



Aligning CoFI and ESG

Conduct of Financial Institutions
Environmental, Social and Governance



Banks are thinking hard about their role in achieving impact. The sector is starting to get real about the role that they play in taking responsibility for their own Environmental, Social and Governance impacts as well as the role they have in influencing change in others, facilitating the deployment of capital to have real impact on New Zealand's environmental and social challenges.

Practically the industry is engaged in some of the immediate priorities facing them in this area; building sustainability centres of excellence, responding to RBNZ stress tests, preparing for climate-related disclosures, developing and executing overall ESG strategies, measuring scope three emissions and identifying particularly climate-related risks and opportunities to inform their adaptation strategies. Shortly they will have to start preparing for other more socially focused regulatory imperatives on the New Zealand horizon such as the newly released modern slavery legislation.

But as climate-related focus progresses, other parts of our banks are busy preparing for another piece of legislation where perhaps the connection to sustainability is less obvious; The Financial Markets (Conduct of Institutions) Amendment Act 2022 (CoFI). While we don't have mandatory reporting of social capital, risks and opportunities there is a substantial overlap between the 'S' in ESG and the social outcomes in CoFI and it is absolutely worth the investment to use the opportunity that is CoFI to really think about how social outcomes are embedded in your strategy, operationalised within your operating model and how they are prioritised in the day-to-day activities of the bank and their impact on customers and wider society.

Social regulation?

CoFI is not a specific piece of ESG or social regulation – like those that are being developed in the rest of the world – and nor should it be. It's our foundational piece of legislation that sets the standard for a focus on driving fair outcomes for customers. Social regulation is still some way away for the New Zealand market, but eventually there might be requirements to disclose your activities that have socially sustainable outcomes in the same way that we are preparing to disclose our environmental impacts. Or more prescriptively, we might get to the point of setting the standard for what constitutes a social undertaking and limiting that to those entities that have social objectives beyond profit. The recent work of the RBNZ around Māori access to capital is an important piece of work for New Zealand's social outcomes.

To achieve social impact successfully, in the same way that we are raising our expectations around environmental impact, would require an objective classification and criteria for what is a social outcome (i.e. social taxonomy and the development of social taxonomy is progressing globally). For example, in jurisdictions such as the EU there has been substantial work done in this space, but progress is slow and

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still a long way behind the environmental taxonomy. However, that doesn't mean that social outcomes and the related UN sustainable development goals are any less important. Social outcomes are rapidly gaining prominence, particularly in a post-Covid-19 world. For example, these can include the following types of topics: access and affordability, data security, customer privacy, rising poverty levels, gender equality, hunger, health, financial literacy, financial inclusion, trust and transparency, reducing inequality, conduct and ethics, well-being and resilience. This is just to name a few in a fast-expanding list.

Where are the overlaps?

One of the challenges around social impact is the wide variety of topics that it includes. Let's focus in really specifically on some of the topics where there is a shared priority with the objectives of CoFI. In our view those are:

- **Product design, quality and safety:**

When designing products and services under the CoFI regime you must ensure you meet your customers' requirements and needs. You will also need to monitor whether the product is operating as intended throughout the lifecycle of the product.

- **Customer welfare:** The central principle of CoFI is to treat customers fairly. You will need to implement a fair conduct programme that ensures delivery of the principle and will mean customers are at the centre of your decision making. The Financial Markets Authority (FMA) has been clear that consumers should have trust and confidence in their banks and their products.

- **Selling practices and product disclosure:**

Banks are required to comply with regulations that ban volume and value-based sales incentives. Your customers must not be subjected to unethical sales practices such as undue pressure. Banks must also assist customers to make informed decisions.

- **Data and privacy issues:** The FMA have articulated that they view technology incidents and technology resiliency of systems that deliver for the customer, as being fundamental to good customer outcomes, i.e. instead of viewing technological failure of these systems as an operational risk to the bank, they are viewing them as an outward facing social risk for customer outcomes.

- **Marketing communication and disclosure:**

Banks must apply their fair conduct programme to their marketing and disclosures, ensuring they act ethically, transparently and in good faith to ensure customers are making informed decisions.

- **Vulnerability and reducing inequality:**

Circumstances arise for customers which can make them vulnerable, create disadvantage or inequality and exercising particular care and support for those customers is key. Banks must have regard for customers in vulnerable circumstances when complying with the fair conduct principle.

As the bank is building its response to these areas of the CoFI legislation and lifting the quality of its related processes, policies and activities there, is therefore, huge potential to have real social impact and a responsibility to respond to those social outcomes proactively and to get those outcomes right for the good of its customers and society as a whole.



You have to build social capital in order to have a social licence to operate. Both CoFI and social impact need to be transformational. Expectations of customers of their banks to deliver corporate responsibility has never been greater.

Why does this overlap matter?

Just as ESG is becoming a strategic imperative for banks, responding to the various facets of 'E', 'S' and 'G' can't be done in isolation from the rest of the strategy if we want to embed change, but also if we want to respond to change efficiently rather than in siloes.

The FMA has made their expectations clear around CoFI; they are expecting a demonstrable change in our banks. Our 2022 [Customer Experience Excellence survey](#) makes it clear that customers are increasingly wanting to deal with businesses that have a social purpose and are making a real impact. Society as a whole is making our expectations even clearer; you have to build social capital in order to have a social licence to operate. Both CoFI and social impact need to be transformational. Expectations of customers of their banks to deliver corporate responsibility has never been greater, but our customers don't expect us to be meeting our regulatory obligations in isolation from our societal responsibilities. Joining up CoFI and social impact is the right thing to do.

- It allows the best minds to collaboratively work on putting customers' outcomes and social capital first.
- It aligns strategic imperatives around ESG and the customer. This helps them to start moving in the same direction at the same time.
- It makes the best use of scarce resources to meet multiple objectives, avoid double ups and drive greater impact.
- It will allow you to start the process of gaining a better understanding of what your social objectives are – and drive an integrated approach to those.
- It sets the standard for integrating individual pieces of social legislation (e.g. health and safety, Modern Slavery etc) with our overall social objectives and ESG strategy.

Overall it creates an aligned foundation of thinking in this space which will set the banking sector up well to do the deeper thinking, influencing and shaping that will be needed to help achieve real societal change in New Zealand and to prepare for the social regulation that will inevitably eventually accompany that.

Where should I start?

It's tempting when you have a firm regulatory deadline such as CoFI to just do what you need to do in order to achieve that specific outcome, but that route only meets one narrow objective. We suggest banks start by bringing together the people that matter in this space, your customer team, your outcomes and conduct team, and importantly your impact or sustainability team. You need to be able to start from a foundation of shared strategic understanding and respond to the strategic objectives you have set yourself both around customer and social impact.

A good place to start this process would be from an outside perspective. From a CoFI perspective your organisation needs to have a shared understanding of what 'fair' treatment means for you and your customers. Your fair conduct programme will eventually be built to explain how you are achieving this. Asking your customers what 'fair' means to them will likely also gain you significant insight into your customers' social expectations of your business.



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Secondly, aim to have a shared understanding of what your goals, commitments, objectives, and priorities are for both your sustainability and impact team and your conduct and customer outcomes team. Building a shared understanding will help you to be conscious of meeting both objectives in everything that you do and will allow you to align and share insight in both of these teams.

Your learnings from this work should form the foundation for a conversation with all the multiple stakeholders across the bank that need to achieve both fair outcomes and social responsibility. Your goal is aligning your strategy in these areas, both to achieve your long-term ambitions as a business, but also to meet and align your short-term commitments and obligations in both spaces. As your strategies align so too will your need to align your operating models, frameworks, policies and processes that support these.

Both CoFI and social impact create a real opportunity for strategic change across the full product and customer lifecycle. Taking the time and responsibility to invest in both will enable you to meet your own business growth ambition and the social expectations of your customers.



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