
- Complaints and disputes are managed effectively and transparently.

Key themes we saw:

The minimum standards for operational infrastructure apply to both large and small organisations. Applicants from smaller organisations often had good systems in place, but needed their internal processes and controls to be better documented and formalised.

Policies, processes and procedures are key reference documents for an organisation's staff. They should always be fit for purpose and reflect the nature, size, scale and complexity of the business. These documents should be regularly reviewed and updated. They also help reduce knowledge loss when a key person leaves – which is an issue for smaller businesses.

Good use of policy and procedure documents

We saw a high number of applicants who provided policy and procedure documents which were well-tailored to their business. These had a dedicated owner to keep documents up-to-date and had good version control and approval processes in place.

Several small businesses, with simpler processes, combined key areas into one policy document. We agree that for small businesses it is more practical to have the policy, procedure and controls documented together.

One applicant found out during their application process that their business had over 200 policies – many of which were redundant or out-dated. Part of their application included a one page overview of their key policies and a future approach to policy management which included:

- A defined business owner with responsibility for reviewing policies.
- A set review cycle for each policy.
- Well constructed version control to record the key changes made.
- Clear accountability and a sign off process.

Over-reliance on consultants

Many applications showed extensive use of consultants and compliance businesses. We understand that working with external consultants can be helpful during a licensing application. However, it is important that any new policies are fit for purpose, tailored to your business model, and outline why your business has taken a particular approach.

It was easy to identify applications that were over-reliant on consultant's templates. Some applicants presented documents that still said: 'Insert company name here'. Applicants regulated outside of New Zealand often provided group policies or compliance manuals developed to meet the regulatory requirements of other jurisdictions. We reviewed these documents to understand how the applicant incorporated New Zealand's requirements and how they would include future changes.

Financial resources

Requirements: You must have adequate financial resources to effectively perform the licensed service at all times.



The minimum standards in our licence guides require:

- evidence of a sufficiently robust balance sheet,
- cash flow projections, professional indemnity insurance, and
- explanation of financial management practices.

We also expected to see a financial management policy and an explanation of key processes. We looked for an explanation of how the applicant maintains an appropriate level of liquid assets, at all times, to cover any unexpected contingencies.

Examples of good practice:

- A sufficiently strong balance sheet, and audited financial statements.
- The Net Tangible Assets (NTA) calculation.
- Cash flow forecast for the next 12 months.

Key themes we saw:

All applicants were able to provide the base requirements outlined above. We also received appropriate cash flow forecasts, approved by an organisation's board, which included assumptions applicable to their business type, and reasonable expected revenue and expenses.

Calculation of cash flow and NTA

The minimum standards for financial resources in our licensing guides ask applicants to explain the systems, policies and controls in place for managing their financial resources. The guide also asks, specifically, how applicants calculate NTA and manage their cash flow. Licensees are required to calculate their NTA monthly and notify us* when NTA becomes negative – this serves as an early flag of any solvency issues.

Many applicants had no documented financial management policy which covered the following:

- The decision-making behind what is the appropriate level of liquid assets to hold.
- Delegations of authority for financial decisions.
- How financial risks are assessed, ranked and mitigated.

*And their supervisor for Managed Investment Scheme managers.

Many small businesses outsourced key financial functions to their accountant, but could still show us a clear understanding of their financial management processes, including when they will notify us if circumstances change.

One application from a very small business showed a simple, but effective, process linking the NTA projections with their balance sheet. If NTA became negative, they showed the type of reporting process they would put in place, and they had a clear plan to remedy the issue.

Several applicants provided a written policy specific to their approach to financial management. It covered corresponding procedures and documented escalation processes to senior management. It also included notification procedures to us or their supervisor.

Many applicants had not calculated NTA as required by our licensing guides, or did not fully understand how to calculate NTA in line with the standard licence conditions. They were often in a negative NTA position after the calculation was corrected.

Licensees need to show a positive NTA or explain why the negative NTA exists. They also need to outline the reasons they should still be given a licence, despite being in a negative NTA position.

Several applicants provided a budget which did not meet the requirement of a cash flow forecast. For start-up businesses, we need to understand the assumptions made, why management thinks they are reasonable, and the level of sensitivity they can withstand.

It can be helpful to see longer range cash flow forecasts and details about when the business expects to have a positive NTA.

Related party receivables

A common issue we saw was that receivables were included from a related party or associate that did not meet the 'permitted' definition of 'related party receivables' set out in the licensing standard conditions. A related party receivable is permitted when it comes from a transaction which happened in the ordinary course of business, on standard commercial terms, at arm's length. Permitted related party receivables cannot exceed 20% of net assets.

In the section titled *Conflict of* [our guide to the FMA's view of conduct](#) we outline that licensees need to be able to clearly identify, manage and disclose any actual and potential conflicts.

The business needs to be able to clearly explain any arrangement with any related parties which have an impact or relevance to their customers.

Shareholder loans

If an applicant had shareholder loans, we wanted to see written shareholder agreements in place, where the relevant shareholder subordinates the debt.

A shareholder loan can only be excluded from the total liabilities of the NTA calculation if shareholder arrangements are in place. Our licensing guides clearly set this out.

Details of future costs

We expected applicants to set out clearly how they have made provision for the future costs of their new licence requirements including:

- Licensing costs.
- Legal costs.
- Compliance costs.
- Consultancy costs.

Governance

Requirements: You must have a high-level body responsible for overseeing compliance with your market services licence obligations – and ensure appropriate risk management.



Examples of good practice:

- A business maintains systems which support good conduct.
- People seek out continuous improvement.
- Complaints and disputes are managed effectively and transparently.
- Governance framework matches the size and scale of the business.
- Evidence of how risks are identified and mitigated.
- Clear examples of the types of reporting to be provided to the oversight body.

Applicants were asked to nominate the oversight body that would oversee the implementation of the new regulatory regime.

The minimum standards require a clear reporting and governance framework which covers all aspects of the business, including compliance obligations and identifying key risks.

As the new regulations had just come into legal effect during our licence assessment process, we wanted to understand how a company's oversight body would operate, its terms of reference, and the level of operational oversight in place.

Larger applicants, with a regulated parent company, demonstrated mature governance frameworks which included regular reporting and boards supported by relevant sub-committees.

For smaller business, we expected to see very simple governance frameworks with evidence that key business risks had been identified and were aligned to their reporting obligations.

Customer-focused culture

One of the five Cs in a guide to the FMA's view of conduct focuses on the culture within organisations.

This means providers of financial services and products act with their customers' needs front of mind. Bad conduct is addressed and good conduct is rewarded within the organisation.

Key themes we saw:

Some applicants with large parent and multiple board structures had parent boards that were relatively removed from the day-to-day operation of the New Zealand business. Alternatively, they provided multiple oversight bodies without indicating who had clear responsibility under the new licensing regime.

We worked with these applicants to identify who would have the responsibility for putting in place and overseeing the new regime in their business; and to ensure their ongoing obligations as a newly-licensed business.

Many smaller organisations needed further guidance to develop appropriate 'fit for purpose' governance frameworks, that were suitable for the size and scale of these businesses. A governance framework for a small business can be simple and straightforward, using external advisers to bring independent challenge.

Common themes in company documents

In board or committee charters and terms of reference documents, we noticed some common areas that needed strengthening. These included:

- Governing reference documents not updated to reflect the new licensee requirements, including the roles and responsibilities of the oversight body.
- No clarity about how the chair was appointed or how key decisions were reached and agreed.
- The overall governance and reporting methodology was not explained.
- More detail needed about the frequency of meetings, standing agenda items, and the types of reports reviewed, but not included in the licence application.

Addressing potential conflicts of interest

The minimum standards in our licensing guides, require applicants to explain the procedures in place to identify conflicts (or potential conflicts) of interest and how they deal with them.

We observed that applicants tended to address conflicts of interest about personal trading controls, but did not consider where other conflicts of interest may arise for their business. Some common examples of conflicts of interest we saw were from:

- Design of the business.
- Compliance reporting to the investment or operational part of the business.
- Lack of independent compliance checks.

We worked with applicants to understand what kind of conflicts of interest they were exposed to and allowed applicants more time to mitigate the conflicts.

New applications

To help new licence applicants we have put together a helpful hints checklist (to avoid common pitfalls) and to save time. Find this in the Additional Resources section on page 25 of this report.

Risk management

Some applicants needed to better explain how their organisation identified and managed risks more comprehensively. We did not require a risk management framework as part of the application process. However, we did expect to see a process which sets out how a business defined the types and significance of risk it is exposed to; how the risk is recorded; the significance of the risk; and the types of controls in place to mitigate it.

Robust gap analysis

One Australian-owned applicant completed a comprehensive gap analysis between their Australian licence requirements and the New Zealand ones. They provided a copy of the project plan which set out how they had aligned their processes to meet the requirements of both jurisdictions. This was supported by a series of development sessions for their directors and senior managers on the new requirements in New Zealand. We felt this met the requirements and showed good practice.

DIMS providers

We licensed a number of small Discretionary Investment Management Services (DIMS) businesses. A common model for these businesses was two directors, an authorised financial adviser and some part time administration support. We saw the emergence of joint ventures and groups established to share costs such as technology, website maintenance, marketing, investment research and compliance costs. There has been positive feedback from these licensees about the benefits of sharing investment information and reducing compliance costs by using new business structures.

We saw a number of excellent applications from small businesses which had developed a simple governance framework covering key areas such as:

- Formal regular meetings to work on improving the business.
- Simple charter or terms of reference for governance meetings.
- A formal process for the sign off of annual accounts.
- A simple process to assess and review operational risks.
- A simple process to review reports received from the compliance assurance programme activity.
- A simple way to determine and record their regulatory obligations.
- A timetable that outlines directors' continuing professional development.

Culture

Requirements: You have governance and compliance arrangements that promote a customer-focused culture with your obligations as a licensee, and ensure appropriate risk management and fair treatment of investors.



Examples of good practice:

- Clearly define what a customer-focused culture looks like for their business.
- Treat customers honestly and fairly.
- Listen to their customers.
- Outline how they will know if staff have adopted this culture.
- Senior management have clearly communicated to staff what culture and compliance means for the organisation.
- Ensure good communication across the whole organisation.
- Address poor conduct. Recognise and reward good conduct.

Key themes we saw:

Most applicants had both an existing code of conduct and staff training in place. They were able to explain the reward and recognition systems in the business which encouraged good conduct.

We would have liked to see more emphasis on how applicants explained their governance and compliance arrangements, appropriate risk management and the fair treatment of investors.

One applicant demonstrated a comprehensive conduct framework which covered its fair treatment of clients and had clearly considered the new regime. Its code of conduct was supported by a large number of mandatory conduct-related courses and ongoing refresher training courses. This is the level of detail we want to see.

Compliance

Requirements: You must have adequate and effective arrangements for challenging and testing your own compliance, its compliance framework and the outcomes.



Examples of good practice:

- Can show the controls developed for the business to meet the new requirements.
- Can explain the elements of their compliance framework.
- Can provide an outline of the testing and monitoring of key controls.
- Seeks out continuous improvement.
- Maintains systems which support good conduct.

In larger organisations, we expected to see a clear explanation of the compliance framework, how it worked in practice, and why it was sufficient for the nature and size of the business.

For smaller organisations, we expected to see a clear explanation of who performs the day-to-day functions and how roles are organised to prevent any key person risk. Issues that can arise with key person risk include conflicts of interest, no division of duties and insufficient resource to manage the business functions if that particular key person is unavailable.

Key themes we saw:

Compliance Assurance Programmes (CAP) was one area where most applicants, from both large and small organisations, needed more time to understand our expectations and develop a suitable approach.

We acknowledge that our CAP guidance could have been clearer. We also acknowledge that CAP was not a generic market term before the licensing guides were drafted.

It is important to be aware of the difference between a business's compliance plan and its CAP. The governance section of our licensing guides sets out the CAP's requirements. The focus of a CAP should not be the actual compliance systems of a business. Instead, it needs to set out the programme of controls and activities in place to provide their board with assurance about how they operate their compliance systems.

Good practice examples of a CAP

A well put-together CAP should set out the items detailed below. A number of applicants provided CAPs which did contain these elements:

- An explanation of the roles and responsibilities for overseeing compliance in the organisation.
- The skills and qualifications of the compliance person/function/provider who performs the independent checks.
- A register setting out a list of the obligations.
- A plan for testing and monitoring controls that gets reported back to the oversight body.
- Examples of how findings are reported and fixed.
- Details of how agreements with clients and outsourced providers are monitored; and how failures are reported and addressed.

Future focus for monitoring

We want to make sure that firms continue to meet the FMC Act eligibility criteria for the period of the licence and strengthen their systems and processes. We also want firms to have the level of maturity and sophistication that is right for their business – and that means recognising when they're good enough.

Licensed firms have an ongoing obligation to meet the eligibility criteria, as well as their other legal obligations. This is what we look for in our monitoring, so that New Zealand investors can have confidence our regulatory standards reduce potential harm.

The overall objective of our monitoring is to seek to promote conduct that contributes to the objectives of the FMC Act – fair, efficient, transparent financial markets – and confident and informed participation in those markets. As a risk-based regulator we will assess which firms and which activities are most likely to pose significant risks to these objectives, and direct our attention to these.

A particular focus for us will be how, and to what extent, licensees can demonstrate tangible customer-focused conduct.

We also want to find out what was effective and what was not, and will consider the policies, procedures and controls businesses designed to meet their new legal requirements.

We will also look at what changes took place after they were granted a licence – and, most importantly, did those changes effect customers in a positive way?

Our view of good conduct behaviour

Licensees also need to ask themselves what good looks like from the perspective of their culture. This may mean they need to dedicate more time and attention to make sure a customer-centred approach is integrated into all aspects of their business.

When we monitor, we want to find out how businesses develop good culture and conduct. We want to understand the specific steps businesses have taken to promote the right attitudes and behaviours from managers and staff across the business, and the positive effects of these efforts.

We will often want to meet with the body that oversees the new obligations. We want to find out how governance and compliance works; and how that compliance culture is tested and monitored.

Additional resources

Applying for a licence under the FMC Act

If you follow these steps your application has a better chance of success:

To offer certain financial products and services in New Zealand, you need to be licensed. Being licensed shows your customers you meet the legal eligibility criteria and levels of compliance in the [Financial Markets Conduct Act](#) (FMC Act).

Preparing an application for the first time can be time-consuming.

We want to help make sure your application is successful. But if you are not across your legal obligations, your application may be unsuccessful.

Also think carefully if you need to be licensed at all? Our website contains useful information to help you make this decision.

Step 1 – Know the legal requirements

Show clearly how you meet the legal eligibility criteria in the FMC Act for your licence class.

Get familiar with the minimum standards for your type of licence and eligibility criteria in our [licensing guides](#).

Your application needs to clearly set out how you will meet these criteria.

You should also seek legal or other expert advice if needed.

Step 2 – Identify the gaps

Work out how you will address these gaps in your business processes to be able to meet the legal eligibility criteria.

You may have to:

- Update existing policies, processes or procedures – streamlining where possible, and/or
- Develop internal procedures and controls to meet the FMC Act requirements.

Step 3 – Apply online

Before you submit your licence application:

- You will need to set up a [RealMe login](#) before you start your application.
- Read all parts of the relevant guide for your licence type on [our website](#).
- Prepare answers to the questions in Part B.
- Check the comments in Part C for any additional supporting evidence you need to provide.

Your application should include the following information about your business:

- A clear description of its operating model and ownership.
- The operating model.
- The products and services offered.
- Your target customers.
- Organisational charts that show reporting lines.

Step 4 – Meet with us early

- Before you submit your application let us know the supporting evidence you will include.
- Meeting with us helps you to better understand the overview of the licensing process and the timing of your application.
- It also gives you the chance to alter your application before you submit it, if necessary.
- Nominate a key person to speak with us. We will liaise with this person once your application is lodged and keep them updated about your application.
- Someone from your business has a better understanding of how it runs than a consultant – so we prefer to speak with one of your team.

Sector specific case studies



MIS Case Study

We received an application from a start-up MIS manager. While the shareholders were very experienced in their investment knowledge and business management they had not developed their internal control environment to meet the minimum standards for licensing.

Following a number of meetings with us, they engaged a consultant to help them develop policies, procedures and controls customised to their business. The consultant was also engaged post licensing to assist them in implementing and putting in place the new processes. The consultant also performed varied compliance checks on an ongoing basis until the manager developed sufficient internal capability.

As they were a start-up business, their Net Tangible Assets were anticipated to be negative for up to six months. To demonstrate they could meet the minimum standards for financial resources, they provided evidence of long term financial support from their shareholders and an 18 month cash flow to demonstrate when their NTA would be positive.

The applicant was granted a licence.



DIMS Case Study

The applicant was a small start-up business applying for a DIMS licence. Due to its business structure – put in place to seed the capital for the new business – it had no employees and the directors were based overseas. Consequently, the applicant could not show that its operational infrastructure met the licensing requirements.

We met with the applicant and worked through some options to help them meet the relevant legal eligibility criteria. They withdrew their application, spent three months restructuring their business model, and then submitted a new application which we granted.

The second application clearly set out: a considered business model, showed enough resourcing to cover key functions, had appropriate segregation of duties, and a person responsible for overseeing compliance. After seeing these improvements, we felt confident to issue the applicant with a licence.



AUCKLAND

Level 5, Ernst & Young Building
2 Takutai Square, Britomart
PO Box 106 672, Auckland 1143

Phone: +64 9 300 0400 Fax: +64 9 300 0499

WELLINGTON

Level 2, 1 Grey Street
PO Box 1179, Wellington 6140

Phone: +64 4 472 9830 Fax: +64 4 472 8076