

Understanding the Conduct of Financial Institutions Amendment Act (CoFI)

On 29 June 2022, the Government passed the Financial Markets (Conduct of Financial Institutions) Amendment Act (CoFI) introducing a new legislative framework for regulating the conduct of financial institutions and their intermediaries. It addresses concerns raised in the Reserve Bank of New Zealand (RBNZ)/Financial Markets Authority (FMA) thematic reviews into conduct and culture in New Zealand's retail banks in 2018, life insurers in 2019, and an evaluation of fire and general insurers in 2021. These reviews followed the Australian Royal Commission addressing Misconduct in the Banking, Superannuation and Financial Services Industry in 2018. While widespread misconduct and poor culture was not found, the review concluded that the overall standard of financial institutions' approaches to identifying, managing and dealing with conduct risk needed to improve markedly. CoFI now provides the regulatory framework for the expected improvements.

What is CoFI?

The key aspects of the CoFI regime are:

- **Conduct and culture:** There is a strong emphasis on promoting good conduct and culture within financial institutions. This includes ensuring they act with integrity, treat customers fairly, and take responsibility for their actions.
- **Duties and obligations:** Financial institutions must comply with a set of duties and obligations designed to protect customers and promote good conduct. These include acting in the best interests of customers, disclosing relevant information and providing appropriate products and services.
- **Licensing:** Financial institutions need to be licensed by the FMA to operate in New Zealand. This means meeting standards around conduct and culture, governance, and risk management.
- **Supervision and enforcement:** The FMA has increased powers to supervise and enforce compliance with the CoFI regime. This includes the ability to impose fines and other penalties on financial institutions that breach the rules.
- **Customer outcomes:** There is a focus on ensuring that financial institutions deliver good outcomes for their customers including requiring each firm to monitor and report on their performance against a set of customer outcome metrics.

Overall, the focus of the CoFI regime is on protecting customers and promoting good outcomes. It represents a significant shift in the regulatory landscape for financial institutions in New Zealand, and is intended to bring the country's regulatory framework in line with international best practice.

Who needs to know about CoFI?

- Registered banks.
- Licensed insurers.
- Licensed non-bank deposit takers.
- Anyone who provides relevant services such as acting as an insurer, being a creditor under a credit contract, certain financial services under the Financial Service Providers (Registration and Dispute Resolution) Act 2008.
- Anyone acting as an intermediary for any relevant service.

When will CoFI take effect?

- CoFI will come into force in March 2025, following a transition period.
- License applications opened in July 2023.
- The Ministry of Business, Innovation and Employment (MBIE) is working on the regulations to support the CoFI regime. MBIE is expecting to release the regulations later this year.

What are the key changes?

The new regime will mean changes across an entire financial institution and includes:

- Obtaining and operating under a licence by the date the new regime starts.
- Applying a 'fair conduct principle' – that a financial institution and their intermediaries must treat consumers fairly. This relates to product and service design, sales and service, complaints and claims handling. Treating customers fairly includes (but is not limited to):
 - Keeping consumers' interests in mind.
 - Acting ethically, transparently and in good faith.
 - Helping consumers make informed decisions.
 - Ensuring products and services are designed to meet the needs of the intended consumers (when viewed as a group).
 - Not using pressure tactics or undue influence to sell products and services.
- Establishing, implementing, maintaining, and complying with an effective and comprehensive fair conduct programme throughout the business to ensure customers are treated fairly.
- Developing a distribution strategy that applies to staff as well as intermediaries. The FMA has published [guidance](#) on what should be considered, such as the roles and responsibilities of the institution and its intermediaries, how distribution arrangements are managed, product information, training and accreditation.
- Complying with regulations on incentives. The regulations (still to be finalised) will prohibit sales incentives based on volume or value targets such as soft commissions involving an overseas trip or bonuses for selling a certain number of financial products.

There is also a broader, overarching obligation for financial institutions to have effective policies, processes, systems and controls for designing and managing incentives in their fair conduct programmes to help mitigate or avoid actual, or potential, negative impacts on consumer interests.

What penalties could apply for CoFI breaches?

CoFI sets out a range of penalties that may apply to breaches of the regulatory requirements. These penalties are designed to ensure financial institutions are held accountable for their conduct and culture and to deter future breaches of the rules.

The penalties that could apply for breaches are:

- **Enforcement action:** The FMA has increased powers to take enforcement action against financial institutions that breach the rules. This could include the imposition of fines, directions to take corrective action, or even court action.
- **Fines:** There could be fines for breaching the regime. The maximum penalty for a breach is \$5 million for companies and \$500,000 for individuals.
- **Orders for compensation:** The FMA could order compensation for customers who have suffered harm as a result of the breach including ordering the financial institution to pay monetary compensation or provide other forms of amendments.
- **Suspension or cancellation of license:** The FMA could suspend or cancel the license of a financial institution that has breached the CoFI regime, if it is considered necessary to protect customers.
- **Reputational damage:** Breaches of the CoFI regime could also result in significant reputational damage to financial institutions. This may impact their ability to attract and retain customers and investors.

The penalties for breaches of CoFI are designed to be significant and in proportion with the seriousness of the breach. Financial institutions that fail to meet their obligations may face significant financial and reputational consequences and may find it difficult to operate effectively in New Zealand.

What should you be doing to prepare for CoFI?

Key activities you can do now

- Agree internally who will be the sponsor of CoFI, noting that the person responsible for designing and delivering the implementation programme may be different from the one who owns CoFI once the licence is in place. Make sure the sponsor and key stakeholders are fully versed on the outcomes that are required under CoFI.
- Allow yourself the time to have meaningful conversations about what CoFI seeks to achieve and the shift that your organisation is likely to need in order to be successful in prioritising fair customer outcomes.
- Understand the CoFI minimum requirements for a Fair Conduct Programme (FCP) and identify:
 - Existing policies, procedures and controls that need updating or revising to include specific requirements or better articulate how your existing practices meet the requirements.
 - Whether any gaps exist and what needs to be established and implemented to close those gaps.
- Compare and optimise existing business practices against regulator commentary and guidance – both here and overseas – to minimise the need to create practices from scratch where possible. In particular, consider the FMA's [CoFI legislation overview, licensing guide and standard conditions](#) and the [Fair Conduct Programme Information Sheet](#).
- Establish a FCP. While the FMA does not expect your FCP to be fully implemented by the time you apply for your licence, it does expect your board of directors to approve the FCP before you submit the application.
- Prepare a high level plan to implement and maintain your FCP to achieve compliance with CoFI and meet the licence conditions. The plan should include timelines and resource requirements.

Future key activities

- Although the precise details of the upcoming ban on sales incentives based on volume or value targets are still to come, particular thought needs to be given to product development and distribution arrangements e.g. arrangements with intermediaries, to ensure they meet the FCP minimum requirements.
- Keep up to date with regulatory and market developments and watch out for regulatory guidance to assist with understanding and developing a FCP. The FMA have signalled their openness to receive questions from the market and have regular and early dialogue with applicants.
- Prepare a more detailed plan to achieve compliance with CoFI that specifies the precise activities that need to be undertaken to ensure the FCP is implemented and operating effectively, who owns these activities, the timeframes for delivery, the oversight and governance activities that need to be in place to confirm their adequacy and accuracy.

Other useful resources include:

- the UK FCA's [Fair treatment of customers](#) (2015)
- [A guide to the FMA's view of Conduct](#) (February 2017)
- the relevant commentary from the Australian Royal Commission addressing [Misconduct in the Banking, Superannuation and Financial Services Industry](#) (2019)
- the RBNZ / FMA thematic reviews into conduct and culture in [New Zealand's retail banks](#) (2018)
- [Life insurers](#) (2019), and
- [Fire and general insurers](#) (2021).

How PwC can help

How you respond to regulation comes down to your strategy. Having an approach that not only prepares your business to adapt to CoFI in an efficient and effective way, but can also stand up to regulatory scrutiny is key.

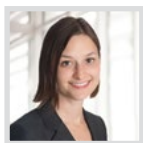
PwC can help you prepare for CoFI. It requires a specific approach for each business, so we recommend a bespoke response. Our Four Step Model to approach CoFI readiness is adaptable for your business. We will also leverage our deep international experience to bring you global insights and best practice through the process. We know that without access to specialist knowledge throughout regulatory change programmes, there is a tendency for the resulting governance, processes and controls to be over-complicated, requiring additional operational overhead without adding an uplift in quality outcomes or compliance.

Overview of our Four Step Model

1. **Assessing current state of conduct risk** framework, policies and practices either by using PwC's CoFI Assessment Framework, or PwC's Conduct Risk Maturity Model, or both depending on your needs and preferences.
2. **Developing and preparing a CoFI uplift plan** that is workable, and that business stakeholders buy in to.
3. **Drafting a Fair Conduct Programme** that allows robust, efficient and transparent governance.
4. **Assessing FCP and licence application readiness** which gives you the confidence to know that you are set up for sustainable success.

Our specialist resources will be available at each step to support you. This may be by leading elements of your uplift programme, reviewing amended documents to check that they contain all the elements needed, or by providing real-time Subject Matter Expert guidance.

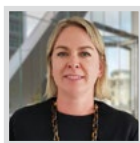
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