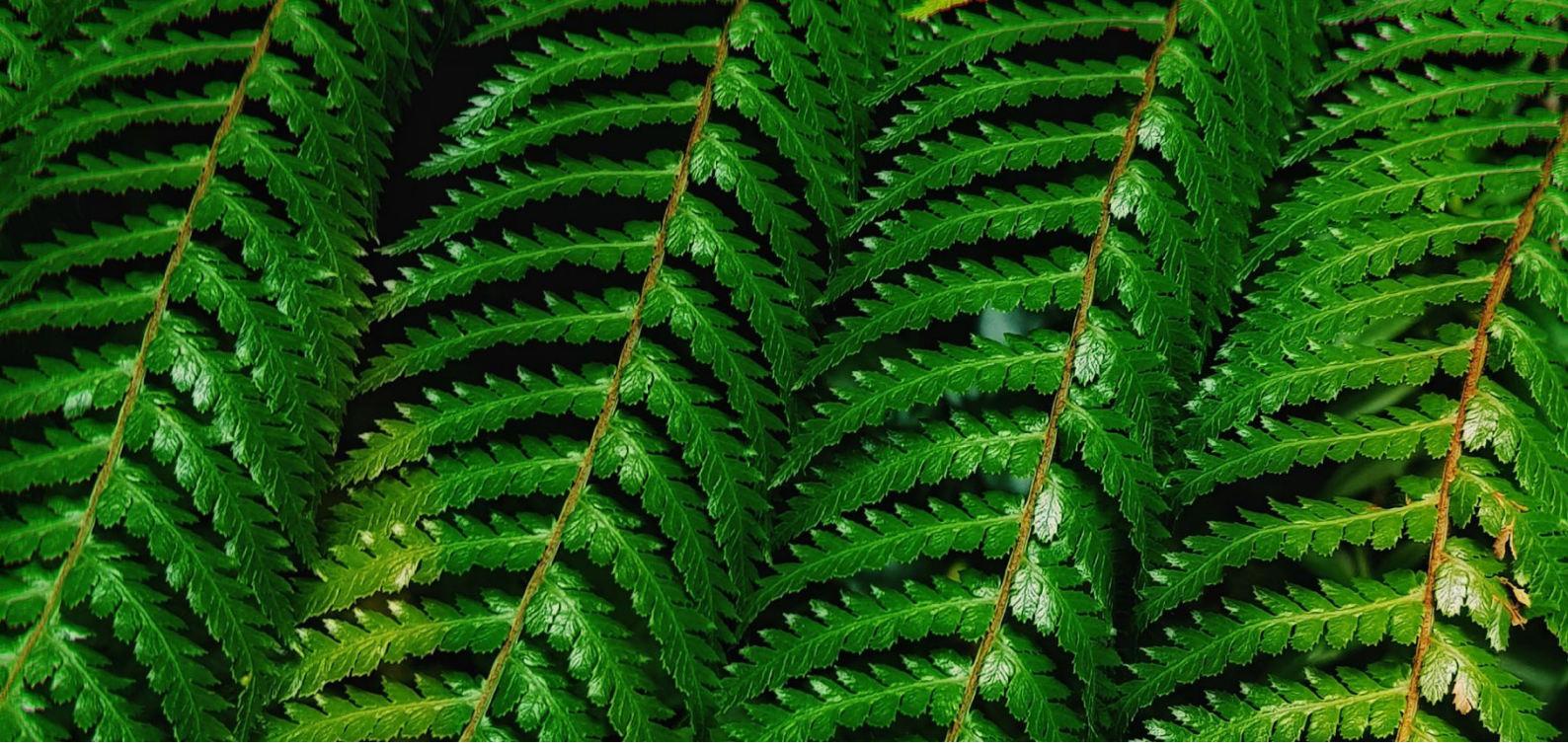

NOVEMBER 2022

Summary of key themes

Consultation on the proposed standard conditions for financial institution licences

FMA
FINANCIAL MARKETS AUTHORITY
TE MANA TĀTAI HOKOHOKO

Contents

Executive summary

We would like to thank all submitters for their feedback on our consultation on the proposed standard conditions for financial institution licences. We received 13 written submissions from a range of stakeholders including industry bodies, banks, insurers and one law firm. We appreciate the points raised and the effort put into each submission.

This document contains a summary of some key themes raised in those submissions. We have included comments in response to some points raised. For a discussion of the costs and benefits associated with each standard condition, including feedback on associated compliance costs, see the Regulatory Impact Statement: Standard conditions for financial institution licences. We will also publish a collation of the written submissions. This may withhold some information in accordance with the Official Information Act 1982 and the Privacy Act 2020.

Key themes

Overarching themes

Some feedback in submissions applied across many or all of the standard conditions, so we have included this section to summarise these general comments.

Duplication of regulatory regimes

Multiple submitters expressed concern that the conditions duplicate or overlap with requirements of other regulators, particularly the Reserve Bank of New Zealand (Reserve Bank). Some suggested that the conditions were appropriate to prudential regulation, but not conduct regulation. Some submitters suggested that financial institutions should be exempt from the proposed conditions on the basis that they are regulated by the Reserve Bank.

FMA response

New Zealand's financial markets are regulated under a "twin peaks" model. This means that two regulators – the Financial Markets Authority (FMA) and the Reserve Bank – both have responsibility for regulating the financial sector. These two agencies represent the "twin peaks" of the regulatory system, each tasked with separate functions. The FMA's remit is primarily conduct regulation and the Reserve Bank's remit is prudential regulation.

Conduct regulation focuses on behaviour of financial markets participants. At its centre is ensuring consumers are treated fairly and that financial service providers act with integrity. The objective of prudential regulation is financial stability and the promotion of sound and efficient banking and insurance sectors. The difference in remits mean that the FMA and Reserve Bank view financial services providers' responsibilities and activities through different lenses. For example, an event may fall within the remit of both regulators, but because of their differing remits one regulator may take more or less interest in the event depending on whether it relates more to conduct or to prudential risk. It is also possible that both regulators may be equally interested in an event but from different perspectives – for example, the FMA may focus on the impacts of the event on consumer treatment and outcomes, while the Reserve Bank focuses on the implications of the event for the financial stability of the relevant entity.

The FMA imposes conditions on licences to ensure licence holders continue to meet the licensing requirements under the Financial Markets Conduct Act 2013 (FMC Act), and to help us effectively monitor the licensed population. All of the firms that will be issued with a financial institution licence by the FMA under the FMC Act are also separately prudentially licensed and regulated by the Reserve Bank. However, the FMA cannot rely on conditions imposed on licences issued by other regulators, or on obligations enforced by other regulators under other regimes that are not within the FMA's remit, to monitor our licensed population. This means that the FMA will not exempt financial institutions from the licence conditions on the basis of other licences held by, or other regulatory regimes that also apply to, financial institutions.

We are however conscious of the regulatory burden and cost implications of financial institutions being required to comply with multiple regulatory regimes and be licensed by both the FMA and the Reserve

Bank. To minimise duplication, we have worked with the Reserve Bank when developing and finalising these licence conditions. We will continue to work with the Reserve Bank when licensing financial institutions and monitoring their conduct and enforcing the Financial Markets (Conduct of Institutions) Amendment Act 2022 (CoFI Act).

Standard condition 1 – Ongoing requirements

General

Most submitters agreed in principle with the proposed condition that licence holders must continue to satisfy the licensing requirements at all times while they hold a financial institution licence.

Scope of standard condition

Some submitters expressed concern that the scope of the condition was very broad and covered all of the financial institution's business. One submitter suggested that requirements, such as capability, that are also dealt with under other regimes, should be "carved out" from the condition.

FMA response

The condition applies to financial institution licences, that is, licences relating to the market service of acting as a financial institution. If a financial institution undertakes other activities that are not covered by its financial institution licence, then those activities are not subject to this licence condition.

The CoFI Act itself is broad in that it requires financial institutions to establish, implement and maintain effective fair conduct programmes throughout their businesses to ensure that they meet the requirement to treat consumers fairly. Therefore it would not be appropriate to limit the condition to only certain aspects of a financial institution's business.

It would also not be appropriate for requirements relating to financial institution licences to be carved out from this condition. The FMA cannot rely on registration or licensing under other regimes to enforce the requirements of the CoFI Act.

Standard condition 2 – Notification of material changes

General

Most submitters agreed with the proposed condition that requires financial institutions to notify material changes to the FMA.

Material changes

Some submitters requested further clarification regarding changes that would be considered material, and some requested an exhaustive list of matters that are considered material.

FMA response

The explanatory notes to the condition provide some examples of the types of changes to the nature of a financial institution service that we would expect financial institutions to report to the FMA. We acknowledge that these examples will not be relevant to all financial institutions; they are intended as an indication of the types of events that we expect to be reported.

We will not be providing an exhaustive list of changes to be reported because whether a change is material may differ between financial institutions, and we cannot foresee all potential changes that a licensee could make to the nature of their financial institution service in future.

We note that the explanatory notes to the condition clarify the types of changes that we do not require to be reported to us. We also encourage licensees to engage with us if they have any queries about whether this condition would apply to a particular circumstance.

Standard condition 3 – Regulatory returns

General

Most submitters agreed in principle with the proposed condition requiring financial institutions to submit regulatory returns to the FMA.

Duplication of regulatory regimes

Multiple submitters provided feedback on the need for the FMA to avoid duplication of reporting requirements and to align returns across those completed for other licences issued by the FMA, such as financial advice provider licences. Some submitters said that the FMA should not seek information which is reported to the Reserve Bank or to other parties.

FMA response

We acknowledge this feedback, and confirm that we will take this into consideration when we are developing the regulatory returns for financial institutions. We will undertake consultation on the regulatory returns prior to introducing these.

The information that we are likely to seek in regulatory returns will relate to licensees' financial institution service, which means that it will be information related to conduct

Regulatory returns consultation

Many submitters commented that they would like to see the regulatory returns consulted on.

FMA response

As we have done in the past, we will publicly consult on the requirements for regulatory returns when we develop these.

Recommendations

Some submissions made recommendations about when or how regulatory returns should be collected.

FMA response

We will take this feedback into account when determining the requirements for regulatory returns. We recognise that financial institutions may have feedback they did not submit during this consultation process, and reiterate that we will consult with industry on the proposed requirements.

Definition of consumers

The explanatory note to the condition states the likely information we will collect in the regulatory returns. This includes factual business information, such as numbers of consumers and associated products. A small number of submitters told us that it can be difficult to establish the number of consumers that they have at a point in time. Some submitters also sought clarification on how 'products' may be defined in the regulatory returns.

FMA response

'Consumers' and 'associated products' are defined terms in the CoFI Act.

The fair conduct principle – that a financial institution must treat consumers fairly – is the cornerstone of the CoFI Act. This is the reason we are interested in collecting information about the consumers that financial institutions interact with. When we seek information in the regulatory returns about consumers and associated products, such as consumer numbers, we will provide more guidance for financial institutions at that time about what information and the level of detail they will need to provide to us.

Standard condition 4 – Outsourcing

General

Most submitters appear to disagree with this proposed condition on the basis that the Reserve Bank also imposes obligations in relation to outsourcing. Some suggested that financial institutions should therefore be exempt from the condition.

FMA response

Under 'overarching themes' above we have outlined general comments relating to feedback about the duplication of regulatory regimes. We acknowledge that the Reserve Bank also has requirements relating to outsourcing for the entities within its remit. Those requirements primarily relate to prudential stability i.e. ensuring the stability of the financial system and the insurance sector when a financial institution or an outsource provider fails. This is different to standard condition 4, which focuses on conduct and the fair treatment of consumers.

Also as outlined above, the FMA cannot rely on conditions on licences issued by other regulators, or on other obligations which are enforced under regimes that are not within the FMA's remit, to monitor our licensed population. This means that the FMA will not exempt financial institutions from the outsourcing licence condition on the basis that the Reserve Bank also imposes requirements in this area.

Purpose and scope of standard condition

A number of submitters told us that the proposed condition is too broad and needs to be limited to matters relating to the fair conduct principle. Some submitters also suggested that while oversight of outsource providers is a sound business practice, it is not relevant for a financial institution licence.

FMA response

This condition requires financial institutions to be satisfied regarding the capability of their outsource providers, because the behaviour of outsource providers can affect how financial institutions' consumers are treated. As outlined above, the FMA cannot rely on the requirements set by the Reserve Bank to achieve this purpose, because those requirements do not relate to the outcomes that consumers receive from their financial institution. We do not think it is necessary to limit this standard condition to fair conduct, but we have amended the explanatory note to the standard condition to ensure that the purpose of the condition is clear.

Impact on other licence conditions

Some submitters also noted that outsourcing conditions apply to other licences issued by the FMA, such as financial advice provider and derivatives issuer licences. One submitter suggested that where a financial institution also holds a licence as a manager of managed investment schemes or derivatives issuer, the condition will impact and alter the outsourcing conditions imposed on those licences.

FMA response

This condition will impose requirements in relation to the relevant services of acting as a manager of a registered scheme, acting as a derivatives issuer and acting as a provider of a discretionary investment management service, where a financial institution is providing these services. Conditions that apply to one licence do not affect or change conditions that apply to a separate licence. However, financial institutions must ensure they comply with all relevant conditions under the separate licences that they hold to provide the services covered by those licences.

We note that the wording for the current standard condition relating to outsourcing for managers of managed investment schemes, derivatives issuers and discretionary investment management services is

not exactly the same as that contained in standard condition 4. However, we consider that the intent and purpose of the various standard conditions relating to outsourcing is the same.

Outsourced distribution arrangements

Some submitters requested that the standard condition be amended to be more explicit that engagement with intermediaries does not constitute an outsourcing arrangement.

FMA response

We reiterate our comments in the consultation document that we would not expect typical distribution arrangements where a third party is involved in distributing the financial institution's relevant services and products to be an outsourcing arrangement.

We are not proposing to amend the condition to provide a definitive list of what arrangements may or may not be outsourcing arrangements. Financial institutions need to review their arrangements with providers based on the attributes of those arrangements to determine if those arrangements would be considered outsourcing of a system or process necessary to the provision of their financial institution service.

Clarifications

Some submitters questioned the status of the important matters and information that financial institutions should consider in relation to outsourcing arrangements, as detailed in the explanatory note to the condition.

FMA response

The explanatory note details matters and information that financial institutions *should* consider. This means that we think financial institutions ought to consider these aspects to comply with the condition, but this is not mandatory. When we are licensing and supervising financial institutions, we expect them to be able to demonstrate how they have complied with the condition.

For example, we expect financial institutions to undertake due diligence before selecting an outsource provider to ensure that they are satisfied about the provider's capability. However, a financial institution may choose to consider some different matters and/or information to those detailed in the explanatory note when conducting due diligence on a proposed outsource provider.

Standard condition 5 – Business continuity and technology systems

General

Most submitters appear to disagree with the proposed condition on the basis that the Reserve Bank also imposes obligations in relation to business continuity and technology systems. Some suggested that financial institutions should therefore be exempt from the condition. Some submitters stated that requirements imposed by the Reserve Bank and the FMA relating to business continuity and technology systems should be consistent and not result in duplication.

FMA response

We acknowledge that financial institutions have obligations to other regulators, including the Reserve Bank.

Under 'overarching themes' above we have outlined general comments relating to feedback about the duplication of regulatory regimes. We acknowledge that the Reserve Bank also has requirements relating to business continuity and technology for the entities within its remit. Those requirements primarily relate to prudential stability, i.e. ensuring the stability of the financial system and the insurance sector when a business disruption occurs. This is different to standard condition 5, which focuses on conduct and the fair treatment of consumers.

Also as outlined above, the FMA cannot rely on conditions on licences issued by other regulators, or on other obligations which are enforced under regimes that are not within the FMA's remit, to monitor the licensed population. This means that the FMA will not exempt financial institutions from standard condition 5 on the basis that the Reserve Bank also imposes requirements in this area. However, the FMA and the Reserve Bank are working together to seek to reduce regulatory burden and align our requirements where possible.

Purpose and scope of standard condition

Some submitters disagreed that a condition relating to business continuity and technology systems should be included on a financial institution licence. They submitted that business continuity and technology systems are related to prudential and operational matters, not conduct. A number of submitters said that the condition is too broad and should relate only to fair conduct or only to processes and technology that have a direct impact on fair conduct.

FMA response

The purpose of this standard condition is to ensure that financial institutions have suitable arrangements in place to be able to manage disruptions to their business. By doing so, consumers will have the security of continuity of the relevant services and associated products they receive from financial institutions. This also ensures that consumers will be treated fairly during a business disruption.

The Reserve Bank, as the prudential regulator for financial institutions, sets requirements in relation to business continuity and technology systems. However, business disruption can impact how consumers are treated, as well as the soundness of the financial system and insurance sector. It is for this reason that we will impose a business continuity and technology systems condition on financial institution licences.

The focus of the CoFI Act – which introduces the licensing requirement for financial institutions – is the fair treatment of consumers. We do not think it is necessary to limit this standard condition to fair conduct, but we have amended the explanatory note to the standard condition to ensure that the purpose of the condition is clear.

Notification requirement

A number of submitters were concerned that the proposed timeframe of no later than 72 hours to notify the FMA of an event that is materially impacting the operational resilience of their critical technology systems is too short. Submitters told us that they will be prioritising their response to their event, and reporting to the FMA will divert resources from that response.

Submitters also sought clarification on when the notification requirement commences. One submitter requested clarification on whether the notification requirement applies to planned system outages for maintenance purposes.

FMA response

We consider that the notification requirement of no later than 72 hour is appropriate, given the critical nature of financial institutions' technology systems to the maintenance of a sound and efficient financial system and insurance sector. The explanatory note to the standard condition clarifies that if some of the details are not available at the time of discovering the event, these can be provided separately, noting they will need to be provided as soon as possible.

The notification period commences when a financial institution discovers an event that materially impacts the operational resilience of their critical technology systems. An event does not need to be reported to the FMA until the financial institution has determined that it is materially impacting the operational resilience of their critical technology systems.

We do not expect this notification requirement to apply to typical planned system outages for maintenance purposes. System outages undertaken to ensure the ongoing maintenance and resilience of a financial institution's critical systems are typically planned and undertaken in a manner to minimise adverse impacts. However, if a planned system outage results in unintended consequences that materially impact the operational resilience of critical technology systems, then that resulting event should be reported to the FMA.

Impact on other licence conditions

One submitter suggested that where a financial institution also holds a licence as a manager of managed investment schemes, derivatives issuer or discretionary investment management service, the condition will impact and alter the conditions imposed on those licences, all of which are not currently subject to a condition relating to business continuity and technology systems.

FMA response

This condition will impose requirements in relation to the relevant services of acting as a manager of a registered scheme, acting as a derivatives issuer and acting as a provider of a discretionary investment management service, where a financial institution is providing these services. Conditions that apply to one licence do not affect or change conditions that apply to a separate licence. However, financial institutions must ensure they comply with all relevant conditions under the separate licences that they hold to provide the services covered by those licences.

We note that although not all licences are currently subject to a condition relating to business continuity and technology services, the minimum standards for licences as a manager of managed investment schemes, derivatives issuer or discretionary investment management service do include requirements in relation to IT systems and business continuity that these licence holders must meet. While the wording in the minimum standard is not exactly the same as that in standard condition 5, we consider that the purpose and intent is the same.

Standard condition 6 – Record keeping

General

Most submitters agreed in principle with the proposed condition requiring financial institutions to maintain records relating to their financial institution service, and to make those records available to the FMA.

Duplication of regulatory regimes

Some submitters noted that there is duplication of other obligations to keep records.

FMA response

We acknowledge that financial institutions already have obligations to maintain records for other purposes. Some of the records maintained to meet those obligations may also satisfy the requirements of this standard condition, but other records will also need to be kept in relation to the fair conduct programme and compliance with the CoFI Act. These records are necessary to enable the FMA to monitor financial institutions' ongoing capability to effectively perform the financial institution service.

Scope of records to be kept

Some submitters were concerned that the scope of documents covered by the condition is wide. One submitter thought the condition may mean that they are required to keep written records of every interaction between their staff members.

FMA response

The purpose of the condition is to provide the FMA with access to the necessary records to monitor financial institutions' ongoing capability to effectively perform the financial institution service. The explanatory note to the condition details the types of records that should be maintained, but it does not prescribe the content of each record, such as staff interactions.

We expect financial institutions to have assurance processes to assess the effectiveness of their fair conduct programme and to monitor their own compliance. We do not specify the type of assurance processes that should be implemented; each financial institution will need to determine the risk and control processes necessary to provide assurance for its internal purposes, and for external purposes, such as demonstrating the effectiveness of their fair conduct programme to the FMA.

Obtaining consent from consumers to share records with the FMA

Some submitters provided feedback that obtaining consent from consumers to share their records with the FMA may be challenging. The definition of "consumer" in the CoFI Act includes persons who are offered a relevant service or associated product, and obtaining consent from persons who are offered, but have not been provided with a relevant service or associated product, would not be practicable.

FMA response

We acknowledge these concerns and have amended the condition to reflect that consent must be obtained from consumers if reasonably practicable.

Cost and privacy concerns

Some submitters were concerned about the cost of making records available to the FMA, and information security risks associated with transmitting information that may be confidential and may contain personal information, for example, information relating to individual consumers.

FMA response

We have amended the explanatory note to clarify that when we review records at our premises, these may be electronic, i.e. we will not always require hard copy records to be sent to the FMA.

The FMA is committed to ensuring the privacy and security of information that it collects, stores and uses. Our privacy statement and our transparency statement explain more about how the FMA collects, stores and uses information.

Timeframe to provide information

Some submitters told us that the 10-day timeframe to provide records to the FMA is too short.

FMA response

We acknowledge these concerns, and have removed the part of the condition that referred to the 10-day timeframe. The explanatory note has been amended to confirm that the standard condition requires financial institutions to have arrangements in place so that the FMA can inspect records without unnecessary delays. We anticipate that the specific timeframe to provide records will be determined at the time that any records are requested.

Retention period

One submitter told us that the retention period is complex and should be simplified.

FMA response

While we only received one submission on this subject, as part of the other changes we made to the condition, we removed the part of the condition that specified the retention period for records. However, we expect financial institutions' record keeping systems and procedures to retain records for a period which enables the FMA to monitor their ongoing capability to effectively perform as a financial institution.

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