SUBMISSION ON

FINANCIAL MARKETS (CONDUCT OF INSTITUTIONS) AMENDMENT BILL

TO FINANCE & EXPENDITURE COMMITTEE

PARLIAMENT BUILDINGS

NOTE: Financial Advice New Zealand is the largest professional body for New Zealand financial advisers which represents the interests of over 1,680 AFA and RFA members.

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General Position on Financial Markets (Conduct of Institutions) Amendment Bill

1. Financial Advice New Zealand supports legislative change that requires financial institutions to prioritise customers' interests and ensures they are treated fairly; from the early design of products and services, their initial and continuing offers of services and products, through to consumer interactions such as in the claims process and complaints process. Overall, we support legislation that improves customers' access to quality products and services and advice on them.

2. The bill is designed to improve the services and products provided to consumers by banks, insurers, non-bank deposit takers, advisers and brokers.

3. We strongly support making institutions and intermediaries (with the express exclusion of Financial Advisers under FSLAA) subject to the Financial Markets Conduct Act's compliance and enforcement tools, making financial institutions display their fair conduct programme to the public, and giving protection to whistle-blowers.

4. However, there are some areas in the bill which are confusing and require further clarification and, other areas which provide unnecessary powers which could have a devasting impact on the sector and New Zealanders to access quality financial advice. We therefore suggest the changes below and additional drafting to strengthen the bill to ensure the outcomes listed above.

5. When considering this bill, we believe due to significant environmental changes in particular COVID-19 the timing of this legislation would place significant pressure on the financial services sector. The sector should be focussing on supporting consumers in this time of economic stress and not on additional legislative and regulative requirements. We believe this bill should be placed on hold for the foreseeable future.

Summary of Recommendations

6. Legislative Oversight Incentives - The bill contains a power to regulate sales incentives (based on volume and soft incentives) for some products and we do not believe there is evidence of harm or systemic failure for this power to be utilised. However, the bill goes much further by giving wide ranging powers to the regulator to determine commercial arrangements for remuneration in licensing conditions– this is a significant power which could have **devasting effects** on the sector if there is not adequate legislative oversight. To allocate these powers to regulations and licensing we believe is dangerous and could destroy the advice sector and New Zealanders access to financial advice and increase the massive underinsurance issue which currently exists. This section should be removed from the bill.

7. Definition of Fair – The bill has no definition of fair. A definition of the term fair be included in the bill to ensure consumers have a clear understanding of its intent.

8. Exclusion of Financial Advisers (under FSLAA) –The drafting is confusing as to whether financial advisers are included in the fair conduct programmes or not. We recommend clarification that financial advisers under Financial Advice Providers, are expressly excluded from the financial institution's compliance with the fair conduct programmes.

9. Definition of Intermediary - The definition of intermediary is confusing and appears to include financial advisers which operate under FSLAA. Clarification is required in the bill to ensure any financial adviser providing regulated financial advice under a FAP is excluded from the bill.

10. Intermediary abides by multiple fair conduct providers and programmes- If an intermediary has numerous product providers, the compliance across all the 'fair conduct programmes may limit the range of providers which are represented by the intermediary thereby changing the advice landscape and the range of products a consumer can be recommended when receiving advice. This section is unworkable and should be removed from the bill.

11. Claims process - An adviser assisting or advocating on behalf of a client (particularly relating to a claim process) will be included in the 'fair conduct programme' as this is outside of the advice process – this is when an adviser needs to be the most independent. An adviser advocating on behalf of a client, particularly relating to a claim process, ought to be expressly excluded from the 'fair conduct programme' so as to maintain the adviser's independence from the product provider, and recognising the financial institution's claims process is outside of the FAP and adviser's advice process. The claims process needs to be excluded from the bill.

12. The bill potentially is unenforceable – this will have to be considered in detail in the select committee process as if it's not enforceable then it is not relevant.

13. Timeliness – the timeliness of the legislation is paramount to not over stress a sector already facing significant change. We recommend the bill not be enforced until FSLAA has had time to settle and any unintended consequences are recognised.

Commentary & Recommendations

Incentives (Duties relating to incentive regulations 446N, 446O,446P)

14. The bill contains a power to regulate incentives (based on volume and soft incentives) for financial products.

15. However, the bill goes much further by giving wide ranging powers to the regulator to determine the commercial arrangements for remuneration via licensing conditions.

16. We do not believe there is evidence of harm or systemic failure to justify the use of this regulatory power over commercial arrangements for remuneration.

17. The current commissions model has been reviewed by the Minister of Commerce, officials, and the sector in the past year, and all have agreed it is viable system of remuneration for financial advisers with no evidence that standard commission rates have led to systemic failure in the sector or poor customer outcomes.

18. The payment of commissions, as a form of remuneration to financial advisers, is a commercial decision between the parties. To regulate these this will severely interfere with the distribution of product and the market.

19. Commissions maintain a sustainable business model for product providers and financial advisers, with the effect that advisers can provide advice to clients without the client having to make payment of advice service fees. We believe this increases the number of consumers who seek advice. Given there is no evidence of systemic failure in the current structure we hold there is no case for regulation of commissions which could led to significant reduction in product coverage, as seen recently in Australia.

20. The powers for the ability to change commissions are far too wide – to allocate powers to the regulator which can change a whole sectors remuneration structure without proper and effective legislative oversight is highly dangerous and could have **devasting and unintended effects** on the sector.

21. These powers need to have legislative oversight and robust evidence-based processes. A small change could remove the financial adviser model from the sector.

22. Recommendation: That the regulatory powers in relation to incentives and remunerations be removed from regulative making powers.

Definition of 'fair'

23. ***Clause 9*** *– inserts new subpart 6A into Part 6 of the Financial Markets Conduct Act 2013*

24. Subpart 6A establishes a new 'fair conduct principle' for the conduct of financial institutions. The definition of the 'fair conduct principle' in this bill is rather circular and unhelpful, viz 446B:

25. "The fair conduct principle is that a financial institution (and an intermediary) must treat consumers fairly, including by paying due regard to their interests" 446B

26. This 'fair conduct principle' is a key part of the legislation. To be silent on the definition of fair is confusing for the consumer if they think they have been treated unfairly. This bill's aim is to provide better outcomes for consumer therefore the pivotal concept of fair must be defined in the body of the bill itself. The alterative would be to have this defined in regulations instead of the body of the bill which is not consumer friendly and it is difficult to locate for an average consumer.

27. Consumers will be subject to both the conduct provisions of both this bill and FSLAA and we therefore recommend that the definition of 'fair' ought to be consistent between the two. For example, is it the intent of the Select Committee to require financial institutions to prioritise consumers' interest, such as required by Financial Advice Providers under the FSLA Act Section 431K or stay with the vague concept of paying 'due regard' to consumers interests?

28. The Code of Professional Conduct for Financial Advice Services, Code Standard One – Treat Clients Fairly, explains in detail what 'fair' entails. Albeit the Code has a different audience to the bill, such commentary is very useful. Being 'fair' in the Code includes concepts such as timely, clear and effective communication, not taking advantage of the clients' lack of financial knowledge or other vulnerabilities, considering the clients concerns and preferences, treating clients with respect.

29. The Select Committee must take the time to determine what the concept of 'fair' means in the context of conduct of the financial institution. This definition underpins the legislation and ensures the Select Committee's intent is drafted correctly.

30. Recommendation: This significant piece of legislation ought to define what 'fair' means in a manner consistent with expected consumer outcomes in recent legislation, and consistent with the sector's understanding of the term within the Code of Professional Conduct for Financial Advice Services.

Financial Advice Providers and financial advisers (446K, 446L, 446E)

31. The drafting of the bill is very confusing around how it refers to those that give regulated financial advice in relation to the 'provision of a relevant service or an associated product'. We believe the intention of the bill is to exclude financial advisers that provide regulated financial advice on behalf of a Financial Advice Provider (FAP). This intent is not currently achieved in the bill.

32. FAPs under FSLA Act are the entities that give regulated financial advice. Individual financial advisers give advice on behalf of the FAP. From 31 March 2021 under the licensing provision of FSLA Act, both FAPs and financial advisers are inextricably linked. All financial advisers must operate under a FAP (transitional) licence to provide financial advice on behalf of the FAP.

33. Under section 446L of the bill FAPs are carved out from the compliance requirements of financial institutions, viz:

    446K Duty to ensure intermediaries comply with fair conduct programme

    446L Duty to ensure intermediary's compliance does not apply in relation to financial advice providers or other financial institutions

34. Despite section 446K, a financial institution does not have a duty under that section in relation to an intermediary that is—

    (a) a financial advice provider (but see section 403(4)(e), which allows conditions to be imposed on a provider's licence relating to its involvement in the provision of relevant services or associated products regardless of whether the provider gives financial advice).

35. However most, if not all, financial advisers under a FAP licensee, are caught under the definition of intermediary under section 446E (1) (a) and (b).

36. Under (1) (a) many advisers are paid or provided a commission many are then caught under the definition of an intermediary under section 446E, viz

    446E Meaning of intermediary:

    (1) In this Act, a person is an intermediary if—

    (a) the person is involved in the provision of a relevant service or an associated product to a consumer (see subsections (3) and (4)); and

    (b) the person is paid or provided a commission or other consideration in connection with that involvement; and

37. Also under clause 446E (1) (b) above, and read in conjunction with clause 446E (3) (c) below, all financial advisers would be captured as an intermediary and 'involved in the provision of a relevant service' by virtue of giving financial advice on behalf of their FAP.

38. 446E (3) "in this subpart, a person is **involved** in the provision of a relevant service or associated product if the persons does any 1 or more of the following:

    (c) gives regulated financial advice in relation to a product:"

39. The unintended consequence of this drafting is financial institutions may consider they have compliance obligation towards advisers in their intermediary channels, specifically compliance around adviser duties, conduct and client care, and adviser skill and diligence.

40. We hold that financial institutions should definitely not be required to include financial advisers in their fair conduct programmes. We believe the bill ought to expressly list financial advisers as exempted in clause 446L.

41. **Recommendation: Clause 446L ought to include the additional words:**

"446L Duty to ensure intermediary's compliance does not apply in relation to financial advice providers or other financial institutions

Despite section 446K, a financial institution does not have a duty under that section in relation to an intermediary that is—

(a) a financial advice provider and <u>all the financial advisers that operate under their licence</u>.

Intermediary has numerous providers

42. In the case where an intermediary, who provides advice on products from more than one provider, there could be the obligation to abide by numerous 'Fair Conduct Programmes'.

43. The compliance requirements of providing advice on products from more than one provider could be considerable which could lead to the unintended consequence of advisers limiting their range of product providers. The removal of consumer choice may be detrimental to the customer.

44. **Recommendation: This is an unworkable clause for intermediaries with multiple product providers and this requirement ought to be removed.**

Claims process

45. An adviser's role is to assist the client navigate the claims process if required. This type of client assistance and advocacy is often provided, highly valued by the client, but is outside of the advice process therefore would be included in the scope of this bill.

46. It appears if an adviser was to advocate for a client in the claim process they would not be excluded from the bill and be required to adhere to the providers 'fair conduct principle' and 'fair conduct programme'.

47. At the point of a claim it is fundamentally important for the adviser remain independent of the provider, and advocate on behalf of their client.

48. **Recommendation: That an exclusion for the claims process be provided in the bill for FAPs and their financial advisers.**

Enforceability of the Legislation

49. The Cabinet paper 'Conduct of Financial Institutions: Introduction of a New Conduct Regime' published on 25 September refers to the 'high-level standard' (point 6) and 'high-level fair treatment standard' (point 8). As identified in the Cabinet Paper the high-level fair treatment standard may not prove sufficient clarity to be directly enforceable – therefore empowering the regulations and conditions to be the enforcing vehicle.

50. Legislation in its own right should have sufficient clarity to be enforceable – otherwise what is the point.

51. Recommendation: That the bill is drafted in such a manner that conduct principles are defined and enforcement measures are drafted - similar to the manner of defining standards under the Code of Professional Conduct for Financial Advice Services and enforcement to those standards under Section 431 of the Financial Services Legislation Amendment Act.

Date of Introduction of Legislation

52. The bill allows for it to come into force no later than 2 years after the date of the Royal assent.

53. Currently, the financial advice services sector is responding to COVID-19 and the requirements of the transitional licensing (commences 31 March 2021), thereafter the full licensing requirements, adapting and complying with the Code of Professional Conduct and legislative obligations on all those that give regulated financial advice. This legislative change brings a disruptive change that significantly alters how advice is delivered and its business configurations especially to advice intermediaries.

54. These changes entail a huge investment in time, human resources and money - not only from Financial Advice Providers and their financial advisers - but also from the product providers and financial institutions who are supporting their intermediary channels.

55. All participants in the financial services eco system should be focused on supporting consumers during these incredibly stressful times and not focussed on new legislative and regulative requirements.

56. On top of COVID-19 having the FSLA Act and CoFI implemented in proximity would be extremely hard for the financial advice industry to absorb.

57. Recommendation: That this bill is suspended for the foreseeable future. In addition to this that there is a 'settling space' of a minimum of two years between start of the licenced regime under FSLA Act (31 March 2021) and the implementation date of CoFI.