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Summary of key themes

An overview of feedback received as part of consultation on the proposed CoFI guidance note on intermediated distribution

FMA
FINANCIAL MARKETS AUTHORITY
TE MANA TĀTAI HOKOHOKO

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Contents

Introduction 3

Key themes 4

Overarching themes 4

General support for high-level, flexible guidance allowing a risk-based and proportionate approach 4

Request for more examples of what good looks like 4

Specific topics 5

Flexibility in relation to attestations will be maintained 5

Intermediaries that are licensed financial advice providers generally present a lower risk 6

The concept of shared responsibility is about collaboration and communication to deliver fair consumer treatment 7

Approaches taken by financial institutions could be burdensome on intermediaries 8

Treatment of existing and legacy products 9

Corporate employer / group insurance schemes are within the scope of this guidance 9

Financial institutions that are also intermediaries 10

Distribution agreements 10

External audits 10

Introduction

Early in 2023, the Financial Markets Authority – Te Mana Tātai Hokohoko (**FMA**) opened consultation to seek feedback on proposed guidance, related to the new conduct of financial institutions (**CoFI**) regime, outlining our expectations when financial institutions are distributing products and services through third parties.

The proposed guidance note was informed by feedback from workshops held with market participants in 2022. This early engagement prior to drafting, which allowed us to include industry insights in the guidance, was a novel approach and was well received by industry. It meant the draft covered a very broad industry that spans a large group of market participants and a wide scope of products and services relevant to intermediated distribution. As a result, the final guidance has not been significantly amended from the draft guidance published for consultation.

We would like to thank all submitters for their feedback on the proposed guidance note. We received 15 written submissions from a range of stakeholders including industry bodies, banks, insurers, financial advice providers, 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. We have also published a collation of the written submissions (which withholds some information in accordance with the Official Information Act 1982 and the Privacy Act 2020).

Key themes

Overarching themes

General support for high-level, flexible guidance allowing a risk-based and proportionate approach

Most submitters agreed that because the draft guidance was high level and not overly prescriptive, it could apply to a broad audience. Submitters generally agreed that the draft guidance was useful and supported a principles-based and outcomes-focused approach. Some submitters identified that this approach meant the draft guidance lacked specific details to be able to provide the same level of 'safe harbour confidence' that more prescriptive guidance can offer. Submitters also acknowledged that the guidance supported financial institutions to comply in a manner proportionate to the risk that their distribution channels would not result in fair treatment of consumers. One submitter requested separate guidance for intermediaries licensed by the FMA as financial advice providers (**FAPs**).

FMA response

The draft guidance was informed by feedback from workshops held with industry participants in 2022. This feedback indicated that the guidance needed to be workable across a wide range of financial institutions, products and distribution models. This has meant that our expectations need to be communicated at a high level, focusing on the desired outcomes while maintaining flexibility for financial institutions in how those outcomes are achieved.

We acknowledge that broad, principles-based guidance based on achieving desired outcomes (without detailed comment on how outcomes should be achieved) has a natural trade-off in that it may not always provide entities with certainty about what approach they should take. The key principle behind an outcomes-focused approach is that rules and regulations are a means to an end, and the focus is instead on what outcomes are achieved rather than how exactly they are achieved. Ultimately, CoFI requires that financial institutions comply with the fair conduct principle in a way that is proportionate and tailored to their particular business, and this will naturally look different across the population of financial institutions.

Request for more examples of what good looks like

Submitters thought that the examples of what the FMA does not expect to see were useful. Some submitters asked for more examples of what the FMA does expect to see, or what the FMA considers to be a 'good' approach. Some submitters also asked for more examples relating to less-common products or situations.

FMA response

As mentioned above, the intention with outcomes-focused regulation is to identify desired outcomes and maintain flexibility for entities to determine how best they will achieve those outcomes. The draft guidance does not aim to prescribe particular distribution methods or approaches for financial institutions to use, but

rather to set parameters and considerations to assist financial institutions in determining these for themselves. This avoids the potential of a one-size-fits-all approach imposing unnecessary compliance costs on financial institutions and intermediaries.

The draft guidance provides some examples of what the FMA does not expect to see, to indicate to financial institutions certain methods or approaches that might be too burdensome on intermediaries or not necessary to achieve the desired outcome. The examples of what the FMA does expect to see do not provide for every possible situation or approach. This is because we expect there is likely to be a broad variety of approaches that could be taken, depending on the type of institutions, products, distribution channels and risks involved.

As CoFI is implemented, we expect to gain further market insights and examples of approaches that have been successful in particular circumstances. We will endeavour to share what has been successful where it is appropriate (for example, because it is a new or novel practice), but we will not be prescriptive about these practices, and they would be shared for educative purposes only.

Specific topics

Flexibility in relation to attestations will be maintained

Submissions indicated that there is a wide variety in practices and preferences relating to attestations. Some submitters indicated that it would be preferable for the guidance to be agnostic as to which situations attestations would be suitable for, to maintain maximum flexibility and avoid giving the impression that attestations were less desirable than other approaches. Other submitters indicated they did not frequently use attestations and were cautious to ensure that when they were used, they provided meaningful assurances and did not become a ‘tick-box’ exercise. Submissions also indicated that intermediaries were generally concerned with the compliance burden that excessive use of attestations could cause.

Submitters indicated there has been some movement among certain industry bodies to facilitate a cohesive approach to attestations, but this does not appear to have been successful yet. One industry body has indicated that after consideration with members, it does not appear practicable to determine an industry approach at this stage, and that it would prefer the guidance does not address the possibility of an industry approach to attestations. One other submitter requested that the FMA lead the development of template attestations to assist the industry in collaborating.

FMA response

Acknowledging the wide variety in practices and preferences surrounding attestations, we will maintain a flexible approach in the guidance. Our view remains that attestations are one tool financial institutions could use (compared to more intensive assurance methods) and are generally suitable in distribution methods that present a lower risk of unfair treatment. This does not mean attestations are not suitable for distribution methods that present a higher risk of unfair treatment. If an attestation is used in a higher-risk situation, we would expect to see it supplemented, for example by supporting evidence, or further investigations where warranted.

We encourage financial 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 their assessment of risk (of treating consumers unfairly), as financial institutions have the responsibility to review their distribution methods under CoFI.

We do not consider it our role to lead the development of template attestations. We continue to encourage an industry-led approach to achieve consistency where possible, to relieve compliance burden on intermediaries who may have to prepare multiple attestations for multiple financial institutions.

Intermediaries that are licensed financial advice providers generally present a lower risk

The draft guidance indicated that intermediaries who hold financial advice provider (**FAP**) licences will pose a reduced level of risk that a financial institution's distribution method will not meet the fair conduct principle. Some submitters suggested that FAPs should not be considered as posing a lower risk in all circumstances. One submitter stated that the emphasis on FAP intermediaries posing a lower risk could imply that other non-FAP intermediaries could not also be lower risk in the right circumstances. Other submitters preferred more explicit language to support financial institutions placing weight on the position that FAP intermediaries present a lower risk.

One submitter suggested that FAP intermediaries present such a degree of decreased risk that the guidance should allow financial institutions to assume FAPs are treating consumers fairly (with the effect that such intermediaries do not need to be subjected to review by a financial institution, unless the financial institution has reasonable grounds to believe consumers are not being treated fairly).

Some submitters sought clarity around whether a different approach should be taken for FAP intermediaries that are involved in the distribution of particular products/services but do not provide advice in respect of those products/services.

FMA response

While we acknowledge the wide-ranging views on this topic, the FMA maintains the position that FAP intermediaries pose a reduced level of risk that an institution's distribution method will not meet the fair conduct principle. This is because FAP intermediaries are already subject to financial advice regime requirements and a licensing regime that requires certain standards of process, competency and conduct, which reduces their risk compared to non-FAP intermediaries. This position is intended as a general starting point. We agree that other factors may increase the risk. Not all FAPs will be lower risk in all circumstances, and various other factors may increase the risk in certain circumstances. Ultimately, financial institutions should determine the level of risk associated with distribution through each intermediary it works with (whether or not it is a FAP), and review the distribution method employed with each intermediary according to that level of risk.

We do not agree with the suggestion that FAP intermediaries should be automatically assumed to be treating consumers fairly and therefore not be required to take part in financial institutions' regular reviews unless there are reasonable grounds to suspect unfair treatment of customers. This position would be inconsistent with the intentions of the CoFI regime, in particular the responsibility of financial institutions to ensure consumers are treated fairly.[1]

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[1] Refer also to the Cabinet paper proactively released by MBIE: *Financial Markets (Conduct of Financial Institutions) Amendment Bill: Further Policy decisions and regulations*, 9 February 2022, at [19.1] – [19.2], which sets out the principles that underpinned the Government's further amendments to the obligations that apply in respect of intermediaries.

We do not propose to make a formal change to the guidance, but state here for submitters seeking clarity that a FAP intermediary involved in distribution but not providing financial advice may still be considered to generally pose a lower risk in the same way as FAP intermediaries involved in distribution and also providing advice. The key point is not that financial advice is provided, but rather that the intermediary holds a FAP licence and so is subject to minimum standards in licence conditions and ongoing monitoring from the FMA.

The concept of shared responsibility is about collaboration and communication to deliver fair consumer treatment

Some submitters were concerned that the inclusion of references to a “shared responsibility” for fair treatment of consumers between financial institutions and intermediaries would create confusion and possibly imply a legal duty on intermediaries where there is not one. Submitters highlighted that under CoFI, it is the financial institution that bears the ultimate responsibility for fair treatment of consumers.

Submitters explained that shared responsibilities may not always be appropriate in all circumstances, citing an example of distribution channels where intermediaries do not provide advice and are involved only in the arrangement of the sale of the product or service. Submitters also explained that in a remediation context, the sharing of responsibilities could actually delay remediation if the financial institution finds that referring back to the intermediary to share responsibilities is unnecessary.

A few submitters queried whether and to what extent amendments to distribution agreements would be required to give effect to the concept of shared responsibility, noting the practical difficulties and costs involved.

FMA response

References to “shared” and “shared responsibility” are not intended to imply any additional legal duties on parties beyond what is already imposed under CoFI. Rather, they are included to acknowledge that multiple parties are involved in intermediated distribution and the dual CoFI and financial advice regimes, which create different but related responsibilities relating to the fair treatment of consumers.

The draft guidance explicitly acknowledges the commercial and legal separation between financial institutions and intermediaries, and their different legal obligations under those regimes. We agree that under the CoFI regime it is financial institutions that must comply with the fair conduct principle. However, in the context of intermediated distribution, we consider that intermediaries should treat consumers fairly and do not agree with the suggestion that intermediaries do not have any role to play in achieving this outcome. The intention of the guidance is to highlight that intermediated distribution often requires collaboration between financial institutions and intermediaries, and that both should have the fair treatment of consumers at the heart of everything they do. This is not a new or novel expectation from the FMA, and it remains in the final guidance.

The draft guidance also acknowledged that what shared responsibility looks like, and the extent of collaboration, will vary in practice due to the breadth of types of arrangements, products, entities and so on. In the context of developing distribution methods consistent with the fair conduct principle, we expect that the way responsibilities are shared between financial institutions and intermediaries will be determined according to the particular circumstances, nature and type of their distribution relationship.

In the context of remediating deficiencies in how distribution methods are operating, we understand that this will also be context-dependent, and we agree that sharing responsibilities is not always going to be

necessary. As we highlighted in the draft guidance, our focus is more on *collaboration* between financial institutions and intermediaries, where it is appropriate and necessary. We have clarified the guidance to acknowledge that collaboration may not be necessary in all remediations, and that the extent of collaboration may differ from one situation to the next. Our primary concern is with situations where remediation may be inhibited by a lack of collaboration between intermediaries and financial institutions. We have also clarified that where remediation responsibilities are shared, parties should take into account practical considerations (such as who has the necessary access to customer information to be able to complete the remediation, each party's agreed roles and responsibilities under any distribution agreement, and what would be the most efficient and timely way to resolve the matter). Ultimately, both financial institutions and intermediaries should also consider what would deliver the best outcome for the customer in the circumstances.

We have also highlighted that part of this collaboration between financial institutions and intermediaries will involve communication. Even though practical collaboration in the process of remediating deficiencies may not always be necessary, we consider that a level of communication regarding the issue for remediation likely will be necessary. By its nature, intermediated distribution involves two parties, and we consider it is important that there is clear communication between them to ascertain the nature of the issue and each of their roles and responsibilities. We consider it to be quite rare that a deficiency in 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 and to confirm they will resolve it.

We do not consider amendments to contractual distribution agreements to reflect this shared responsibility to be mandatory. We are more focused on whether the financial institution and intermediary are clear between themselves on what their exact roles are and where responsibilities lie. We encourage recording this agreement in writing, but do not consider it necessary to be in a contractual form (although parties may benefit from the certainty this would provide).

Approaches taken by financial institutions could be burdensome on intermediaries

A few submitters were concerned that despite encouragement of a risk-based and proportionate approach, financial institutions may still err on the side of caution and take an overly conservative approach to ensure compliance with their CoFI obligations. They suggested that the draft guidance's broad and flexible approach could drive this behaviour because it did not create the certainty of a 'safe harbour' in the form of suggested acceptable approaches.

These submitters suggested that some emphasis on the level of confidence financial institutions need to have in their distribution channels meeting the fair conduct principle would be of assistance. They also requested that the FMA monitor what financial institutions are requiring from intermediaries, to ensure that excessive burden is not placed on intermediaries.

FMA response

It is up to each financial institution to determine its risk appetite and approach to compliance with CoFI obligations to ensure that its distribution methods are operating consistently with the fair conduct principle. We encourage all financial institutions to take a risk-based, proportionate approach as set out in the guidance. The draft guidance explicitly refers to the FMA's concerns that some financial institutions may respond to CoFI by imposing compliance measures on intermediaries that go beyond what is necessary and proportionate to the risk involved. We maintain this position and reiterate that we do not expect financial institutions to disproportionately impose compliance burden on intermediaries in the distribution of

their products and services. We do not expect financial institutions to take overly conservative approaches except in relation to distribution methods that present a high risk of not treating consumers fairly (to the extent they have any).

We are currently developing our CoFI monitoring approach, which will be driven by consumer outcomes. The monitoring approach is outside of the scope of this guidance. We do not anticipate that we will monitor the burden placed on intermediaries by financial institutions, except in situations where we become aware consumers may be being treated unfairly as a result.

Treatment of existing and legacy products

Some submitters, particularly insurers, identified that the guidance did not specifically explain the FMA's expectations relating to financial institutions' existing and legacy products.

FMA response

The draft guidance referenced legacy products in the form of an example relating to consumer communications. We have not made any further changes to the final guidance in this respect because the legislative requirements and expectations under CoFI are the same, regardless of whether a product is new, pre-existing or a legacy product.

Corporate employer / group insurance schemes are within the scope of this guidance

Some submitters suggested that the guidance would benefit from specifically addressing distribution through group insurance schemes through, for example, corporate employers. In this scenario, a financial institution enters into a group policy with an employer. The relationship is only between the financial institution and the employer, but the policy is held for the benefit of the employer's employees. Employees automatically become beneficiaries of the group policy when they commence employment, and premiums are paid for by the employer (generally as part of a remuneration package). These submitters were unclear on whether the employer (and its staff involved in onboarding new employees) would be considered 'intermediaries'. Submitters also identified that in this scenario there is no direct contractual agreement between the insurer and the employee, and as such the insurer often holds limited information about the employee.

FMA response

In the scenario where an insurer provides insurance under a group scheme where the policy holder is the employer and the insured are its employees, we expect that the employer generally would not receive any commission. This means that 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 the consumers. 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. We have clarified the guidance to make clear that this is a type of intermediated distribution. We have also included some examples around customer communications to demonstrate how financial institutions' fair conduct programmes might provide for distribution consistent with the fair conduct principle in this context.

Financial institutions that are also intermediaries

We received feedback that the guidance addresses intermediaries that are FAPs but that there is no mention of intermediaries that are also financial institutions. Some submitters considered that intermediaries who will hold a licence as a financial institution under CoFI should also be able to be treated as posing a lower level of risk.

FMA response

We agree that intermediaries that are also financial institutions licensed under CoFI could be considered to pose a lower level of risk because of their obligation to comply with the fair conduct principle. While the draft guidance already identified intermediaries also being financial institutions as a factor that may decrease risk (in the table on page 17), we have updated the guidance to reflect this position more clearly.

Distribution agreements

Some submitters suggested it would be helpful if the FMA gave a firmer view of how important it is to incorporate the fair conduct principle into contractual/distribution agreements.

FMA response

The draft guidance indicated that a distribution agreement is one of the ways intermediaries and financial institutions can formalise their arrangements. While we see this as good practice, it is not considered to be necessary in all circumstances. It is more important that the parties have agreed their roles and responsibilities between them, than the form of this agreement.

External audits

Submitters indicated there was some confusion with the FMA's position in relation to the use of audits when financial institutions conduct their reviews of whether their distribution methods are operating consistently with the fair conduct principle. Some submitters considered that the FMA's position that it expected audits to be considered only in higher-risk distribution methods suggested that we therefore expected audits to be used in relation to non-FAP intermediaries because they were higher risk than FAP intermediaries. One submitter suggested that a simpler position would be for the FMA to state that audits are not expected in any situation.

FMA response

We do not agree with the interpretation that non-FAP intermediaries are expected to be automatically higher risk simply because FAP intermediaries are considered to pose a lower risk. As mentioned above in

the section on risk treatment for FAP intermediaries, factors other than FAP status may increase or decrease the risk associated with any intermediary. Financial institutions will need to determine the level of risk associated with each intermediary on a case-by-case basis, and as such, we do not consider that the guidance should be read as suggesting that audits will always be appropriate in relation to non-FAP intermediaries.

We also do not consider that a blanket approach to the use of external audits is appropriate, and maintain our position that external audits may be useful in some higher-risk situations. We do not expect external audits to be used as a routine compliance measure in most situations.

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