FMA
FINANCIAL MARKETS AUTHORITY
TE MANA TĀTAI HOKOHOKO

SEPTEMBER 2024

FMA submission on the Finance and Expenditure Committee's inquiry into banking competition

Introduction

The Financial Markets Authority – Te Mana Tātai Hokohoko (**FMA**) is an independent Crown entity and New Zealand's principal conduct regulator of financial markets. Our statutory objective and function is to promote and facilitate the development of fair, efficient, and transparent financial markets; and to promote the confident and informed participation of businesses, investors and consumers in financial markets. Well-regulated financial markets are a cornerstone of a successful New Zealand economy and the financial wellbeing of New Zealanders.

The FMA has a strong focus on protecting consumers and investors, and the integrity of markets, and supports the Finance and Expenditure Committee's inquiry into banking competition; it is within the FMA's statutory mandate to take an interest in the state of competition in our markets, as the FMA considers competition is essential for promoting and facilitating the development of fair, efficient, and transparent financial markets[1].

The FMA has powers and general functions it can perform to achieve its objectives, aiding delivery of the outcomes sought from well-working competition. These powers and functions include licensing and supervising the conduct of financial services firms, issuing exemptions and designations, collecting and disseminating information or research, issuing reports or making comments, conducting inquiries into any matter relating to financial markets, and keeping under review the law and practices relating to financial markets.

New Zealand's financial markets sector has been going through a lengthy period of regulatory change, including implementing new regimes for financial advice, financial institutions (banks, insurers and non-bank deposit takers) and their conduct towards consumers, and climate-related disclosures for certain large financial institutions. As these changes take effect, they provide significant opportunities for the FMA, as the conduct regulator of financial markets, to advance more positive outcomes for consumers.

[1] The 'efficient' part of the FMA's main objective '*to promote and facilitate the development of fair, efficient, and transparent financial markets*" (in section 8 of the Financial Markets Authority Act 2011 and repeated as a main purpose in section 3 of the Financial Markets Conduct Act 2013) deliberately included competition when the FMA was established. The relevant regulatory impact statement and Cabinet paper characterised "efficiency", as it applies to the FMA, as meaning improved competition in financial markets by (i) promoting the confident and informed participation of investors and consumers in financial markets, and (ii) facilitating capital raising and promoting commercial certainty.

Structure of our submission

In this submission we provide information to the Committee on the FMA's role and functions relevant to the banking sector, with respect to two areas in the inquiry's terms of reference (**TOR**). The TOR asks the Committee to consider "any possible impact of the regulatory environment on competition and efficient access to lending, including" (among other things):

- "The role of bank regulators (FMA, MBIE, RBNZ) and whether the regulatory environment could be simplified"; and
- "Climate related disclosures".

TOR: "Any possible impact of the regulatory environment on competition and efficient access to lending, including…the role of bank regulators (FMA, MBIE, RBNZ) and whether the regulatory environment can be simplified"

Overview of the financial markets regulatory system and the agencies involved

New Zealand's financial markets regulatory system is based on the 'twin peaks' model, with the FMA responsible for conduct regulation and the Reserve Bank of New Zealand (**RBNZ**) responsible for prudential regulation[2]. Most countries around the world have implemented a 'twin peaks' model as international best practice, including Australia and the United Kingdom. The value of this model was particularly apparent after the global financial crisis when banks suffered significant lapses in prudential supervision and/or widespread failures in corporate conduct and ethics.

The Ministry of Business, Innovation & Employment (**MBIE**) is responsible for providing to the Government policy advice for the financial markets conduct regulatory system, specifically including the regulation of the conduct of banks; MBIE is also the monitoring agency for the FMA. RBNZ and the Treasury have policy functions in relation to prudential legislation; the Treasury is the monitoring agency for RBNZ. Further information about the roles and responsibilities for financial markets regulation is outlined in the Regulatory Charter: Financial markets regulatory system[3].

Regulatory co-operation is essential to an effective 'twin peaks' model, and has been embedded in the statutory architecture. The FMA is a member of the Council of Financial Regulators (**CoFR**), along with RBNZ, the Commerce Commission, MBIE and the Treasury. The function of CoFR is to facilitate co-operation and co-ordination between members of the Council to support effective and responsive regulation of the financial system in New Zealand[4]. As well as being joint chairs of CoFR, the FMA and RBNZ have express statutory functions to co-operate with each other (and with other CoFR members) and have extensive information-sharing powers to facilitate this. The FMA has Memorandums of Understanding with RBNZ[5] and the Commerce Commission[6] to formalise and facilitate information-sharing and relevant work in areas of dual regulation or interest. The regulators and departments work together through CoFR and its

[2] The FMA's conduct regulation focuses on behaviours in financial markets. It aims to ensure that consumers and investors are adequately informed and treated fairly, and that financial service providers act with integrity and conduct themselves appropriately. The RBNZ's prudential regulation aims to ensure that institutions adequately manage their own financial risks and the risks they collectively pose to the financial system.
[3] https://www.mbie.govt.nz/dmsdocument/3082-regulatory-charter-financial-markets-pdf
[4] As set out in the Reserve Bank of New Zealand Act 2021
[5] https://www.fma.govt.nz/assets/MOU/200319-mou-rbnz.pdf
[6] https://www.fma.govt.nz/assets/MOU/140331-mou-commerce-commission.pdf

sub-committees (including the Banking Forum), and directly between functional teams (such as licensing and supervision) across priority themes[7], areas of interest and intersection. Within CoFR's digital and innovation theme, the FinTech Forum was established, which regularly meets and provides general guidance and information, particularly to start-ups, with the aim of supporting innovation and competition[8].

The evolution of the FMA's role and financial markets conduct regulation in New Zealand

Following the global financial crisis and the collapse of over 60 finance companies in the mid-2000s, New Zealand's historical product- and disclosure-focused model for securities regulation moved towards a broader focus on conduct in financial markets, and greater regulatory engagement and supervision. These changes reflected similar shifts internationally and led to the formation of the FMA in 2011 and passage of the Financial Markets Conduct Act 2013 (**FMC Act**) in 2013.

The FMA's regulatory functions include licensing a range of financial markets participants, monitoring market participants and their compliance with financial markets legislation, investigating and enforcing, and providing guidance and information. This includes regulating certain products and services that may be offered by banks, such as managed funds, derivatives and the provision of financial advice.

The FMA also enforces fair-dealing laws that consist of prohibitions on deceptive or misleading conduct in relation to financial products and services, including those provided by banks.

In 2018, the FMA began to implement the financial advice regulatory regime brought in by the Financial Services Legislation Amendment Act 2019, with the full regime coming into effect in March 2023. The regime was designed to ensure the conduct and client-care obligations of financial service providers remained fit for purpose and to set industry-wide standards for conduct and competence. All financial advice providers must hold or operate under a licence from the FMA to provide regulated financial advice to retail clients and adhere to a Code of Conduct. More about the regulation of financial advice is on the MBIE website[9].

New Zealand is unusual in not having had general conduct regulation of retail banking and insurance products. This is a standard feature of most other jurisdictions, including Australia and the United Kingdom, which have had these requirements for some decades. We consider the absence of a proper conduct regime will have exacerbated the issues identified in the Commerce Commission's market study, such as the longstanding absence of investment in technology systems.

The FMA and RBNZ's 2018 and 2019 Bank and Life Insurer Conduct and Culture reviews[10] found New Zealand banks and insurers did not have robust systems and controls for managing conduct risks, which were affecting outcomes for consumers. In particular, the reviews found issues such as poor product design that did not consider the needs of consumers, sales incentives driving sales of unnecessary or inappropriate products, and poor administration or management of products leading to overcharging. Banks and insurers were asked through these reviews to identify and report on issues requiring remediation. Since the Conduct and Culture reviews, more than $170 million has been paid in remediation to New Zealand consumers.

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[7] CoFR currently has five priority focus areas: Climate-related risks, economic resilience, digital and innovation, financial inclusion, and regulatory effectiveness. www.cofr.govt.nz

[8] www.fintech.govt.nz

[9] https://www.mbie.govt.nz/business-and-employment/business/financial-markets-regulation/financial-markets-conduct-act/regulation-of-financial-advice

[10] https://www.fma.govt.nz/assets/Reports/Bank-Conduct-and-Culture-Review.pdf; https://www.fma.govt.nz/assets/Reports/Life-Insurer-Conduct-and-Culture-2019.pdf

The reviews also highlighted a lack of specific regulatory requirements in relation to conduct across the banking sector, particularly in respect of the delivery of banking products distributed without financial advice. The lack of conduct requirements in this area has hampered the FMA's regulatory oversight and the development of consistently strong governance and management of conduct risk across the industry. This regulatory gap in conduct regulation for banks and insurers has created the risk of ongoing, systemic harm to New Zealand customers.

CoFI responds to harm to consumers and fills a regulatory gap by introducing conduct regulation of retail banking and insurance services

The Financial Markets (Conduct of Financial Institutions) Amendment Act 2022 (**the CoFI Act**) introduces general conduct regulation of registered banks, insurers and non-bank deposit takers when carrying on their core retail business of providing basic, everyday banking and insurance products to consumers, including their ongoing customer relationship. It will also bring New Zealand into line with international norms for conduct regulation.

From 31 March next year, financial institutions will be required to be licensed by the FMA, and to establish and comply with 'fair conduct programmes' that are designed to ensure they treat consumers fairly. For example, this includes banks having policies, processes, systems and controls in place in relation to training for staff, communications with consumers, and how their products are designed, distributed and managed in a manner that supports the fair treatment of consumers. The CoFI regime complements existing requirements that regulate certain financial products and services, which tend to be ancillary to institutions' core business and focus more on the point of sale or the content of disclosure documents. The regime is designed as principles-based legislation with proportionate and non-prescriptive requirements. More about the CoFI Act is on the MBIE website[11].

The FMA is taking a risk-based and outcomes-focused approach to licensing and supervision, engaging with financial institutions to ensure they are well-supported throughout the licensing window until 31 March. CoFI will provide the FMA with powers to directly influence banks in relevant areas as they implement their fair conduct programmes. This will bring a greater focus on good outcomes for consumers to help address some of the issues highlighted in the Commerce Commission's recent market study on personal banking services, such as difficulties with switching, impediments to innovation, and helping mortgage advisers to get the best deal for their customers. There will be further opportunities as part of CoFI for the FMA's conduct regulation to be applied directly to the providers of banking services, which we consider will address some of the issues raised in the inquiry's Terms of Reference and achieve similar outcomes for consumers that competition regulation aims to achieve.

Simplification of the regulatory environment

In April 2024, the Government agreed to transfer regulatory responsibility for the Credit Contracts and Consumer Finance Act 1986 (**CCCFA**) from the Commerce Commission to the FMA. This means the FMA will become the sole conduct regulator for financial services[12] once the necessary legislation is introduced to Parliament and enacted. This will simplify regulatory settings for lenders, refining New Zealand's 'twin peaks' model for financial markets regulation described above.

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[11] https://www.mbie.govt.nz/business-and-employment/business/financial-markets-regulation/financial-markets-conduct-act/conduct-of-financial-institutions-regime

[12] https://www.mbie.govt.nz/dmsdocument/28286-progressing-financial-services-reform-minute-of-decision-proactiverelease-pdf

On 2 September, Cabinet made further policy decisions to reform the financial services sector, including aligning consumer credit regulation with the financial markets conduct regime, simplifying minimum requirements for fair conduct programmes required under CoFI, and requiring the FMA to issue a single licence covering different market services (including for consumer credit where applicable). These reforms aim to streamline the financial services regulatory landscape and remove unnecessary compliance costs. The FMA supports the intent of these reforms. More about these financial services reforms is on the MBIE website[13].

TOR: "Any possible impact of the regulatory environment on competition and efficient access to lending, including…climate-related disclosures"

Climate-related Disclosure (CRD) regime

MBIE and the Ministry for the Environment have responsibility for policy advice to the Government on the CRD regime.

The CRD regime commenced 1 January 2023, with Climate Reporting Entities (**CREs**) with 31 December balance dates filing climate statements before the end of April 2024. The mandatory annual climate statements cover governance arrangements, risk management, strategies, and metrics and targets for mitigating and adapting to climate change impacts. The CRD regime is intended to bring transparency to large entities' climate-related risks and opportunities so these become routinely considered in business and investment decisions, contributing to our financial system and economy becoming more resilient to climate risks.

The CRD regime captures approximately 180 large entities, including 13 New Zealand-incorporated banks, and 11 overseas banks which operate in New Zealand. The threshold for climate reporting is $1 billion in total assets for registered banks, licensed insurers, credit unions, and building societies; this currently captures almost all banks and one building society (Nelson Building Society). Therefore, the costs for the smaller banks and the building societies are likely proportionately higher than for the larger banks. During the policy process in 2020, the FMA raised concerns that the thresholds determining entities captured within the regime were too low[14]; the FMA's view on the thresholds remain unchanged. More information about the CRD regime is on the MBIE website[15].

The CRD regime is about mandatory disclosure, not mandatory action. While CREs need to collect and analyse information to comply with the disclosure requirements, the regime does not mandate any climate actions that CREs must take or follow, such as improving climate resilience, reducing greenhouse emissions, divesting from activities that contribute to climate change or governing and managing climate-related risks in a certain manner (if at all).

[13] https://www.mbie.govt.nz/business-and-employment/business/financial-markets-regulation/2024-financial-services-reforms
[14] See paragraphs 106-108 of https://environment.govt.nz/assets/publications/Cabinet-papers-briefings-and-minutes/cabinet-paper-climate-related-financial-disclosures.pdf
[15] https://www.mbie.govt.nz/business-and-employment/business/regulating-entities/mandatory-climate-related-disclosures

The External Reporting Board (**XRB**)[16] is evaluating the effectiveness of the CRD regime, with an interim report[17] published by the University of Otago in January, and a final report expected in late 2025.

The FMA's role

The FMA is responsible for independent monitoring and enforcement of the regime, providing guidance about compliance expectations, and reporting on monitoring activities and findings. Monitoring is intended to ensure CREs file statements that are accurate and not misleading, and retain appropriate records.

From the outset, the FMA has been clear that its regulatory approach was built on enabling the market to learn and build capability, deterring and addressing only serious non-compliance within the first few years of the regime. With the first climate statements filed in March/April this year, the FMA has been focusing on reviewing the statements, giving timely feedback and encouraging the development of good practice. During the regime's early stages, we have been engaging with some CREs and key stakeholders, including banks, to 'right-size' the reporting obligations and ensure the regime is workable. For example, we have considered several exemption applications in relation to CRD requirements and are using our exemption powers to tailor requirements and remove unnecessary regulatory burden where appropriate, whilst still aiming to meet the Government's policy objectives[18]. More information about the FMA's regulatory approach in relation to the CRD regime is on the FMA website[19].

Impact of CRD on efficient access to lending

The CRD regime is relatively new and its impact on access to lending is not yet visible. Although the regime doesn't impact directly on bank customers, any policies that banks opt to take to reduce their climate-related risks and financed greenhouse gas emissions may impact bank customers in terms of acceptance of lending requests and future lending costs. However, as noted above, the CRD regime is about mandatory disclosure, not mandatory action. Therefore, any policies that banks implement that may impact access to lending will not be mandated by the CRD regime but be based on having access to more information about and/or greater awareness of their climate-related risks and opportunities.

The CRD regime is not the only driver of potential climate-related investment decisions. The CRD regime is generally about entities reporting the impact of climate change on *their* business and investment decisions. Our experience is that there is growing interest among New Zealand investors in environmental, social, and governance (ESG) factors, including climate change, and recent research indicates that investors are interested in the impact their investments have on climate change[20].

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[16] The XRB is the independent Crown entity responsible for preparing the climate standards which CRE's must comply with: https://www.xrb.govt.nz/standards/climate-related-disclosures/aotearoa-new-zealand-climate-standards/

[17] https://www.xrb.govt.nz/dmsdocument/5141/

[18] Under sections 556 and 557 of the FMC Act, the FMA is able to grant exemptions on terms and conditions from compliance obligations in the FMC Act and associated regulations if it is satisfied that the exemption is necessary or desirable to promote one or more of the purposes of the FMC Act (that includes to avoid unnecessary compliance costs, promote innovation and flexibility in financial markets, promote confident and informed participation of consumers, investors and businesses, and promote and facilitate fair, efficient, and transparent financial markets) and the exemption is not broader than is reasonably necessary to address the matters that gave rise to it.

[19] https://www.fma.govt.nz/business/services/climate-reporting-entities/

[20] For example, a recent survey of New Zealand consumers indicates 74% of respondents were interested in investments in companies that have a positive impact on the climate, environment and society. https://responsibleinvestment.org/wp-content/uploads/2024/07/Voices-of-Aotearoa-Demand-for-Ethical-Investment-in-New-Zealand-2024.pdf