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Thursday 30 April 2020

Committee Secretariat
Finance and Expenditure Committee
Parliament Buildings
Wellington
New Zealand

Submission: Financial Markets (Conduct of Institutions) Amendment Bill

This submission to the Finance and Expenditure Committee on the Financial Markets (Conduct of institutions) Amendment Bill (the Bill) is from the Financial Services Council of New Zealand Incorporated (FSC).

We wish to appear before the committee to speak to our submission, being represented by:

- Richard Klipin, CEO, Financial Services Council
- A staff member or member of the Financial Services Council (to be confirmed)

The FSC is a non-profit member organisation and the voice of the financial services sector in New Zealand. Our 64 members comprise 95% of the life insurance market in New Zealand and manage funds of more than $89bn. Members include the major insurers in life, disability and income insurance, fund managers, KiwiSaver and workplace savings schemes (including restricted schemes), professional service providers, and technology providers to the financial services sector.

Our submission has been developed through consultation with FSC members and represents the views of our members and our industry. We acknowledge the time and input of our members in contributing to this submission.

This submission was prepared prior to and during the escalation of the Coronavirus disease 2019 (Covid-19) pandemic. While grateful for the extension for submissions, the focus of many FSC members has needed to remain on Covid-19 response during this period. In line with correspondence to Minister Faafoi dated 18 March 2020, and ongoing conversations with the regulators over the past month, we recommend that the Bill is postponed. A new timetable needs to be developed when Covid-19 is controlled, there is better understanding of its financial consequences and following the commencement of the new financial advice regime in early 2021. This would allow businesses to focus on supporting customers during a period of economic uncertainty and when the financial advice regime is fully embedded before this further overlapping regime is implemented.

The FSC's guiding vision is to be the voice of New Zealand's financial services industry and we strongly support initiatives that are designed to deliver:

- strong and sustainable customer outcomes
- sustainability of the financial services sector
- increasing professionalism and trust of the industry.

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We welcome the opportunity to provide feedback on the Bill and are supportive of the introduction of legislated conduct requirements in the future. This Bill reinforces the growing focus on good outcomes for consumers and effective systems and controls to identify, manage and remedy conduct issues are fundamental to achieve this.

We acknowledge, as with other industries, there are issues of poor conduct in the financial services industry however we would like to highlight the commitment of our members to treating their customers fairly and, through their participation in the FSC, have developed the FSC Code of Conduct with the purpose of:

- Lifting the professionalism of the financial services industry
- Helping members to deliver good customer outcomes
- Increasing trust and confidence in the financial services industry
- Enabling more New Zealanders to build, manage and protect their wealth
- Building a sustainable financial services industry.

We understand the significant time constraints imposed during the preparation of this Bill. Despite good intent, there is widespread concern amongst our members regarding the haste at which this Bill is being rushed through Parliament:

- It has not been well thought through and sufficiently consulted on
- A number of important aspects of the Bill lack detail and clarity
- An over reliance on regulation making power which would only become apparent following the passing of the Bill
- There are some areas where it duplicates or potentially conflicts with existing legislation
- There are unintended consequences at a time of great economic uncertainty
- General concerns on the complexity and inequity the Bill represents in its current form
- It may not achieve all the desired outcomes

We are concerned that there are now many existing licencing regimes in the industry and creating yet another one is disruptive and costly. The objectives of a conduct licensing regime could leverage off the existing regulation delivering the same result with less complexity.

The FSC has a continued message to Government and officials on the importance of ensuring the alignment of new regimes and legislative amendment with existing legislation of comparable principles. In this instance the Credit Contracts and Consumer Finance Act (CCCFA), Financial Markets Conduct Act (FMCA), Financial Services Legislation Amendment Act (FSLAA) and the Fair Trading Amendment Bill which is also at Select Committee stage.

This submission contains key recommendations that will go some way to strengthen the final form of the Bill and we expand on these recommendations below including an appendix with proposed amendments. We strongly encourage continued consultation following the passing of the Bill, even if the Bill is narrowed in scope initially, to ensure carefully considered and workable solutions are developed over time rather than through regulation.

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I can be contacted on 021 0233 5414 or richard.klipin@fsc.org.nz to discuss any element of our submission.

Yours sincerely

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Chief Executive Officer

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1. Licencing

Those who are captured by the Bill are already highly regulated and will, in a lot of cases, already hold FMCA licences. As the obligation to have a conduct licence is based on the entity type rather than the activity or service being performed by the entity (for example insurance product manufacturers and financial advice providers) certain aspects of a financial institution's conduct will be subject to more than one FMCA licence, both of which relate to conduct. This is problematic as the duplication creates unnecessary complexity and inconsistencies in the regulatory framework for financial service providers.

There is considerable overlap between the new requirements and current provisions in the FMCA, but obligations are expressed differently which could lead to duplication and coexisting obligations which could be disruptive and costly. For example, the new fair conduct principle and the obligation to treat scheme participants equitably (s143 of the FMCA) have similar effect. It would be efficient if they were expressed in the same way to avoid duplication.

There are now many existing licencing regimes in the industry without introducing the complexity, expense and disruption of an additional licensing regime when the objectives of this conduct licensing regime could be incorporated into or amendments made to existing licences. We encourage further consultation on approaches to streamlining licensing across the industry so as to avoid unnecessary licence process duplication. In addition, further consideration is required to ensure all regulators are required to share information so that conduct licensing is as efficient as possible.

<u>Scope of who it covers (s446D)</u>

The FSC membership is made up of a variety of entities providing a variety of services. Therefore, there are differing views on this section with some opposed to widening the scope and some supporting widening the scope. Those not captured by the Bill are also subject to extensive regulation and compliance and as such it is their view that they should continue to remain out of scope.

The proposed scope may also result in different conduct outcomes for consumers and an uneven playing field for market competitors. For example, KiwiSaver products provided by a bank (or its subsidiary) may be in scope for licensing but KiwiSaver provided by a fund manager is not, however it is recognised that with differing business models it is not possible to apply the same licensing regime for both. Differing structures (group and subsidiaries) may also capture some and not others creating further competitor disparity.

<u>Services and products (s446F)</u>

As with licencing scope, what services and products that are intended to be captured is also not clear in respect of the reference to 'relevant service or any associated product' in section 446C.

There are often multiple entities involved in the product life cycle, for example, a financial institution may undertake some but not all aspects of designing, offering and servicing a product. This makes the scope confusing. Further difficulties have been identified in relation to products which have been white labelled which may potentially result in two financial institutions being subject to the conduct obligations which is confusing for a customer. An example of this is an insurance product manufactured by an insurer which is sold by a bank (noting that the clause 446J carve out only

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applies in respect of A's role as an intermediary not in its role in other aspects under section 446C(1)).

It would be clearer if the fair conduct principle applied to products and services where the financial institution is the entity responsible for the legal obligations under the product or service contract instead of applying to 'relevant service' and 'any associated product', particularly given many of the products and services potentially captured by these broad definitions are already subject to their own regulatory regimes which contain their own conduct obligations, for example FMCA (in respect of managed funds) and CCCFA (in respect of lending products).

There is also a risk that the compliance burden may deter financial institutions from broadening their range of products resulting in reduced accessibility for consumers.

2. Fair conduct programme (sections 446G and 446H)

Available to the public (s446H)

The duty to make the fair conduct programme (the Programme), and all material changes to the Programme, available to the public is a duty that poses many challenges to our members. We do not consider that this will meet the intent behind the legislation, which is to improve conduct and reduce the risk of harm to consumers.

Due to the content requirements of a Programme, it is expected to be an extensive and detailed document which would be difficult for customers to understand. The document would inevitably contain commercially sensitive information. In order to make it publicly available, such information would need to be redacted or simplified which may water down its content. There is also the risk of industry templates, organisations outsourcing for Programmes to be completed which are too generic, and that financial institutions may replicate other financial institutions' Programmes resulting in little differentiation.

Whilst the overall intention of public disclosure of a Programme is to have information available to consumers so that they are able to have a more informed understanding of how they will and should be treated, these risks and pressures of having their Programme in the public domain may result in all Programmes ending up being largely similar or generic documents.

We also question the value of a publicly available Programme for customers when they already receive extensive disclosures including product disclosure statements, policy terms and product documents and additional non-product specific information In addition to being extensive and detailed, Programmes are likely to be a technical and operational document. The addition of a Programme may detract from the importance of some of these existing documents. Industry experience also shows that consumers tend not to access information that is available to them such that the benefit of public disclosure is likely to be marginal at best.

We recommend that Programmes are provided solely to the FMA.

Intermediary Compliance with Programmes

There are concerns for intermediaries who distribute the products of multiple providers and will therefore need to comply with multiple Programmes. This could result in the unintended consequence of intermediaries reducing their product offering to ensure ease of ongoing compliance

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or preferring to become effectively tied agents of a single product manufacturer (at least for each class of product), reducing the independence of their advice which is not in the best interests of consumers.

Those intermediaries that are licenced to provide financial advice should be excluded from having to comply with Programmes of financial institutions. A preferred approach was set out in paragraphs 53 to 58 of the Cabinet Paper, to wait and see how effective the FSLAA regime is before deciding if it is necessary for FAPs to come under the proposed conduct regime. In the interim, there could be obligations on the financial institution to provide product training to FAP intermediaries and to take action if they become aware of any misconduct by a FAP intermediary and reporting such conduct to the FMA.

3. Intermediaries (s446I and s446K)

There are uncertainties on what oversight of an intermediary by a financial institution will look like, the scope of the "reasonable steps" referred to under section 446K(1) and/or whether this is what is intended to be prescribed under section 446K(2). Whilst it is understood that the intermediary will be required to be trained by the institution on the product or products they are distributing, what is not clear is the range of obligations beyond training such as sales tools and materials and resourcing a quality assurance program for example and how extensive this would be required to be. It is also unclear in practical terms the powers a financial institution will have to "ensure" compliance.

There is also the possibility that intermediaries may favour one or some financial institutions over others according to ease of interactions and perhaps even favouring minimal oversight (in addition to avoiding compliance with possibly multiple Programmes as outlined above).

The definition of an intermediary is also too wide and could include unintended activities of FSPs. One possible option is to amend section 446E(3)(d) which is preferable to relying on occupations and activities being prescribed under section 446E(4) as the list of these could be endless where the focus needs to be on distributors. We recommend that further detail on what is out of scope would be more helpful.

4. Incentives

Generally, there is an overreliance in the Bill on regulation making powers leaving considerable uncertainly on the final shape of the regime and the potential to impose significant additional obligations on financial institutions in the future.

The ability for regulations to prohibit incentives based on volume or value sales opens up the ability for incentives to be limited or taken as far as a complete ban despite the Government's stated policy intention. We note the Cabinet Paper focused on a ban on volume and sales targets and yet the Bill is not reflective of that position and is potentially much wider. We understand and support discouraging poor sales conduct, however by imposing blanket incentive bans or limits the market will experience a reduction in sales activity which is contrary to policy intent. This is evidenced in the market following the FMA's Bank Incentives Report recommendations and the inequity we can now see between banks (including their fund manager businesses) and non-banks. There is a risk of an

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intermediary or adviser transitioning to a product provider that is not captured by the Bill so that incentives based on sales targets can be obtained.

Further regulation making power to impose conditions in licences relating to incentives compounds the lack of clarity in this area. The impact on the access to insurance and advice needs to be considered further in the New Zealand context and we suggest that research needs to be undertaken into potential impacts on consumer access and the uptake of products. In addition, such a wide definition of incentives is unworkable when there are constructive incentive based sales incentives that can and do operate fairly. We recommend a constructive approach to incentives, encouraging structures that are responsible (to align with s431R(4) of the FMCA. We also consider that absolute clarity is needed with regard to what is required given the huge impact these may have on the market.

5. Implementation timeframes and review period

The financial services industry is currently experiencing an unprecedented period of regulatory change at a time of economic instability and a widely predicted recession as a result of Covid-19. We note that the RBNZ has deferred its reform programmes for six months in light of the current situation[1]. We recommend that the Bill is postponed, and a new timetable developed when Covid-19 is controlled, allowing businesses a respite to focus on customer delivery.

Separately but related, the Government needs to give due consideration to the commencement of FSLAA (in early 2021 due to Covid-19) which represents a significant and positive change to the regulation of financial advice and should be allowed to fully embed before a further overlapping regime is implemented. We consider that the implementation of FSLAA and an active, fully resourced regulator, will go some way to address the issues identified in the Conduct and Culture Review. We therefore recommend a realistic time for implementation after consultation with the industry, and promulgation of the regulations as soon as possible to assist with practical considerations and scope.

We also request that a five (5) year review clause is added to the Bill as was included the Financial Advisers Act, to ensure that an evaluation can be made when all the legislative instruments are in place.

[1] ***https://www.rbnz.govt.nz/news/2020/03/regulatory-relief-to-provide-headroom-for-customer-focus-and-risk-management***

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Appendix: Proposed Amendments to the Financial Markets (Conduct of Institutions) Amendment Bill

Legislative Provision	Current Wording	Drafting Issues	Proposed Solution
446E(3)	*In this subpart, a person is **involved** in the provision of a relevant service or an associated product if the person does any 1 or more of the following:* *(a) negotiates, solicits, or procures a contract for the service or the acquisition of the product:* *(b) carries out other services that are preparatory to that contract being entered into:* *(c) gives regulated financial advice in relation to the product:* *(d) assists in administering or performing the service or the terms or conditions of the associated product*	The definition of **involved** is too wide and may include those who provide advisory services to financial institutions such as loss adjusters and medical assessors.	1. Amend s446E(1)(a) as follows: *(a) The person distributes a product issued by a Financial Institution* 2. Replace 446E(3) with the definition of "distributes" being "recommending or otherwise facilitating the acquisition of a financial product"
446I(3)	*A financial institution or intermediary contravenes this section even if a failure to comply relates only to 1 consumer*	There are concerns that this will lead to overwhelming burden for FMA to enforce. If every individual consumer breach results in a contravention even where breach is remedied and no harm results it becomes very difficult for the FMA to enforce.	We recommend removing this subsection. Exercise of powers should be proportionate to the customer detriment and provider response, taking into account remediation. The enforcement action and penalties should reflect whether there are processes in place to identify and fix issues, and whether issues are remediated. On the contrary, if

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			an organisation did not identify an issue or fix it appropriately, the enforcement and penalties should be more robust.
446P	*(1) In this Act, incentive, in relation to a relevant service or any associated product, means a commission, benefit, or other incentive (whether monetary or non-monetary and whether direct or indirect) that is offered or given to a person (A) if—* *(a) the commission, benefit, or other incentive is offered or given to A in connection with A (directly or indirectly) being involved in the provision of the service or the products; and* *(b) A's entitlement to the commission, benefit, or other incentive, or the nature or value of the commission, benefit, or other incentive, is determined or calculated in any way by reference (directly or indirectly) to the volume or value of the services or products.*	The definition of incentive is too wide, giving the ability for all types of incentives to be regulated not just sales/volume related targets.	*(1) In this Act, incentive, in relation to a relevant service or any associated product, means a commission, benefit, or other incentive (whether monetary or non-monetary and whether direct or indirect) that is offered or given to a person (A) if—* *(a) the commission, benefit, or other incentive is offered or given to A in connection with A (directly or indirectly) being involved in the provision of the service or the products to consumers; and* *(b) A's entitlement to the commission, benefit, or other incentive, or the nature or value of the commission, benefit, or other incentive, is determined or calculated in any way by reference (directly or indirectly) to a targeted volume or targeted value services or products.*

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S446O	***Intermediary must comply with incentives regulations*** *Every intermediary that offers or gives an incentive to any of its employees or agents or to another intermediary in connection with the provision of a financial institution's relevant services or associated products must also comply with the regulations made under section 546(1)(of) (which relate to incentives).*	Further clarity is required on who is ultimately liable and what the defences are.	
446S	*consumer insurance contract—* *(a) means a contract of insurance entered into by a New Zealand policyholder wholly or predominantly for personal, domestic, or household purposes (see section 446U); but* *(b) does not include—* *(i) a contract to the extent that it provides for life insurance or health insurance; or* *(ii) a contract that is subject to a certificate under section 446V*	We understand that this definition is based on the definition of 'consumer credit contract' in section 11 of the CCCFA.	Include that the policy holder be a 'natural person'.