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CoFI guidance note:

Intermediated distribution

This guidance note is for financial institutions

It gives guidance on the FMA's expectations when financial institutions distribute products and services through intermediaries

FMA
FINANCIAL MARKETS AUTHORITY
TE MANA TĀTAI HOKOHOKO

About FMA guidance

Our guidance:

- explains how we interpret the law
- describes the principles underlying our approach
- gives practical examples about how obligations could be met
- explains when and how we will exercise specific powers under legislation.

Guidance notes: provide guidance on a topic or topic theme. Issuing guidance is just one of the ways we can be transparent and share our intended approach with the market. Guidance notes are not binding, but they help market participants to be confident they understand our approach and how we interpret, and intend to apply, the law relating to their responsibilities. The guidance is not intended to create or impose obligations that are additional to the legislative requirements discussed.

Information sheets: provide concise guidance on a specific process or compliance issue or an overview of detailed guidance.

You might also like to check the reports and papers on our website. For example, our monitoring reports describe actual practice we are seeing and our comments on this.

Disclaimer

This guidance note does not constitute legal advice. We encourage you to seek your own professional advice to find out how the legislation discussed and any other applicable laws apply to you, as it is your responsibility to determine your obligations.

Examples are provided purely for illustration. They are not exhaustive and are not intended to impose or imply particular rules or requirements. Examples provided should not be taken as limiting financial institutions from considering alternative approaches or otherwise using an approach that is proportionate. Examples that refer to particular types of financial institutions may be equally applicable to other financial institutions.

Document history

This version (version 1.0) was issued in June 2023.

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Overview

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CoFI distribution requirements for fair conduct programmes

Provide for distribution methods to operate in a manner that is consistent with the fair conduct principle to treat consumers fairly. *(s446J(1)(b)(i))*

Customer at the centre > Treating consumers fairly should be central to how institutions design and manage the distribution of their products and services.

Fair conduct programmes > Institutions can choose how their fair conduct programmes provide for distribution methods to operate consistently with the fair conduct principle. One approach is having a written distribution strategy as part of their fair conduct programme, covering areas such as:

- likely consumers of the products and services
- what distribution methods are appropriate and why
- roles and responsibilities of the institution and intermediaries
- acknowledgement that treating consumers fairly is a shared responsibility of institutions and intermediaries
- how distribution arrangements will be managed, and what processes, controls and data are needed
- what product information, training or accreditation will be provided.

Regularly review whether the distribution methods are operating in a manner that is consistent with the fair conduct principle. *(s446J(1)(b)(ii))*

Avoid 'set and forget' > Institutions must regularly review how distribution methods are operating.

Risk-based approach > Institutions can adjust the intensity and frequency of review to reflect the level of risk of consumers not being treated fairly.

- Distribution methods carrying higher risks > more intensive approach to review, e.g. increased data flows and metrics, increased quality assurance processes.
- Distribution methods carrying lower risks > less intensive approach, e.g. using intermediary attestations, red flags, sampling, lead and lag indicators.

Manage compliance costs > Institutions can comply in a proportionate way to avoid unnecessary compliance costs to themselves or their intermediaries.

Ensure that any deficiencies identified in how distribution methods are operating are remedied within a reasonable time. *(s446J(1)(b)(iii))*

No 'one size fits all' approach > Appropriate steps to remedy deficiencies will vary depending on the issue.

Collaborative process > It will often be appropriate for financial institutions and intermediaries to take a collaborative approach to addressing issues.

Introduction

The Financial Markets (Conduct of Institutions) Amendment Act 2022 (CoFI) amends the Financial Markets Conduct Act 2013 (FMC Act) to introduce a new conduct regime aimed at ensuring financial institutions treat consumers fairly.

CoFI is a principles-based regime intended to drive positive industry behaviour change to ensure the fair treatment of consumers. Requirements are intended to be flexible and non-prescriptive. It is not a rules-based regime that prescribes how outcomes must be achieved.

The Financial Markets Authority – Te Mana Tātai Hokohoko (FMA) intends to take an outcomes-focused approach to supervising financial institutions. This means we will be focusing more on the outcomes resulting from treatment of consumers rather than just on the methods financial institutions have chosen to comply with CoFI obligations. We believe that financial institutions know their businesses best and are best placed to determine the most effective actions to achieve CoFI obligations and objectives.

> *"As with many regulators around the world, the FMA's approach recognises that regulation and rules are a means to achieve fair outcomes for consumers and markets, rather than an end in themselves.*
>
> *Our approach particularly recognises the need to establish an ethos of strong conduct and culture in the finance sector – genuine, owned by all and not treated as a matter of tick box compliance."*
>
> *Speech by Samantha Barrass, FMA Chief Executive, INFINZ Conference, 27 October 2022.*

Purpose of this guidance

This guidance outlines our expectations when financial institutions are distributing products and services through intermediated channels.

This guidance communicates high-level expectations that can be applied across different sectors and distribution models. CoFI applies to a range of financial institutions, so the guidance needs to be workable for a diverse range of business models and distribution methods.

This is also consistent with our outcomes-focused approach to the regime and our intention to empower financial institutions to take ownership of how they drive fair treatment of consumers in their businesses, including how they manage the risk of consumers not being treated fairly. We want firms to have the flexibility to design and implement fair conduct programmes that are fit for purpose and right-sized for their businesses and distribution models.

This guidance does not prescribe what financial institutions must do to comply with CoFI, or set out a list of steps or rules that financial institutions must take to satisfy the legislative requirements. There is no 'one-size-fits-all' approach. While we acknowledge that a prescriptive approach can provide more certainty by setting concrete rules, these may not be appropriate or workable in all cases and would constrain financial institutions' ability to design tailored approaches that work for them and deliver better client outcomes. It may also result in unintended consequences that cause unnecessary compliance costs for financial institutions or intermediaries.

This guidance includes prompting questions that financial institutions may find useful to ask themselves when developing their approach. These questions reflect topics our staff may cover when supervising and engaging with financial institutions. Like the rest of this guidance, the questions should not be seen as a checklist or manual, but a way to identify potential gaps or opportunities for improvement.

Our views in this guidance were informed by feedback from a series of workshops we held with financial institutions and intermediaries in July and August 2022, as well as the submissions received in a formal consultation on the draft guidance early in 2023. We encourage financial institutions and/or intermediaries to contact the FMA if they require help or support with the topics covered by this guidance.

Who and what this guidance applies to

Financial institutions

This guidance is for financial institutions. Financial institutions are banks, insurers and non-bank deposit takers (NBDTs) that provide products and services to consumers. These institutions are required to be licensed to provide the market service of 'acting as a financial institution' under the FMC Act, and are subject to statutory conduct duties introduced by CoFI. In this guidance, we use the terms 'financial institution' and 'institution' interchangeably.

Intermediaries and agents

We expect this guidance will also be of interest to intermediaries and agents involved in distributing financial institutions' products and services.[1] The fair conduct programme requirements that financial institutions will need to meet in relation to distribution methods[2] apply to *all* distribution channels (regardless of whether the entity involved in the distribution meets CoFI's legal definition of an intermediary, agent, or both).[3]

For the purposes of this guidance, when we refer to "intermediaries", we are referring to all third parties that are involved in the sale and distribution of financial institutions' products and services to consumers. Examples of intermediated distribution include mortgage or insurance advisers, motor vehicle dealers selling vehicle finance and insurance, retail stores selling add-on insurance products, and group insurance schemes held by employers for the benefit of their employees.

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[1] See page 12 for information about determining the roles and responsibilities of financial institutions and intermediaries.
[2] Specifically, section 446J(1)(b)(i)-(iii) FMC Act.
[3] If an entity is unsure whether it meets the legal definitions of 'intermediary', 'agent' or both, we encourage it to obtain legal advice.

Intermediaries holding a financial advice provider licence

Intermediaries that provide financial advice are required to be licensed by the FMA as a financial advice provider (FAP) or operate under a FAP licence. These intermediaries are subject to their own set of conduct duties under the financial advice regime in subpart 5A of Part 6 of the FMC Act, and must comply with the Code of Professional Conduct.

Both CoFI and the financial advice regime require consumer interests to be considered in relation to the distribution of products and services. Ultimately our view is that the CoFI and financial advice regimes are complementary, with broadly consistent overarching policy objectives. The policy intention is that the dual regimes create a shared responsibility between financial institutions and FAP-licensed intermediaries for fair treatment and outcomes for consumers.

Acknowledging the complementary nature of the two regimes, CoFI requires institutions to take into account other legal obligations their intermediaries may have in determining what policies, processes, systems and controls are effective for the purposes of their FCPs. An intermediary that holds a FAP licence will generally pose a reduced level of risk that the institution's distribution method will not meet the fair conduct principle. However, the firm should conduct its own risk assessment that takes all relevant factors into account.

Intermediaries that are also licensed as financial institutions under CoFI also pose a generally reduced level of risk that the financial institution's distribution method will not comply with the fair conduct principle.

Scope of guidance

This guidance is about intermediated distribution. This means any situation where an intermediary is involved in the distribution of a financial institution's products or services, rather than this being handled solely by the financial institution itself.

Direct distribution channels are not within the scope of this guidance. Examples of direct distribution include sales through a financial institution's own branches or phone services by its staff, or through its own website. However, financial institutions may find parts of this guidance useful in relation to their direct distribution methods.

Examples

Intermediated distribution

- A general insurer distributes general insurance products through insurance advisers. The insurer's products are only some of a range of insurance products that the insurance advisers may choose to recommend to their clients.
- A car dealer offers its customers vehicle financing by an NBDT.
- A bank sells an insurer's products through the bank's branches.
- A life insurer distributes life insurance products through employers, who hold group insurance schemes for the benefit of their employees.
- A health insurer distributes health insurance products through employers, who allow the insurer's representatives to visit their workplace and provide financial advice to their employees to aid them in the selection of a policy (which may or may not benefit from a group/employer discount).

Intermediated distribution does not include distribution by financial institutions directly to customers. This is sometimes referred to as ‘vertically integrated’ or ‘direct’ distribution. For example:

- A general insurer selling a car insurance product directly through its own website or call centre.
- A bank’s employees arranging home loans for the bank’s customers.

Spotlight: Employer / group insurance schemes

Where an insurer provides insurance under a group scheme, and the policy holder is an employer and the insured are its employees, we expect that the employer generally would not receive any commission. This means the employer generally would not meet the s 446Q definition of an intermediary (and nor would its employees, provided they also do not receive commission).

However, our view is that distribution through employer/group insurance schemes is still an example of intermediated distribution and within the scope of this guidance. The employer is a third party involved in the insurer delivering its products and services to the employees, who are consumers as defined in s 446P. Where the employer is the policy holder, the employer will also be a consumer.

The fair conduct programme requirements that financial institutions need to meet in relation to distribution methods apply to all distribution channels, whether intermediated or direct, and regardless of whether a third party involved meets the legal definition of an intermediary, agent, or both. Therefore, this guidance applies to employer/group insurance schemes because they are an example of intermediated distribution.

This guidance does not focus on incentive arrangements or related CoFI provisions (see section 446J(1)(i) and sections 446K-M). By ‘incentive arrangements’, we mean the ways in which intermediaries are incentivised or remunerated by financial institutions for their involvement in distributing financial institutions’ products and services, e.g. an intermediary being paid commission by a financial institution for selling the institution’s products.

CoFI distribution requirements

This section provides a brief overview of the CoFI legislative requirements discussed in this guidance.

What the legislation requires

Fair conduct principle

CoFI requires financial institutions to comply with a fair conduct principle to treat consumers fairly (section 446C). This includes:

- paying due regard to consumers' interests
- acting ethically, transparently, and in good faith
- assisting consumers to make informed decisions
- ensuring that the products and services that the financial institution provides are likely to meet the requirements and objectives of likely consumers (when viewed as a group)
- not subjecting consumers to unfair pressure or tactics or undue influence.

When we refer to "fair treatment" in this guidance note, we mean "treating consumers fairly" as set out in the fair conduct principle.

Fair conduct programmes (FCPs)

To ensure compliance with the fair conduct principle, financial institutions are subject to statutory duties to establish, implement, and maintain effective FCPs, and to take reasonable steps to comply with them (sections 446G and 446I). There is a list of minimum requirements that FCPs must cover (section 446J). We have issued an information sheet to help institutions to establish, implement and maintain their FCPs.

This guidance focuses on FCP requirements relating to distribution methods (section 446J(1)(b)(i)-(iii)). Specifically, an FCP must include effective policies, processes, systems and controls for designing and managing the provision of the institution's products and services to consumers, including by:

- providing for the distribution methods they use (including distribution methods that involve intermediaries) to operate in a manner that is consistent with the fair conduct principle
- regularly reviewing whether the distribution methods are operating in a manner that is consistent with the fair conduct principle, and ensuring any deficiencies are remedied within a reasonable time.

When we refer to the "CoFI distribution requirements" in this guidance note, we mean the statutory requirements set out in section 446J(1)(b)(i)-(iii).

Factors to take into account

In considering what policies, processes, systems and controls are effective for the purposes of its FCP, a financial institution must have regard to the following factors (section 446J(2)):

- the nature, size, and complexity of its business
- the services and products it offers
- the methods by which it provides services and products to consumers
- the types of consumers it deals with, including consumers in vulnerable circumstances
- the types of intermediaries that are involved in the provision of its services and products, including the nature and extent of the following:
    - their involvement; and
    - their legal obligations in connection with that involvement (for example, under the financial advice regime in subpart 5A of the FMC Act in the case of FAPs)
- the types of agents that are engaged to carry out work in relation to the financial institution's services and products, including the nature and extent of that work and of the authority of those agents
- any other factors that may be prescribed in regulations (currently none have been prescribed).

In this guidance we refer to these factors as the "FCP factors".

Our view is that the requirement to have regard to these factors should assist financial institutions with designing FCPs that are proportionate and tailored to their particular businesses.

In particular, we consider that the requirement to take into account the types of intermediaries they use, and the legal obligations those intermediaries have, should help institutions have the confidence to comply with the CoFI distribution requirements in a manner that is proportionate to the level of risk associated with the type of intermediary. For example, an intermediary that holds a FAP licence is regulated under the financial advice regime and therefore poses a reduced level of risk to consumers, compared to intermediaries that do not hold a FAP licence (all else remaining equal). An institution might determine that in establishing and embedding its FCP, it does not need to impose certain policies, processes, systems and controls on FAP intermediaries to provide for a distribution method that operates consistently with the fair conduct principle.

Distribution consistent with fair conduct principle

Fair conduct programmes must include effective policies, processes, systems, and controls providing for distribution methods to operate in a manner that is consistent with the fair conduct principle.

(Refer: s446J(1)(b)(i))

Our expectations

General approach

Having an effective, embedded FCP should result in fair treatment of consumers being central to the way institutions design and manage the distribution of their products and services, and not an afterthought.

CoFI gives financial institutions flexibility to determine how their FCPs provide for distribution methods to operate in a manner that is consistent with the fair conduct principle.

One approach would be for a financial institution to have a written distribution strategy that provides for its distribution methods to treat consumers fairly. We understand that many financial institutions already follow this approach. The distribution strategy may comprise one or more documents.

This strategy could include an assessment of the risk that the distribution methods used will not operate in a manner consistent with the fair conduct principle, along with implementation of appropriate mitigations to address the level of risk to consumers that is identified.

We set out below certain areas that financial institutions may wish to address when developing their FCPs. Considering these areas should help financial institutions to provide for distribution methods to operate in a manner that is consistent with the fair conduct principle.

Determining the likely consumers of products and services

For each of their different types of products and services, financial institutions should consider identifying and documenting:

- the intended purpose
- the likely consumers (or circumstances) they are designed for
- the likely requirements and objectives of those consumers (at a general or collective level).

This is sometimes referred to as the “target market” for products or services.

Individual product or service specification documents could inform this part of the FCP. This could include considering whether the likely types of consumers may be in vulnerable circumstances and how this will be identified and taken into account. It could also include considering if there are any types of consumers for whom the product or service is unlikely to be appropriate, require additional advice or support, or would not generally be expected to meet their requirements or objectives.

This process may be straightforward for simple types of products or services, such as products that are intended for the mass-market. For more complex types of products or services, this may need to be considered and documented at a more granular level.

While identification of the intended purpose and likely consumers, requirements and objectives is often undertaken as part of product design, it is still an important input into an institution's distribution strategy.

Examples

Likely consumers

- The range of intended consumers of a mass-market home loan product is very wide (e.g. any consumer purchasing a residential property).
- The intended consumers of a life or health insurance product with significant exclusions and/or detailed eligibility criteria are a much narrower subset of people, so the target market is more carefully defined to take into account the exclusions or eligibility criteria.

Determining appropriate distribution methods

Financial institutions should consider identifying and documenting what distribution methods are appropriate, including considering how the selected distribution methods are:

- appropriate for the likely consumers of the products or services, and the likely requirements and objectives of those consumers
- likely to result in the products or services being distributed to those types of consumers.

Examples

Selecting distribution methods

- A life insurer determines that a new income protection insurance product will only be distributed through insurance advisers. The complex nature of this product and the exclusions that apply mean the insurer considers the product is only appropriate to be provided to consumers on an advised basis by experienced insurance advisers who can assess the client's individual circumstances and requirements, and advise whether this product is suitable for them. The insurer develops a distribution strategy consistent with its selection of this sole distribution method.
- An institution determines that a retail bond offer will be reserved for subscription by clients of the joint lead managers, NZX participants and other approved financial intermediaries invited to participate in the bookbuild, with no public pool for the offer. The nature of this product and the rules that apply to a regulated offer mean it is only appropriate to be sold by experienced brokers and market participants who are familiar with the process and can ensure investors are provided with the statutory and other information required to purchase the bonds. The institution develops a strategy that takes into account the nature of this product.

Determining the roles and responsibilities of financial institutions and intermediaries

Financial institutions should consider identifying and documenting the respective roles and responsibilities of the institution and the intermediaries involved in distributing their products and services, and how these support fair treatment. For example:

- Who is responsible for initial product design and product options, and ongoing product reviews and improvements? For example, to ensure products work as intended and remain responsive to consumer needs.
- Who is responsible for assessing suitability of the product for consumers and whether it meets their requirements and objectives?
- What information will be exchanged between the institution and intermediaries, and when?
- Who is responsible for communicating with consumers, and when?
- How will post-sale interactions and ongoing service to consumers – such as periodic product suitability reviews and consumer complaints – be managed, and by whom?

Our view is that fair treatment is a shared responsibility of financial institutions and intermediaries. Intermediated distribution often requires collaboration between financial institutions and intermediaries, and they should both have the fair treatment of consumers at the heart of everything they do.

'Shared' means we expect that institutions and intermediaries will collaborate where it is appropriate and necessary to ensure consumers are treated fairly. In doing so, institutions and intermediaries must comply with their respective legal obligations to consumers (e.g. under the financial advice regime in subpart 5A of Part 6 of the FMC Act for FAP intermediaries, and under CoFI for financial institutions). They also need to comply with their contractual obligations (e.g. under distribution agreements). 'Shared' does not mean compromising the commercially and legally separate relationship between financial institutions and intermediaries.

Financial institutions and intermediaries have responsibility for different aspects of the consumer relationship. We do not intend to be prescriptive about this, as what shared responsibility looks like in practice will vary. For example, the role of an intermediary that provides financial advice may differ to that of an intermediary that does not provide advice. Collaboration between financial institutions and intermediaries may not always be necessary, and the extent of it may differ according to the particular arrangements the parties have in place. Practical considerations such as access to customer information, relevant distribution agreement provisions (if any) and efficient resolution of issues should be taken into account when determining what type or level of collaboration is appropriate in the circumstances.

The key is that financial institutions provide for their FCPs to clearly identify the roles and responsibilities of each party, taking into account the unique factors and characteristics of the products and/or services provided, to ensure fair treatment and outcomes for consumers. Our primary concern will be with situations where fair treatment of consumers and remediation of deficiencies in the distribution methods are inhibited by a lack of collaboration between financial institutions and intermediaries.

Where roles and responsibilities overlap, it is particularly important to clarify who is responsible or how responsibility will be shared – or at least how this will be determined in particular circumstances. A lack of clarity about this creates a heightened risk of consumers falling into a gap and not being treated fairly.

We note that section 446J(1)(c)(i) separately requires institutions to have clearly defined roles, responsibilities, and accountability arrangements in relation to identifying, monitoring, and managing risks associated with conduct that fails to comply with the fair conduct principle.

Spotlight: Consumer communications

The approach to whether an institution or intermediary should be responsible for consumer communications varies across sectors and institutions.

We do not intend to be prescriptive about this, but we consider that the roles of each party should be clearly identified and documented.

We note that section 446J(1)(j) separately requires an FCP to cover communicating with consumers about the institution's products and services in a timely, clear, concise, and effective manner. Our view is that an institution can do this directly itself, or by having arrangements in place for intermediaries to do this, or a combination.

Examples

Consumer communications

- An insurer does not have any direct contact with consumers when selling its products. It puts agreements and processes in place with the insurance advisers distributing its products, to ensure the advisers communicate all relevant information to their clients, including regular communications to encourage clients to review their cover and products, and information about the insurer where required.
- A NBDT that distributes certain products through non-FAP intermediaries chooses to take responsibility for all post-sale consumer communications.
- A bank and the mortgage advisors that distribute its products take a joint approach to communications. The bank directly notifies consumers of changes to interest rates and other product changes. The mortgage advisers supplement this with their own communications to the client, e.g. contacting the client to offer a product review for key events such as the end of a fixed-term interest rate.
- A bank provides training for new intermediaries on communications and mandatory pre-sale disclosures that need to be made to consumers in relation to particular investment products. The intermediaries must complete this training before being approved to distribute those products.
- An insurer undertakes a review of its existing communication strategy and identifies a lack of communication by the insurer and intermediaries with consumers holding certain legacy products.[4] The insurer puts in place new processes to satisfy itself that these consumers are receiving relevant information about their policies.
- A life insurer provides life cover to employees of a large corporate through a group insurance scheme. The employees automatically receive cover when they begin employment, as a benefit of their remuneration package. The insurer works with the employer, as the holder of the group policy, to ensure information about the cover and important updates about changes to the policy are provided to employees, and that employees have the necessary contact details to get in touch with the insurer if they have questions or concerns.

[4] By legacy products we mean products that are no longer offered to new customers but continue for customers who already hold them as noted in the 2019 Life Insurer Conduct and Culture review.

Determining how distribution arrangements will be managed

Financial institutions should consider addressing how arrangements with intermediaries that distribute products and services will be managed. For example, the financial institution could formalise these arrangements through written distribution agreements with intermediaries.

The institution should also consider what processes and controls may be required so that distribution arrangements support fair treatment. If there is no formal written contract, additional controls may be needed.

While we consider that contractual agreements are good practice, we acknowledge that there could be scenarios where it is not practical or proportionate to have one in place, and so we do not consider them a necessity in all circumstances. In those cases, we expect financial institutions to be able to explain what processes and controls they have in place in the absence of contractual provisions to provide confidence that distribution involving those intermediaries will operate consistently with the fair conduct principle. We would expect to see the roles and responsibilities of the financial institution and intermediary agreed, ideally in writing even if it is not in the form of a contract. If deficiencies in the arrangements with an intermediary are identified, the institution should consider what steps are needed to address these, which may include formalising the relationship.

Example

Managing distribution arrangements

A small NBDT distributes its products through a large number of brokers. It does not have any formal agreements in place with the brokers. The NBDT has regular review processes and controls in place to give it confidence that consumers are being treated fairly.

The NBDT identifies that some instances of distribution are occurring that are not consistent with its expectations. In this particular case, the NBDT considers this can be addressed through improved communication and training of intermediaries.

Determining what product information or training will be provided

Financial institutions should consider identifying information, training or accreditation (including the appropriate form or medium for this) that will be provided to intermediaries involved in distributing products and services, to support appropriate distribution and fair treatment of consumers.

In doing so, financial institutions could consider factors such as the existing information, knowledge and experience the intermediaries have. For FAP intermediaries, this can take into account the standards of competence, knowledge and skill they must meet under the financial advice regime.

Institutions should also consider the need for ongoing training and accreditation or updated information as products evolve or change, to supplement any initial product training or information.

Our view is that:

- Financial institutions are responsible for providing appropriate product information and training to intermediaries. This enables intermediaries to understand the features of particular products and be updated on product changes, supporting fair treatment and outcomes for consumers. The information institutions provide might include their reasons for selecting a particular distribution method, or details about particular product features that have influenced their identification of the group of likely consumers, so that intermediaries have an understanding of how the institution intends to deliver distribution methods that operate consistently with the fair conduct principle.

- FAP intermediaries are responsible for ensuring they have the competence, knowledge and skill to provide advice, as required by the financial advice regime and Code of Professional Conduct.

Examples

Product information and training

- An NBDT requires non-FAP intermediaries to complete training before being approved to distribute its products. The NBDT has taken into account that the non-FAP intermediaries are not subject to any mandated competence requirements to distribute these types of products.
- An insurer provides information about new and updated products by email to advisers that distribute its products. The insurer has taken into account the competence and experience of the advisers in distributing these types of products.
- A bank has a formal product accreditation process that intermediaries must pass, initially and on an annual basis, to be able to distribute certain products. This accreditation includes training on key fair treatment risks that the institution has identified in creating and selecting the distribution methods.
- A bank offers online training to intermediaries on a newly launched investment product. This covers some novel features of the product compared to others currently on the market, to ensure the intermediaries understand the product so they can distribute it appropriately.

Useful questions

Distribution consistent with fair conduct principle

- How have you provided for your chosen distribution methods to operate in a manner that is consistent with the fair conduct principle? Can you demonstrate that consumers are at the centre of your chosen approach?
- How have you taken into account the FCP factors (listed in 446J(2)) in designing your policies, processes, systems and controls?
- How does your FCP reflect that fair treatment of consumers is a shared responsibility of financial institutions and intermediaries? How do you know who is responsible for what? How have you managed the risk of situations arising where no party takes responsibility and consumers are not treated fairly?
- How have you satisfied yourself that risks are being managed in relation to the distribution of your products and services? For example:
  - The risk of a product or service being inappropriately distributed beyond the types of consumers or circumstances it was designed for.
  - The risk of a product or service not meeting the likely requirements and objectives of likely consumers (when viewed as a group).
  - The risk of consumers being subjected to unfair pressure or tactics, or undue influence during the sales process.

    - The risk that consumers are not provided with appropriate or sufficient information to make informed decisions about the product or services.
- What is the risk of issues (e.g. with the product or service, or with the distribution method) not being detected or reported to you?

Reviewing distribution methods

Fair conduct programmes must include effective policies, processes, systems, and controls for regularly reviewing whether distribution methods are operating in a manner that is consistent with the fair conduct principle

(Refer: s446J(1)(b)(ii))

Our expectations

Avoid 'set and forget'

CoFI requires financial institutions to regularly review whether their chosen distribution methods are operating in a manner that is consistent with the fair conduct principle. Financial institutions must avoid a 'set and forget' approach in relation to CoFI distribution requirements. For example, once a distribution strategy is in place, the financial institution should check whether the strategy remains fit for purpose or adjustments are needed to better support treating consumers fairly, and whether the actual distribution that has taken place is consistent with the desired distribution strategy.

Consistent with our outcomes-based approach, we do not intend to prescribe the methods that institutions should use or the types of information they should gather to review how their distribution methods are operating. Institutions are best placed to determine this themselves as they know their products and businesses best; methods will vary according to factors such as the type of product, the distribution method, and whether the intermediaries provide advice. We note that:

- Processes for reviewing distribution arrangements with intermediaries vary. These may include formal review processes, regular meetings, informal engagements, and ad hoc investigations of trigger events.
- Data and metrics (lead and lag indicators) such as claims, loss ratios, complaints, consumer research and cancellation rates are commonly used to assess consumer treatment and outcomes.

Frequency of review

We do not intend to prescribe how frequently financial institutions should review their distribution methods. Our view is that 'regularly' means the review is done on a repeated and consistent basis. The frequency of the reviews will vary depending on the financial institution's assessment of risk (see below).

FCPs need to be responsive to emerging issues to be effective. If analysis of key metrics suggests there is a problem with an intermediated distribution method, we expect that the particular distribution method will be reviewed sooner.

Intensity of review

Our view is that financial institutions can take a risk-based approach to this requirement. The distribution of some products and services may involve higher potential risk of unfair treatment than others. We expect financial institutions to take this into account when considering the intensity and frequency of their review of distribution methods.

This means it would be acceptable, in our view, for a financial institution to rely on risk management techniques such as sampling, data assessment and red flags for reviewing a relatively lower-risk distribution method, rather than a more intensive supervisory approach such as formal reviews, which would be suitable for a higher-risk distribution method.

In assessing the level of risk associated with distribution through each intermediary they work with, financial institutions should have regard to the FCP factors (listed in 446J(2)), which should be considered in their totality. For example, distribution through a FAP intermediary licensed by the FMA may pose an inherently lower risk, but when other factors are taken into account, the overall risk may be higher (and vice versa).

The institution should also take into account the processes and controls it has put around distribution of its products (e.g. under its distribution strategy). See the section 'Distribution consistent with fair conduct principle' above.

Examples

Factors that may decrease risk (non-exhaustive)	Factors that may increase risk (non-exhaustive)
Simple product (e.g. simple terms and few exclusions, short duration)	Complex product (e.g. complex terms and many exclusions, long duration)
Likely consumers are likely to have a low number of vulnerability characteristics	Likely consumers are likely to have a high number of vulnerability characteristics
FAP intermediary licensed by FMA and subject to financial advice regime	Non-FAP intermediary
An intermediary that is a financial institution itself (e.g. an insurer distributes an insurance product through a bank intermediary)	
An intermediary that is an NZX market participant subject to NZX Participant Rules	
Short distribution channel with few parties between the institution and the end consumer or otherwise involved in the distribution	Long distribution channel with multiple parties between the institution and the end consumer or otherwise involved in the distribution
Experienced intermediaries with established relationships with the institution	New or inexperienced intermediaries

Contractual or other written agreements in place	No contractual or other written agreements in place
Strong controls over the distribution method and arrangements	Weak controls over the distribution method and arrangements

For distribution methods the institution has assessed as carrying higher potential risk of not operating in a manner consistent with the fair conduct principle, our view is that the institution should apply a more intensive approach to reviews, e.g. by increasing data flows and metrics, or increasing proactive quality assurance processes and other controls on the distribution of their products and services, or supplementing attestations with supporting evidence or further investigations where they are warranted.

For distribution methods the institution has assessed as carrying lower potential risks, the institution can apply a less intensive review approach, e.g. relying on a combination of methods such as intermediary attestations, red flags, lead and lag indicators, and other lighter customer review processes.

Where the institution makes changes to its distribution methods or receives information that affects its assessment of risk, it should consider whether adjustments to these settings are appropriate (on a temporary or more permanent basis).

Examples

Reviewing distribution methods

- A life insurer provides a life insurance product through insurance brokers. The life insurer's distribution strategy requires it to regularly review the operation of its distribution methods. The insurer analyses a range of data and information, including various lead and lag indicators, to assess consumer treatment and outcomes. The insurer's analysis indicates that distribution of the product through its insurance brokers is supporting fair treatment. No changes to this distribution method are required at this stage.
- An insurer identifies a high proportion of insurance claims being declined for a particular product. The insurer conducts further analysis to determine the reasons for this (e.g. an issue with the product design, or with how and to whom the product is being sold by intermediaries) and makes changes to its distribution methods.
- A NBDT provides products and services to consumers directly via its own branches and website, and through non-FAP intermediaries. The NBDT has assessed the potential risks to fair treatment for each of these methods, and has implemented more oversight for the higher-risk methods that have greater potential to result in unfair treatment or outcomes for consumers. The NBDT still maintains oversight of the lower-risk methods, but with lesser frequency and intensity.
- An institution is planning to add the ability for certain products to be sold to consumers on a non-advised basis by intermediaries. The institution conducts a pilot and implements a number of checks to measure how the change impacts consumer treatment. As a result of the pilot and initial monitoring, the institution determines that non-advised sales of these products are not suitable for some types of consumers, so it implements processes to provide for those types of consumers to be serviced on an advised basis.

Managing compliance costs

We have heard concerns that the CoFI distribution requirements may result in new compliance measures that are onerous and costly for institutions and intermediaries. Our intention in supporting institutions taking a risk-based approach to the intensity and frequency of reviews is to avoid unnecessary compliance costs. We want to reiterate that institutions can comply in a proportionate way, and this is consistent with our expectations.

We have heard concerns that some financial institutions may be responding to CoFI by imposing compliance measures on intermediaries that go beyond what we consider is needed under a risk-based approach. Where financial institutions have moved early with new compliance measures to meet anticipated CoFI requirements, we encourage them to review their settings in light of this guidance and consider whether any adjustments may be appropriate to reflect the level of risk.

We consider there needs to be a balance between managing risk, and not adding unnecessary cost or reducing product and service choice for consumers.

Spotlight: Attestations

A number of financial institutions have developed or are considering using attestations as a means of supporting compliance with the CoFI distribution requirements. CoFI itself does not include any legislative requirement for institutions to use attestations.

Attestations involve requesting intermediaries to periodically (e.g. annually) declare ('attest') to the institution that certain statements are correct, e.g. that the intermediary has complied with contractual and legislative requirements, has completed any product training and accreditation requirements, and has complaints processes and other business processes in place.

Our view is that attestations are one tool institutions could choose to use in preference to more intensive assurance methods, where appropriate for the institution's assessment of risk.

Attestations can be viewed as a 'lighter' compliance measure. This is because they rely on an intermediary's declaration of fact without supporting documentation or verification (although some institutions may require this in addition to an attestation). This means we would only expect to see attestations being used for lower-risk distribution methods. We expect to see attestations used less frequently in higher-risk distribution methods; but when they are, they should be supplemented by supporting evidence, or further investigations where warranted. Regardless of the level of risk, we generally expect to see attestations used in combination with other review processes (e.g. assessment of lead and lag indicators, and spot checks).

Where an intermediary is unable to give a requested attestation, that may trigger a request for further information or assurance checks.

We have heard concerns that a lack of consistency in the approach to attestations may unnecessarily increase the compliance burden for intermediaries that distribute products and services of multiple financial institutions, as they may need to complete multiple attestations. We encourage institutions and intermediaries to work together to find a mutually beneficial approach for their specific arrangements. Whether to use attestations as a compliance measure or not is ultimately a decision for each financial institution based on its assessment of risk, as it bears the obligation to review its distribution methods under CoFI.

The attestations we have seen appear to cover similar topics and questions. We consider this is an area where there is scope for an industry-led approach to reduce compliance burden. For example, sectors could explore developing a standard template. Industry associations could play a leadership role in this.

We encourage institutions to consider whether the attestations they are requesting are useful to help provide confidence that their distribution methods are operating consistently with the fair conduct principle, rather than being a 'tick-box' compliance exercise.

We don't consider it is necessary for institutions to seek declarations that FAP intermediaries have processes in place to comply with their legal duties under the financial advice regime.

What we do not expect

To further assist financial institutions, we provide some comments in this section on steps we do not consider are necessary to comply with the CoFI distribution requirements. This does not prevent institutions from adopting these measures if they choose.

In our view, regularly reviewing whether distribution methods are operating in a manner that is consistent with the fair conduct principle does not require:

- Constant surveillance of intermediaries

  The changes made to the CoFI legislation before enactment to remove the previous reference to institutions "managing or supervising" intermediaries reflect this. CoFI is not intended to compromise the commercially and legally separate relationship between financial institutions and intermediaries.

- Monitoring individual instances of advice or individual sales

  A financial institution's responsibility for regularly reviewing whether distribution methods are operating in a manner consistent with the fair conduct principle is at the general or collective level, not at the level of each individual consumer interaction or sale.

  An institution may still choose to do some file reviews or other consumer outcome checks as part of its processes to assess consumer treatment. This type of sampling is consistent with a risk-based approach and can be done in a proportionate manner (see 'Intensity of review' above).

- Institutions supervising intermediaries' legal compliance

  We do not expect institutions to supervise FAP intermediaries' compliance with their obligations under the financial advice regime. FAP intermediaries are responsible for their own advice processes and for ensuring the advisers and authorised bodies operating under their licence comply with the financial advice regime.

  We also do not expect institutions to supervise non-FAP intermediaries' legal compliance with obligations, or act in a manner that would compromise the commercially and legally separate nature of those intermediaries.

Spotlight: External audits

We have heard concerns that some institutions have responded to anticipated CoFI requirements by imposing on intermediaries an obligation to obtain annual external audits or independent assurance reports, which can be costly. This cost may be magnified for intermediaries that distribute products and services of multiple financial institutions.

CoFI does not impose any legislative requirement on institutions to require intermediaries to obtain annual external audits or independent assurance reports.

Generally, we do not consider external audits or independent assurance reports of intermediaries' distribution activities are necessary for financial institutions to comply with the CoFI distribution requirements. We would not expect to see these as a routine compliance measure in most situations.

External audits and independent assurance reports can be viewed as a 'strong' compliance measure because they involve independent third-party verification and assessment. Under a risk-based approach, we would expect this type of tool to be considered only for higher-risk distribution methods or to respond to a specific risk or issue that has triggered an independent review, rather than as a routine compliance measure (see 'Intensity of review' above).

Useful questions

Regularly reviewing distribution methods

- How well do you understand your intermediaries' business structure, sales techniques, and other products sold?
- How do you know that intermediaries distributing your products and services are treating consumers fairly? How do you know if there are issues?
- What gives you confidence that consumers, especially those considered to be in vulnerable circumstances, are not subject to unfair pressure or tactics, or undue influence when making decisions about your products and services?
- How do you decide what measures to use to review the operation of your distribution methods? What gives you confidence these are effective?
- How do you decide how frequently to review the operation of your distribution methods? What would trigger an earlier review?
- How have you taken into account the FCP factors (listed in 446J(2)) when designing your policies, processes, systems and controls for regularly reviewing the operation of your distribution methods?
- How do any attestations that are provided by intermediaries help you understand whether consumers are being treated fairly?

Remedying deficiencies

Fair conduct programmes must include effective policies, processes, systems, and controls for ensuring that any deficiencies identified in how distribution methods are operating are remedied within a reasonable time.

(Refer: s446J(1)(b)(iii))

When we refer to "addressing issues" in this section, we mean "remedying deficiencies" as set out in 446J(1)(b)(iii).

Our expectations

No 'one size fits all' approach

A deficiency could be any shortcoming or issue that impacts distribution methods operating in a manner that is consistent with the fair conduct principle. Because the nature of deficiencies may vary widely, we do not intend for this guidance to be prescriptive about what steps an institution should take to remedy an issue – the remedy will depend on what the issue is.

Remediation processes in relation to consumers who have been subject to unfair treatment may also be necessary when remedying deficiencies in distribution methods. A detailed discussion of customer remediation and our expectations for this is outside the scope of this guidance.

Examples

Options to remedy deficiencies

- Changing the service or product design, or the way it is distributed (e.g. from non-advised to advised, or from intermediated to direct distribution).
- Putting in place additional controls around the distribution of a product or service.
- Providing additional product information or training to intermediaries involved in distribution.
- Ceasing to distribute a particular product or service through intermediaries.
- Using review and dispute resolution processes that are provided for under a distribution agreement to work with the intermediary to resolve underlying root causes (which may be systemic in nature).
- Ceasing to work with a particular intermediary (e.g. if a serious deficiency cannot be remedied).
- Consider proactively self-reporting the deficiency to the FMA (particularly in the case of deficiencies that are serious or that are proving difficult to remedy). [5]

[5] We also encourage financial institutions and/or intermediaries to contact the FMA if they require guidance or support with remediation principles.

Timeframe for remedying deficiencies

What constitutes a “reasonable time” will depend on the circumstances. Some issues could take weeks or months to fully address. Others may be able to be resolved very quickly. We expect institutions to be able to explain why their timeframe for addressing an issue is “reasonable” and account for any delays. We also expect institutions to prioritise stopping any further harm to customers as soon as possible after the issue has been identified.

Collaborative process

Our view is that financial institutions and intermediaries have a shared responsibility for fair treatment of consumers. This means that when issues arise in the way distribution methods are operating, it will often be appropriate for institutions and intermediaries to work collaboratively to address these. This can be reflected in a financial institution’s FCP. For example, an institution might have a joint process for addressing issues, with both parties playing a role rather than this being something that rests solely with one party. Where remediation responsibilities are shared, practical responsibilities should be taken into account. These may include:

- Who has the necessary access to customer information to be able to complete the remediation
- Any relevant agreed roles and responsibilities under any distribution agreement
- Efficiency and timeliness considerations

We understand that collaboration may not always be needed to resolve all deficiencies in the operation of distribution methods. Because of the broad variety of the types of arrangements, entities and products involved in intermediated distribution, the extent of collaboration may differ from one situation to another. Our primary concern will be with situations where remediation may be inhibited by a lack of collaboration.

However, in most circumstances, we consider that a collaborative approach will necessarily involve a level of communication between financial institutions and intermediaries. Communication can facilitate understanding of the extent of harm when issues occur. Even if parties do not need to collaborate to resolve the deficiency, we expect it will be quite rare that a deficiency in the operation of an intermediated distribution method can be appropriately resolved without any communication, even if it is only for one party to inform the other of the issue’s existence and to confirm they will resolve it.

We do not intend to be prescriptive about this – financial institutions can work with intermediaries to determine what works best for them. We also note that references to shared responsibility are not intended to imply any additional legal duties on parties beyond what is already imposed under CoFI.

Useful questions

Remedying deficiencies

- How do you work with your intermediaries to track issues that are identified in how your distribution methods are operating?
- How do you keep track of issues that are identified in how distribution methods are operating?

- How do you decide when an issue has been remedied? What gives you confidence that you understand the extent of the issue? How do you know that other similar issues don't exist (e.g. in other parts of your business or other distribution methods)?
- When and how do intermediaries become aware that you have identified issues with how distribution methods that involve them are operating?
- When and how do you and your intermediaries notify each other of any issues identified with how distribution methods are operating?
- How do intermediaries know what you expect of them when issues occur? What happens if you disagree on how to remedy an issue, the role of each party, or anything else in relation to the issue and remediation?

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