NEW ZEALAND
BANKERS ASSOCIATION

Submission

to the

Ministry of Business, Innovation and Employment

on the

Draft Financial Services Legislation Amendment Bill and proposed transitional arrangements

4 April 2017

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About NZBA

1. NZBA works on behalf of the New Zealand banking industry in conjunction with its member banks. NZBA develops and promotes policy outcomes that contribute to a strong and stable banking system that benefits New Zealanders and the New Zealand economy.

2. The following sixteen registered banks in New Zealand are members of NZBA:
   - ANZ Bank New Zealand Limited
   - ASB Bank Limited
   - Bank of China (NZ) Limited
   - Bank of New Zealand
   - Bank of Tokyo-Mitsubishi, UFJ
   - Citibank, N.A.
   - The Co-operative Bank Limited
   - Heartland Bank Limited
   - The Hongkong and Shanghai Banking Corporation Limited
   - Industrial and Commercial Bank of China (New Zealand) Limited
   - JPMorgan Chase Bank, N.A.
   - Kiwibank Limited
   - Rabobank New Zealand Limited
   - SBS Bank
   - TSB Bank Limited
   - Westpac New Zealand Limited.

Background

3. NZBA welcomes the opportunity to provide feedback to the Ministry of Business, Innovation and Employment (**MBIE**) on the draft Financial Services Legislation Amendment Bill (**Bill**) and proposed transitional arrangements, and commends the work that has gone into developing the Bill, accompanying Consultation Paper and additional material.

4. If you would like to discuss any aspect of the submission further, please contact:

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Executive summary

5. NZBA submits that those providers which contract with wholesale clients should not be subject to the duty to place client interests first (clause 431H).

6. With regard to the proposed capture of wholesale service providers in the licensing regime if they also provide services to a retail client, NZBA does not consider that the retail client obligations should carry over to the wholesale clients receiving that service.

7. NZBA submits that, as currently drafted, the duty in clause 431H to put the clients' interest first is too broad to be practically applied and could have unintended consequences.

8. NZBA submits that the word 'agreed' in the duty to agree on the nature and scope of the advice (clause 431G) presents some difficulties, and that this duty could potentially contradict the duty to put the client's interests first.

9. NZBA generally supports the proposed distinction between financial advisers (**FAs**) and financial advice representatives (**FARs**), however it is difficult to fully endorse this model without simultaneously seeing the final Code of Conduct and the licensing regulations.

10. NZBA notes that any of overlap between the protections under the proposed regime, and those provided by the Credit Contracts and Consumer Finance Act 2003 (**CCCFA**) and the Responsible Lending Code will require careful consideration.

11. NZBA submits that a FAP should have a defence if it can show it took all reasonable steps to ensure its FAs/FARs complied with their legislative obligations.

12. NZBA does not support the director liability that will attach to financial advice disclosures.

13. NZBA submits that the current exceptions in the Financial Markets Conduct Act 2013 (**FMCA**) relating to unsolicited meetings should be retained, and does not agree to any limitations being placed on these exceptions.

14. NZBA considers that by expanding the description of 'Exclusions from definition of financial advice' the Bill increases regulatory uncertainty over what is, and is not, financial advice.

15. NZBA is concerned that the Bill as it is currently drafted is broad and would prohibit the use of any sale or volume-based incentives, which are an important part of managing a large distribution network.

16. NZBA submits that the Bill should provide clear guidance to the Code Committee that in removing distinctions (Category 1 and 2, class and personalised) this does not imply that the conduct, competency and disclosure requirements should apply the same to all financial advice interactions.

17. NZBA has a number of concerns about the proposed transitional arrangements, and provides some suggestions to address such concerns.

Wholesale clients

The duty to put the clients' interests first

18. NZBA submits that those providers which contract with wholesale clients should not be subject to the duty to place client interests first (clause 431H). Wholesale clients are sophisticated and do not need this protection, which NZBA notes is not provided in Australia. NZBA considers that overlaying this statutory duty on top of a wholesale client's contractual protections is not necessary.

19. NZBA considers that if clients have been appropriately categorised then the obligation under clause 431H should not apply to wholesale clients and if it did this would direct efforts and resources away from the intended focus of this regime (retail clients).

The division of wholesale and retail services

20. The Bill states that if a financial advice or broking service is provided to *any* retail client, the entire service is deemed to be a retail service. While NZBA considers that it is appropriate to capture wholesale service providers in the licensing regime if they also provide services to a retail client, NZBA does not consider that the retail client obligations should therefore carry over to the wholesale clients receiving that service.

21. Financial advice providers (**FAPs**) should be focusing on providing timely, accurate and understandable information to retail customers who are seeking financial advice. Wholesale clients should not be the focus of the protection provided under regime. This distinction appropriately lowers compliance costs and creates efficiencies in dealings with wholesale clients who by definition are sufficiently sophisticated and informed to ensure that their contracts provide them with sufficient protections. Better demarcation could be achieved by ensuring the categorisation of the customer is appropriate and providing that retail service obligations should not apply to those services provided to wholesale clients.

22. Overall, it is difficult to see how the different client and service types fit together. A number of new terms have been introduced, but only some are defined (for example what constitutes a 'service' or a 'type of financial advice' (in the new subsection 403(3)(d))). NZBA's members found the diagrams on pages 17 and 18, and the examples from page 45, of the Consultation Paper useful, and would encourage the production of similar information to accompany the publication of the final Bill to enable further consideration through the Select Committee process.

The duty to put the clients' interests first

23. NZBA supports introducing a conflict of interest obligation within the Bill. However, NZBA submits that the duty in clause 431H as it is currently drafted is too broad to be practically applied and could have unintended consequences.

24. In addition to our submissions about the duty as it relates to wholesale clients (see paragraphs 18-19 above), NZBA has the following comments on the duty:

    a. The current proposed wording of *'…doing anything in relation to the giving of the advice*' could create barriers to the provision of legitimate information-only services. The wording could apply to, for example, general market research.

    b. As currently worded, some providers might interpret the duty as meaning that, in some cases, advisers are *compelled* to give financial advice, which is full in scope and not limited to the customer's current focus area. This is not an obligation found in the equivalent Australian duty to 'prioritise the interests of the client', and NZBA is concerned that this may not allow for an information-only service to be offered.

    c. NZBA submits that there should be a 'safe harbour' available for FAPs who take all reasonable steps to ensure that they, or persons acting on their behalf, comply with the duty to place client interests first. It may be appropriate to frame a safe

harbour provision over all of the duties, for example by including a statement within clause 431(E) that 'reasonable steps' will be a defence, or adjusting the enforcement sections of the Bill accordingly (please also see our comments at paragraphs 34-35 below under the heading 'Liability').

d. NZBA submits that FAs and FARs should be able to limit the application of clause 431H by advising the client of the nature and scope of the advice (i.e. the duty in clause 431G, discussed further below).

e. NZBA notes there is difficultly in the wording '*or ought reasonably to know*' (that there is a conflict of interest). For example, NZBA submits that a FAR giving advice on behalf of a FAP cannot always be assumed to have the knowledge of the FAP. NZBA submits that the test should be subjective as opposed to objective.

f. The Financial Markets Authority (**FMA**) have noted that they consider the duty to be a motivational test, rather than an outcomes-based test. Currently the wording appears to be more outcomes focused, and NZBA submits it should be motivational as per the FMA's interpretation.

g. NZBA submits that, as it is currently worded, the duty could potentially be more difficult to comply with in a robo-advice context, given the constraints when not face-to-face with a client. More generally, NZBA suggests that the wording of all of the duties should be tested against a robo-advice scenario (please see also our comments on the duty to agree on nature and scope of advice at paragraph 25 below).

h. NZBA submits it is unclear how the duty will work in a situation where a customer is in arrears on a credit product. In these cases, a lender will normally try to assist a customer with advice, for example restructuring the loan. However, the lender also has a duty to try to recover the debt. Whilst this conflict currently exists and is managed, the application of the duty and associated civil liabilities may make it attractive to avoid offering any advice to customers in this situation.

Duty to agree on nature and scope of advice

25. NZBA has the following comments on the duty in clause 431G of the Bill to agree on the nature and scope of the advice:

a. There is some difficulty with the word 'agreed' in subsection (1)(a):

i. Whilst this is currently used in the Code of Professional Conduct for Authorised Financial Advisers (**AFAs**), the guidance on the standard focuses on communication of scope to the client in addition to promoting understanding. It may be more appropriate for clause 431G (1)(a) to refer to disclosure of any limitations of the nature and scope of the advice. It appears to NZBA that the Bill imposes a more onerous obligation on, for example, bank tellers, than is currently imposed on AFAs.

ii. It is unclear how 'agreement' would work practically, and how should such agreement be evidenced from a compliance perspective? NZBA agrees that it is important for the customer to be assisted to understand the limitations, and be able to walk away if this is not appropriate for them. However, a requirement to agree on the nature and the scope of advice is unlikely to work practically for generic advice on low risk products which

are provided in high volumes as evidencing these agreements will likely be burdensome for providers and create a poor customer experience.

b. Can limiting the nature and scope of advice in itself contradict the duty to put the client's interests first (under clause 431H)?. If so, how could this be avoided?

Distinction between financial advisers and financial advice representatives

26. NZBA submits that the wording of the distinction between a FA and an FAR may confuse consumers. As both are licensed at the firm level and are giving advice on behalf of the FAP they are employed by, it is somewhat false to call only one a 'representative'.

27. NZBA understands that the rationale for having more than one type of adviser is to provide operational flexibility for FAPs to determine the best way to structure their businesses. NZBA understands that a FAP's decision as to whether they will employ FAs or FARs will come down to the level of control a FAP will have over the advice that is being provided. Where advice is simpler and an adviser will be more likely to respond in a manner prescribed by the FAP, the FAP would likely chose a FAR to provide that advice and would be responsible for the advice provided. Where advice is more complicated and more likely to "stray" into a discussion that the FAP has less control over, either due to the level of detail or the complexity of the products involved, a FAP would likely use a FA to provide the advice, and the FA would be personally liable for disciplinary action in relation to the advice. The licensing process provides flexibility for a FAP to identify the boundaries of the advice FARs can give on particular products, and would set out the competency requirements to be able to do so, and how this competency will be achieved.

28. NZBA considers that this essentially retains certain aspects of the former AFA/Qualifying Financial Entity (**QFE**) structure, as well as parts of the class advice/personalised advice distinction, but allows FAPs to determine the boundaries of what it is comfortable to provide in its particular circumstances. This allows FAPs to make licensing decisions based on their particular risk profiles and the commerciality of providing certain types of advice. To the extent that this is correct, NZBA supports such an approach.

29. However, it is difficult to fully endorse this model without simultaneously seeing the final Code of Conduct and the licensing regulations. These will play a crucial role in whether this approach will achieve the goal of the review of providing better access to advice for consumers.

30. The advantages and disadvantages of being a FA compared to a FAR remain unclear, given that no difference in Code standards seems contemplated by the regime and the Code is specifically prohibited from restricting types of advice to FAs only, but a difference in duties applies. This makes it difficult to comment on the proportionality of the requirements. If the intention is that the Code, Regulations or licence conditions will make or are permitted to make a different standard applicable to all FAs or to restrict services to FAs, this should be clearly signalled in the Bill. Currently, it appears only that the FMA may apply certain differences by licence conditions relating to FARs based on individual FAP services, processes and competence arrangements.

31. Given that the FAP is accountable for both FAs and FARs, it is not clear why the duties in 431O(1)(a) for a FAP regarding processes and controls over advice and incentives apply only to advice given by its FARs.

Potential overlap with CCCFA regime

32. NZBA notes that there is a level of overlap between the protections under the proposed regime, and those provided by the comprehensive consumer focused compliance regime in the CCCFA and the Responsible Lending Code.

33. NZBA submits that this interrelation will require careful consideration, and, if a conflict between the two regimes is determined necessary, due consideration should be given to which should prevail and why.

Liability

34. NZBA submits that a FAP should have a defence if it can show it took all reasonable steps to ensure its FAs/FARs complied with their legislative obligations.

35. We understand that director liability will attach to financial advice disclosures. Regarding this, NZBA submits:

    a. Whilst this liability may be appropriate for product disclosure statements (**PDS**), it seems inappropriate when disclosure is part of the financial advice regime, but the core is suitable advice. It may cause entities to focus disproportionately on this element.

    b. Whilst the content of the disclosure statement is currently unknown, we understand that disclosures are likely to involve an element of tailoring, for example by a group of advisers and over time as products and incentives change. Disclosures are therefore likely to be more numerous and dynamic than PDS. It therefore seems unrealistic to require Board oversight, except through the processes and procedures of the entity for approval. These will already be considered as part of licensing and are likely to be part of conditions.

Offers in course of unsolicited meetings

36. NZBA submits that the current exceptions in the FMCA relating to unsolicited meetings should be retained (i.e. the restrictions should not apply to FAs or FARs giving advice in the ordinary course of their business). NZBA does not agree to any limitations being placed on this exception, as this could lead to confusion as to which rules apply, and when. NZBA submits that there is no need for further regulation in this area unless there is evidence of consumer harm resulting from the current exemption, which NZBA is not aware of.

Financial advice exclusions

37. NZBA considers that by expanding the description of ‘Exclusions from definition of financial advice’ (clause 6 of new Schedule 5 of the FMCA, located in Schedule 2 of the Bill) the Bill increases regulatory uncertainty over what is, and is not, financial advice. NZBA considers that there is uncertainty in the proposed regime around determining whether a recommendation has been made and therefore whether the interaction is determined to be financial advice or not.

38. As a general rule NZBA would prefer to avoid areas of regulatory uncertainty where there are sanctions for a breach of these regulations. NZBA suggests defining a 'recommendation' using 'implicit' or 'explicit' terms to help better protect against avoidance of the Act.

Incentives

39. NZBA is concerned that the Bill as it is currently drafted is broad and would prohibit the use of any sale or volume-based incentives. Volume-based incentives are an important part of managing a large distribution network. NZBA agrees that 'inappropriate' incentives can drive behaviours that may not be in the clients best interests, however considers that the undefined term of 'inappropriate' is too broad.

40. NZBA submits that the Bill should instead prohibit solely volume-based incentives. It should be clear that what is required is a balanced approach to sales incentives, which includes objectives such as compliance, process adherence and appropriate conduct.

Conduct, competency and disclosure requirements

41. NZBA submits that the Bill should provide clear guidance to the Code Committee that in removing distinctions (Category 1 and 2, class and personalised) this does not imply that the conduct, competency and disclosure requirements should apply the same to all financial advice interactions. This is because:

    a. What is suitable for a more complicated investment will not be suitable for mass-market transaction, savings, or lending products.

    b. The ability for a large, well-regulated financial institution to specify different levels of conduct, competency, and disclosure for the products it provides is critical to the cost/benefit proposition to maintain access to products for the mass-market.

    c. If the balance is not right, some providers may continue to take a 'no advice' approach, which will not achieve the reforms' objectives.

42. Currently, clause 28 of Schedule 2 of the Bill allows the competence standards in the Code to vary by type of advice, product, or other circumstances (1)(b), but this is not explicitly allowed for conduct and client care in (1)(d).

43. NZBA submits that FAPs should have the flexibility to set their own competency standards, product scope, processes and restrictions through discussion with the FMA and ultimately through the licensing process (see our comments regarding transitional arrangements at paragraphs 45-56 below).

44. We note that the Code must set standards of competence for 'all persons that give financial advice' (clause 28 of Schedule 2). It is unclear what standards of competence might apply to FAPs, for example for the provision of robo-advice.

Transitional arrangements

45. NZBA submits that the licensing plan does not appear to sufficiently facilitate the early provision of robo-advice. Many providers will provide robo-advice and have channels with individual advisers and representatives. This is desirable so that advisers can support customers when queries arise. However, an early full licence to

facilitate robo-advice would result in crystallisation of the competence requirement for the full adviser sales force. The transitional regime therefore favours robo-advice only providers.

46. To remove this barrier, NZBA submits that the transitional regime should be adjusted to allow for a robo-advice licence to be obtained first once a transitional licence has been received, whilst the status quo is preserved for other elements of the advice service. Otherwise NZBA considers that the time to transition to a full licence is too long to wait to introduce personalised advice tools to the market. The intent of the revised regime is to provide better access to quality advice and robo-advice is an effective way to deliver that advice to a higher volume of clients.

47. NZBA is concerned that allowing a year for completion of the development of the Code is unlikely to be sufficient, or is likely to lead to a Code which is unclear or difficult to implement. The AFA Code was developed in a year, but relied heavily on an existing competence standard which had acceptance in the industry. The new Code must cover a much wider range of products (including bank accounts, credit card, loans, mortgage, life and general insurance), there is no widely accepted standard to build on, and it must also cover robo-advice and any opinions given in marketing materials (which might currently be regarded as class advice).

48. In addition, we note that no timetable has been proposed for the development of the Regulations. We believe that late development of the disclosure requirements in the current regime caused difficulties with the development of the Code, resulting initially in some duplication between the Code and the Regulations and some confusion about implementation. We suggest that development of the draft Regulations should be included within the proposed timeline, and that consultation on the wording of the Regulations should be substantially complete before consultation on the Code is complete.

49. NZBA supports the idea of basing the commencement of provisions on the completion of the Code. However, NZBA submits that the current proposal for transitional licences to take effect six months after the Code of Conduct is approved may not be enough time depending on the content of the Code. If, for example, the Code standards require providers to alter their business models, this may not be sufficient time. It is difficult for submitters to comment meaningfully on this given the necessary dependence on the detail of the Code.

50. NZBA submits that the transitional requirements whereby FAs currently employed by a QFE can continue on the same terms as they currently operate until their FAPs becomes fully licenced, but that any new FA recruited must meet the new competence standard creates some unusual incentives. For example, this may discourage mobility in the market for a two year period. If the intention is that an individual who was an AFA or RFA may move provider and not be required to meet the new standard, this should be clarified.

51. NZBA further submits that the transitional provisions should not prevent new FAs and FARs (outside of QFEs) from entering the market. If the Code of Conduct introduces higher competency standards, NZBA queries how long it will take new market entrants to meet those standards, and whether training will be readily available.

52. NZBA submits that it is currently unclear whether FAPs are able to add advice on new products during the transition period, and this should be clarified. If the intention is that new products cannot be added without new competence standards applying, this may dis-incentivise product change during the transitional period.

53. NZBA submits that it is not clear how Registered Financial Advisers (**RFAs**), AFAs and QFE advisers would provide class or personalised advice during the transitional period when those distinctions will no longer exist. For example, how would an RFA who can only provide class advice on KiwiSaver give advice during the transitional period? Whilst the scope of the service could be explained, it would be helpful to see some examples of how MBIE envisage this working for advisers who can only provide class advice on certain products.

54. It is currently difficult to comment on whether two and a half years for advisers and representatives to reach the competent requirements is sufficient, given that the standard is unknown. NZBA notes that education providers will need to use this time to finalise and publicise their courses, the number of providers is unknown, the volume of advisers and representatives to be qualified is likely to be significantly higher than when the previous Act was implemented and that more people will need to demonstrate competence across a number of product areas.

55. NZBA is also unclear how the transition will work for FAPs who wish to adopt methods of meeting the competence standard other than those suggested in the Code. We understand that the approach would need to be agreed with the FMA and might be included in licence conditions. However, a FAP would need to have certainty about their approach at the beginning of the transitional period, but might not be able to submit a complete application at that point. We ask that further guidance is provided on how the FMA expects to review individual FAP approaches in advance of a licence application, during the August 2018-February 2019 period, to ensure that two years are available for training.

56. With regard to the grandfathering of AFAs and RFAs, NZBA does not agree with the proposal that AFAs need an additional 5 years to comply with the changes. This is dependent on the level of change introduced by the new Code. If AFAs only need minimal changes to competency, knowledge and skill requirements, then NZBA submits 2 years may be a more appropriate period. This should be determined once the Code standard is finalised and the number of qualification providers is known. It is accepted that the timing may need to be longer than for RFAs, given that the supply of education providers may be a restricting factor.

Miscellaneous

57. Clause 50(1) of the Bill provides:

> In Schedule 1, replace clause 21(a) with:
>
> (a) financial products of a kind prescribed for the purposes of this paragraph that are issued by a registered bank; or

58. NZBA understands that this relates to the exclusion for registered banks, whereby category 2 products do not require disclosure. Because under the new regime the category 2 definition will fall away, the exclusion will instead refer to financial products of a kind to be prescribed for the purposes of that paragraph (which presumably will be similar to category 2).

59. NZBA submits it is important for registered banks to be able to avail themselves of the exclusion without a gap due to the change in legislation. Therefore, NZBA submits there needs to be assurance that the prescription for the exclusion will be

effective not later than the amended legislation, or that the existing exclusion will be preserved in the interim.

60. NZBA further submits that the word ‘the’ in Schedule 2, Clause 28(4)(b) should be replaced with ‘a’, to read: ‘a way in which a financial advice provider or financial adviser may demonstrate the provider’s or adviser’s competence, knowledge and skill’.