NOVEMBER 2023

Fair outcomes for consumers and markets

A guide to outcomes-focused regulation

Purpose of this guide

The Financial Markets Authority - Te Mana Tātai Hokohoko (FMA) is moving towards an outcomes-focused approach to regulation. Setting out fair outcomes for consumers and markets is a prerequisite for this.

The purpose of this guide is to introduce what outcomes-focused regulation entails, and implications for our engagement with providers going forward. As part of this we set out the fair outcomes for consumers and markets that we consider providers should be working towards.

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Introduction

E ngā mana, e ngā reo, ngā mātā waka o te motu, tēnā koutou, tēnā koutou, tēnā koutou katoa.

The FMA's objective is to promote and facilitate the development of fair, efficient and transparent financial markets. Our functions enable us to promote the confident and informed participation of businesses, investors and consumers in financial markets.

We take an active role as a kaitiaki of New Zealand's financial markets, to foster our vision that more New Zealanders than ever believe the financial services sector is working well for them.

This document introduces outcomes-focused regulation and why it is important. It sets out our view of fair outcomes and that they are the end results we want providers of products and services to focus on for consumers and markets. This is not a replacement for, nor a rewriting of our rule book. It means measuring success from the viewpoint of New Zealand consumers and markets.

Message from Samantha Barrass

Tēnā koutou

Providers of financial products and services can make a real difference to our lives. From opening our first bank account to buying a home or saving for retirement, meaningful participation in the financial system by us all is essential for our future wellbeing and prosperity as a country. It underpins economic growth and successful financial markets. As well, I firmly believe that for the financial sector to reach its full potential for New Zealand, we need a modern, adaptable regulatory approach. As a kaitiaki of financial markets, I want to ensure that the FMA's work is risk-based and focused on the issues that matter most to New Zealanders, while ensuring that providers remain empowered to innovate and have flexibility in terms of their business needs. Having a shared sense of what fair outcomes are for consumers and markets is an important part of this.

We all know what is fair when we see it, but experience tells us not all providers adequately take this into account when they design products and services or implement rules and regulations. We want firms to adopt a demonstrable focus on results. Compliance needs to start with the intent and purpose of rules and a focus on what shifts the dial for consumers and markets. It is particularly important we move away from compliance as a matter of form and prescription.

Fair outcomes should be at the heart of everything we do – for the FMA as well as the industry. It will likely require new ways of thinking and different approaches. This is a journey we need to go on together.

Success will come from building the FMA's understanding of consumers' perspectives and experiences across different demographics. We will need to engage with providers to understand how this regulatory approach aligns with their business model, provides opportunities, creates challenges, and prompts need for support.

New Zealand is a very special country with a unique perspective and experience of striving for a fair go for all. Our ambition is to deliver the fairest financial system in the world, with more New Zealanders than ever believing the financial sector is working well for them. I believe that together, with a clear focus on the outcomes that matter, we can make significant strides towards this goal.

This is a great next step for New Zealand's financial markets.

Ngā manaakitanga,

Samantha Barrass
Chief Executive

"Fair outcomes should be at the heart of everything we do – for the FMA as well as the industry. It will likely require new ways of thinking and different approaches. This is a journey we need to go on together."

Executive summary

The FMA is embedding a regulatory approach that puts fair outcomes for consumers and markets at the heart of our work. We have identified seven fair outcomes, which we see as essential to deliver our vision of more New Zealanders than ever believing that our financial markets work well for them.

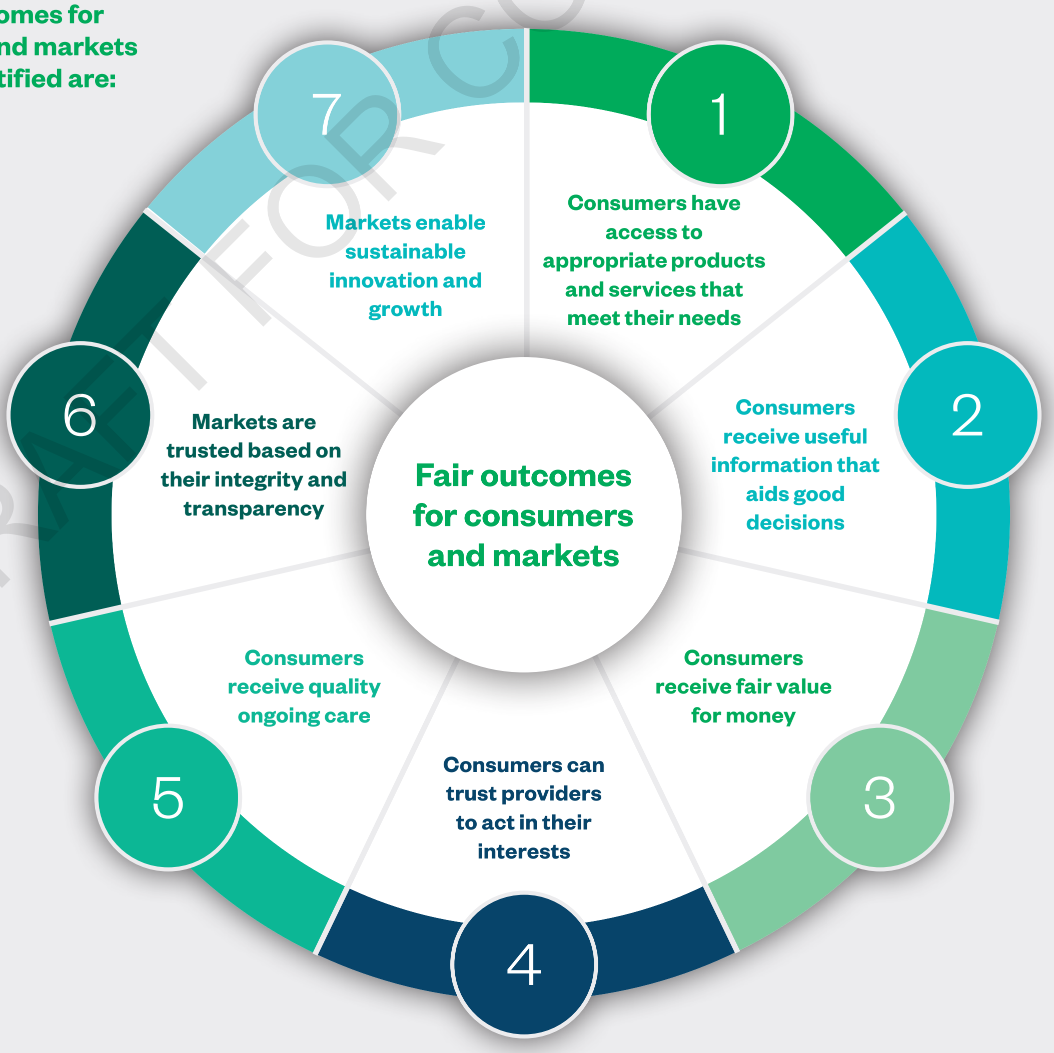
While we have always expected firms to deliver fair outcomes, by developing a consistent approach and providing certainty about the results we are focused on, this will turn our vision into something more real and practical for the financial sector. We intend that outcomes-focused regulation will underpin our work with the industry.

These are not rules. They do not change firms' obligations. They provide a focus for compliance and business efforts, supported by our existing legislative framework. Delivering these outcomes is the most effective way for good conduct to be demonstrated.

Providers of financial products and services must take ownership of the outcomes and consider how their leadership, management, governance and operations all work together to deliver them in a way that is most appropriate and effective within their business context.

These outcomes will inform how we exercise our role as a kaitiaki of financial markets and approach our supervisory and enforcement work. This will help us work towards ensuring our financial system is optimised to deliver the best results for New Zealand.

The fair outcomes for consumers and markets we have identified are:



Setting the context

Our role

We are the principal conduct regulator and a kaitiaki of New Zealand's financial markets.

Our role as a kaitiaki means we have a responsibility to encourage everyone who wishes to participate in the sector to be able to do so with confidence and in a fully informed manner. In a very broad sense, this includes anyone who provides financial products or financial services and anyone who might need or acquires financial products or services.

We work to foster the resilience of the whole financial sector by understanding and guiding conduct, connections, and interactions. This approach is underpinned by our determination to promote fair financial markets and financial wellbeing. Our actions are guided by doing what's right, and our relationships are balanced by manaaki - acknowledging the mana of all others in all circumstances; and tiaki - nurturing pono, truth and authenticity.

We focus on protecting investors, consumers and the integrity of markets through influencing behaviour. We seek to be innovative and forward-looking, including in our use of new regulatory approaches and ways of working, while being conscious of unnecessary regulatory burden. We communicate our priorities, are open about our intentions and actions, and clear about what we expect from others and what they can expect from us.

Outcomes-focused regulation

Outcomes-focused regulation is a regulatory approach that focuses on the end results we want to see for consumers and markets. We need to be clear on the outcomes that matter, work together on this shared endeavour, and regulate in a way that gets us there.

This approach acknowledges that firms are better placed than regulators to determine what processes and actions are required within their businesses to achieve regulatory objectives. Instead of prescribing the processes or actions that firms must take, the FMA is setting out the outcomes that regulation seeks to achieve. We will then step back and let firms find the most efficient way to achieve these outcomes.

A focus on outcomes supports effective regulation through influencing behaviour, and creating the conditions and incentives to promote good conduct from the outset, rather than after harm has been done. This shift in approach is consistent with global regulatory practice.

While rules are still an integral part of regulation, we want to avoid a 'tick box' mentality where technical compliance is the end goal, as this may not provide the best result for consumers or markets. A focus on rules alone can create conditions where risks are either missed or over-managed and consumer harm goes unaddressed, and can also prevent swift behavioural changes (for example in response to new technologies and innovations).

Adopting a more deliberate outcomes focus guides us to thinking about what end results are important and puts the emphasis on providers to embed this in the way they do business. It highlights the importance of viewing rules in their broader context, considering the purpose of the legislation and as a means to achieve a fair result. Importantly, it ensures compliance and regulation are right-sized for the market and firms' circumstances and are centred on the risks that matter to consumers and markets.

Prioritising outcomes also means we will more easily be able to identify and challenge approaches that don't support fairness. This will be an important part of our engagement model and the results we see in the market will alert us to where we need to have robust conversations about appropriate practices. Providers will all be working within the same outcomes-based framework, and those that want to do the right thing can have the confidence they won't be at a competitive disadvantage. We will be outspoken where we see practices that are unfair and take enforcement action where appropriate.

Fair outcomes

Seeking fair outcomes is not new for the FMA but it is now a strategic priority for us, building on previous work we have done to articulate our approach to regulation.

In our 2017 publication *A guide to the FMA's view of conduct*, we signalled how we would use conduct as a lens for looking at how providers behave when meeting their existing obligations to their customers, and for shaping how we interact with them. We have also undertaken thematic reviews of the banking and insurance sectors with a focus on conduct and culture and the experiences of consumers.

As a next step we have identified a clear set of fair outcomes. These will help create certainty about the specific results we are focused on. These will sit at the heart of our regulatory approach and inform our engagement with industry. They are aligned with and support the FMA's statutory objectives and functions including:

- promoting and facilitating the development of fair, efficient and transparent financial markets, and
- promoting confident and informed participation of businesses, investors and consumers in financial markets.

What is a fair outcome?

A fair outcome is the end result we are seeking for consumers and markets, and embeds the concept of pono (doing what is right). New Zealand's financial markets conduct regime is designed to facilitate choice and flexibility for consumers and promote market innovation. Therefore, a focus on fair outcomes does not mean consumers are insulated from risks or that a product always makes money. However, it does mean products and services meet the needs of identified consumer groups and are targeted accordingly, and that providers ensure consumers have access to the knowledge and tools needed to make informed decisions and weigh consequences based on their individual preferences.

What do the fair outcomes mean for regulatory compliance?

These fair outcomes are not rules. They do not create, replace or even supplement existing legal obligations. Rather, focusing on the outcomes will assist firms to more easily meet those obligations in a way that achieves the purpose and intent behind them, as well as supporting regulatory compliance and helping to signal whether the regime is working as it should. If we can observe fair outcomes in the market, this is a strong indication of good conduct.

Providers will need to take ownership of the fair outcomes and demonstrably embed them in the way they operate. This will mean continually refreshing their understanding of consumer expectations and experience across all the products and services they offer and the demographics they work with, ensuring that fairness is prioritised across all contexts and circumstances. For the FMA, defining these outcomes provides an opportunity for us to ensure we are focusing our efforts on work that is creating measurable improvements for New Zealanders.

We recognise that outcomes-focused regulation may be challenging for some providers. While it supports flexibility and creativity, it also requires a greater exercise of judgement, and for some, a change in how they approach compliance. However, it is also an opportunity to grow participation and engagement with our financial system, increase efficiency through innovation, and ensure our markets are benefitting all New Zealanders.

Seven fair outcomes for consumers and markets

The seven outcomes represent our view of the experience consumers should have when participating in New Zealand's financial sector and the results we want to see in our broader capital markets. We see fair consumer and market outcomes as essential to the proper functioning of our financial sector.

Our intention is that these collectively capture the key results we want providers to deliver for consumers and markets, and individually are sufficiently distinct to stand alone as the basis for our regulatory discussions and actions.

We have also provided examples to help contextualise the outcomes and demonstrate why we have chosen them. These are intended to highlight both good practices and examples of situations where there may be room for improvement. They are illustrative only and do not cover the full range of situations where that outcome will be relevant.

1 Consumers have access to appropriate products and services that meet their needs

The concepts that underpin this outcome are:

Access refers to the availability of financial products and services that meet diverse consumer needs, including their personal circumstances, preferences, goals, risk tolerance, and values. The need for access may be a driver of market innovations that promote inclusion and increase the diversity of products and services, and consumer experiences.

Appropriateness refers to the suitability to a consumer of a financial product or service through its entire lifecycle. This includes the design, offer and distribution of a product or service, through to post-sale interactions. Suitable sales, advice and review processes that meet the needs of consumers are critical to this. There is also a consumer protection element, for example, having checks and balances to prevent consumers from accessing products and services that are not suitable for them.

Relevant issues and examples

These are illustrative only and do not cover the full range of situations where this outcome will be relevant

- FMA's *Consumer Experience with the Financial Sector Survey 2022* found that Māori communities were more likely to buy into riskier investments such as cryptocurrency, and may have lower trust in the banking sector. This indicates that more needs to be done to improve access to appropriate products and ensure our financial system is accommodating of a te ao Māori worldview to encourage participation.
- Hard-to-reach consumers, such as those who live regionally or have lower levels of technological capability, may find themselves without access to financial products and services that are essential to daily life, like banking. Increasing digitisation can help improve access, but also risks excluding those who do not or cannot use certain forms of technology, so the use of multiple communication channels may assist.
- Some complex financial products, such as derivatives, require a higher level of financial capability and risk tolerance, and may be inappropriate for all consumers. In the FMA's 2020 *Supervision Insights* report we highlighted significant weaknesses in the way derivative issuers assessed customers' knowledge, experience and understanding of derivatives, and noted some of these providers collected insufficient information to support a product suitability assessment.

2 Consumers receive useful information that aids good decisions

The concepts that underpin this outcome are:

Information includes all communications consumers receive, through a variety of channels that influences their decision-making. This relates to both current and prospective consumers.

Useful refers to easily understood and digestible information that is material, accessible, timely and reliable, to support informed decision-making.

Relevant issues and examples

These are illustrative only and do not cover the full range of situations where this outcome will be relevant

- Without access to useful information, consumers risk remaining in products that may no longer be relevant or appropriate for them, such as a KiwiSaver fund that is not aligned with their investing preferences and stage of life. FMA's 2019 report on using behavioural insights to improve KiwiSaver outcomes is an example of how more effective member communications can encourage more active engagement with KiwiSaver by consumers.
- FMA research has demonstrated that retail investors find it difficult to make informed decisions about ethical investing. The FMA's 2022 thematic review of the effectiveness of disclosure practices in managed funds labelled or marketed as sustainable, ethical, or green, found that all funds reviewed had weaknesses in information disclosure, and most had multiple areas where improvement was needed.
- Replacing life insurance policies is a high-risk transaction for customers, because of the possibility of claims being denied in the future and original policy benefits being lost. The FMA's 2018 *Thematic review of insurance replacement business practices* found instances of poor-quality advice, with fewer than half of the firms reviewed advising customers that replacing their life insurance could lead to worse cover or potential loss of benefits, creating considerable doubt that consumers have adequate information to make an informed decision.

3 Consumers receive fair value for money

The concept that underpins this outcome is:

Value for money refers to fairness to consumers in pricing and equity in exchange of value – essentially, the price a consumer pays for a product or service is reasonable in relation to the overall benefits they can expect to receive. Value needs to be considered from many dimensions. For example, low prices do not always mean fair value. While price can be a consideration, it is not the only factor. This concept is also supported by providers' consideration of their products and services in relation to different groups of consumers. Different approaches to different groups can be justified but they must be fair.

Relevant issues and examples

These are illustrative only and do not cover the full range of situations where this outcome will be relevant

- FMA's 2022 *Value for Money Industry Report* for Managed Investment Scheme Managers and KiwiSaver Managers found a prevalence of trail commission costs being embedded within (and thereby increasing) fund fees, typically without an ongoing advice service (or no advice service) to benefit the consumer and with no disclosure of that practice by the fund manager.
- The FMA commissioned research in 2020 into active versus passive management in KiwiSaver and found there was no significant relationship between the level of active management employed by providers and the fees they charge, suggesting use of an active management style is not, as was claimed by industry, a significant driver of higher fund fees.
- The FMA's 2021 *Review of credit card repayment insurance* found it to be a poor-value product for consumers, due to numerous exclusions and prescriptive conditions applied at the time of the claim.

4 Consumers can trust providers to act in their interests

The concepts that underpin this outcome are:

Trusted providers refers to the actions of a provider to safeguard its consumers' assets and data, and be operationally resilient (to keep their promises and avoid disruptions to consumers).

Acting in the consumer's interest includes providers avoiding or effectively managing actual or potential conflicts of interest. For providers, this underscores the importance of not engaging in unfair pressure or tactics or placing undue influence on consumers before, during and after the point of sale.

This outcome is supported by a provider culture that consistently puts the consumer at the centre of decision-making and day-to-day activities, as well as having appropriate disclosure, governance, systems, controls, and financial strength.

Relevant issues and examples

These are illustrative only and do not cover the full range of situations where this outcome will be relevant

- Linking advisers' incentives and remuneration to volume-based sales targets can present a conflict of interest, motivating advisers to act in their own interests rather than those of the customer. In May 2023, the FMA sent a letter to the Chief Executives of New Zealand registered banks following reports some banks had reinstated sales targets, asking them to reflect on staff incentives and how these are aligned with the outcome of fair treatment of consumers. The potential for conflicts of interest has also been highlighted in the FMA's 2018 reviews of *Bank incentive structures*, and *Conflicted remuneration (soft commissions) in the life and health insurance industry*.
- The FMA's June 2022 information sheet on cyber security and operational systems resilience highlights the increasing digitisation of financial services, and the growing prevalence of cyber-attacks, emphasising the importance of having effective resilience and operational systems risk management in place across all parts of the supply chain to safeguard consumers' data and avoid disruptions.

5

Consumers receive quality ongoing care

The concept that underpins this outcome is:

Ongoing care means continuous fairness is provided to consumers after acquiring a financial product or service. Consumers should be able to update, alter, switch or exit a product without encountering unreasonable barriers. It also means that providers take proactive steps to ensure sub-par outcomes are not repeated. Consumers should find it easy to access their providers when things go wrong or they need help, and complaints should be promptly and effectively addressed. It also means recognising when consumers are in vulnerable circumstances and responding appropriately. For insurance products it includes claims assessments that result in fair, timely and effective resolutions for consumers.

Relevant issues and examples

These are illustrative only and do not cover the full range of situations where this outcome will be relevant

- The FMA's 2021 *Insurance conduct and culture: Fire and general insurers update* identified a lack of ongoing monitoring of suitability throughout the product lifecycle. In the majority of cases there was little or no ongoing communication with customers, which can be a cause of recurring poor customer outcomes.
- In September 2023, the FMA and the Commerce Commission published a joint message outlining ways that providers can support customers experiencing financial difficulty. This includes being proactive, training staff to recognise signs of difficulty, and discussing with customers the range of solutions available, with the intent to foster good outcomes. The FMA's customer vulnerability information sheet highlights our expectation that anyone who provides financial services must have business-appropriate support systems for customers in vulnerable circumstances.

6 Markets are trusted based on their integrity and transparency

The concepts that underpin this outcome are:

Integrity refers to providers adhering to high standards of market conduct. Put another way, this means that our markets are well-functioning and work to prevent misconduct and crime. For example this means that market manipulation and insider trading are dealt with; and issues such as frauds and scams, money laundering and the financing of terrorism are tackled. This has significant implications for the reputation of our markets.

Transparency includes the widespread availability and disclosure of corporate and investor information that supports a more efficient market through price discovery and increasing liquidity.

Relevant issues and examples

These are illustrative only and do not cover the full range of situations where this outcome will be relevant

- Insider trading and market manipulation are serious offences that undermine market integrity and erode investor confidence by creating an unfair advantage or deceiving investors. The FMA takes a strong stance against this behaviour and will take enforcement action where misconduct has occurred. For example, following civil pecuniary penalty proceedings brought by the FMA, two individuals were found to have breached market manipulation and disclosure provisions relating to the trading of shares in Oceania Natural Limited, leading to the highest pecuniary penalties to date for these contraventions - $1.33 million and $760k respectively.
- The FMA and RBNZ's 2023 *Governance Thematic Review* highlights that good governance fosters a culture of accountability and transparency. Key principles for good governance include clearly defined roles and responsibilities for the board, robust selection processes and suitability assessments, effective succession planning, sufficient independence and diversity, sufficient capacity to fulfil obligations, effective and appropriate challenge by the board, and a focus on continuous improvement.
- Audit quality is a cornerstone of market integrity and investor confidence. The FMA commissioned research in 2019 on perceptions of audit quality in New Zealand and found that in general, investors had a lack of faith and trust in the audit profession and the quality of auditing in New Zealand, indicating there is more work to be done to ensure the expectations of investors are met.

7 Markets enable sustainable innovation and growth

The concepts that underpin this outcome are:

Innovation includes new market developments, often supported by technology adoption (including the use of AI), that create benefits for participants. For example, such benefits might include increased access to markets or screening out high-risk market participants.

Growth includes the greater availability of capital across the spectrum of investment stages. This includes cost-effective capital-raising that benefits the long-term wealth creation of New Zealanders.

Sustainable includes taking a balanced approach between short-term and long-term gains, and being accountable to current and future consumers for actions that are taken.

Relevant issues and examples

These are illustrative only and do not cover the full range of situations where this outcome will be relevant

- The FMA's exemption power can be used to alleviate regulatory burden, if we are satisfied that granting an exemption is necessary or desirable to promote one or more of the purposes of the FMC Act (including avoiding unnecessary compliance costs and promoting innovation and flexibility in the financial markets), and the relief is not broader than reasonably necessary. One example is a class exemption that enables issuers listed on the Catalist Public Market for small and medium-sized businesses to make 'same-class' offers and small offers of $2 million or less through the market. This provides increased opportunities for capital raising by small companies, enables a greater range of investment opportunities for consumers, and encourages a diversity of financial product markets to meet different needs.
- The *Capital Markets 2029* report, co-sponsored by the FMA, was published in 2019. It sets out a series of visions and ambitions for the industry and the country to identify what success might look like across the capital markets ecosystem and against which future assessments could be made.
- The Fintech Forum run by the New Zealand Council of Financial Regulators provides regulatory support and information for the FinTech sector, with resources aimed at helping those on the innovation journey access the support and guidance they need.

What an outcomes-focused approach means...

For providers

Working towards fair outcomes will mean acting and thinking differently. For some this may be completely new, while for others it will be a continuation of their focus on good customer outcomes following our previous reviews into conduct and culture, and our 2017 publication *A guide to the FMA's view of conduct*. For all, there will need to be a considered approach. While some practices, products and services will not change, it will not be enough to just continue with the status quo. All providers, regardless of size, will need to understand how their governance, leadership, management and operations can deliver the fair outcomes, and where they need to make changes. They will need to keep their approach under review and adapt as circumstances change.

The outcomes set the expectations we have for providers. We want to facilitate an environment of greater flexibility and responsibility in New Zealand's financial markets, by leveraging firms' own drive for productivity and efficiency. Rather than the FMA prescribing in detail how we want firms to operate, we want to understand how firms believe these outcomes are best achieved, which may be through the creation of new ways of working, or new products, services and solutions. Overall, this will benefit consumers, the market and the wider economy.

Over time, our regulatory conversations with firms will be built around the efforts they are making to achieve these outcomes. Providers will need to consider how they monitor and review their progress and how they articulate that to us.

For consumers

An outcomes-focused approach will support New Zealanders to be confident and informed consumers, and help give them a good grasp on how they can expect to engage with the financial system. While people may not always be familiar with rules, everyone will have an intuitive sense of what 'fair' is and whether they have been treated in line with this.

Consumers should receive useful information from providers that gives them a strong understanding of potential benefits and possible risks of a financial product or service, and tells them what to expect from their provider and the market. This should empower them to make choices, raise issues or make complaints when necessary. We expect that over time consumers will gain greater confidence in their interactions with providers of financial products and services.

Consumers and consumer advocate groups have a role to play in sharing their experiences, advocating for positive outcomes, knowing what good looks like in their providers, and helping to support the end results being achieved. Our approach should help consumers feel empowered to act if they have been treated unfairly. To be successful, providers must implement an outcomes-focused approach in a way that is accessible to different consumer groups.

For the FMA

These outcomes will guide the FMA's approach to exercising its regulatory powers and responsibilities, including our approach to monitoring and supervision. It will require a mindset change to the way we act.

These outcomes will be the starting point for decision-making at the FMA. In particular, for our supervisory approach, we will use them as the basis for how we frame our discussions with and assessments of providers.

We recognise that this requires a more sophisticated dialogue with providers. We will be interested in everything that firms are doing to achieve these outcomes. We will work to understand firms' viewpoints, the key risks or constraints, and the journey they are undertaking as they deliver these outcomes.

To support the delivery of this regulatory approach, we will make use of our full range of tools, including engagement, influence and advocacy. We will be proportionate and deliberate, which will be reflected in our supervisory and enforcement culture. Where we see unfair outcomes, we will consider the best use of our toolkit to respond.

Our monitoring activities will focus on whether we are seeing these outcomes in the market. This will inform our conversations with providers to help them understand whether they are on track. We plan to communicate to firms their level of conduct maturity on an ongoing basis, so they know if they have more work to do.

Whether or not fair outcomes are being achieved will also inform our conversations with the government and other regulators if we identify places where law reform may be required.

For the economy

We consider that an outcomes-focused approach will encourage more engagement and dynamism in our financial markets – supporting an economy that New Zealanders have confidence to invest in, and is attractive to overseas capital, new ideas, and innovation. A focus on the fair outcomes and new ways of thinking required to support them should create more choice for consumers, and more competition and innovation in our financial markets, products and services. It will create a culture and environment for doing business in which people want to participate.

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