CONFIDENTIAL

New Zealand Bankers' Association

Additional Submission to the Commerce Committee

FINANCIAL SERVICE PROVIDERS (PRE-IMPLEMENTATION ADJUSTMENTS) BILL

15 April 2010

ADDITIONAL SUBMISSION ON THE SUPPLEMENTARY ORDER PAPER AMENDMENTS TO THE FINANCIAL SERVICE PROVIDERS (PRE-IMPLEMENTATION ADJUSTMENTS) BILL

This submission is the collective view of the New Zealand Bankers' Association (**"NZBA"**):

- ANZ New Zealand Limited
- ASB Bank Limited
- Bank of New Zealand
- Citibank, N.A.
- The Hongkong and Shanghai Banking Corporation Limited
- Kiwibank Limited
- Rabobank New Zealand Limited
- TSB Bank Limited
- Westpac New Zealand Limited.

This is an additional submission to the NZBA's submission on the Financial Service Providers (Pre-Implementation Adjustments) Bill (**"Bill"**) dated 25 March 2010.

INTRODUCTION

The NZBA supports the objective of the amendments proposed in the Supplementary Order Paper dated 16 March 2010 (**"SOP"**) to improve the framework for regulating investment transactions under the Financial Advisors Act 2008 (**"FAA"**). However, we consider that in order to fully achieve this objective and the overriding objective of the Bill, further changes are required.

REQUEST TO MAKE ORAL SUBMISSION

The NZBA would like to appear before the Committee to discuss this additional submission. We would also be happy to provide further information to the Committee on request.

SUBMISSION

The NZBA submits as follows.

1. **Power for entities to make investment management decisions too narrow:** As the SOP is currently drafted, only individuals are able to make "investment management decisions" (subject to one exception discussed below). This is not how the market works in New Zealand or in other jurisdictions. In banks, for example, decision making for customer portfolio investments is often made centrally by a team of people, perhaps approved by several senior executives. There is not one individual making the various decisions – the decisions are being made on behalf of the corporate entity which takes responsibility for those decisions.

   In Australia, this problem does not arise because the regime recognises the role corporate entities play by specifically licensing corporate entities as well as or instead of the individual adviser, whereas the FAA licences only individuals.

   There is only one exception in the SOP which allows entities to make "investment management decisions". This exemption allows entities appointed by "product providers" to make investment management decisions in certain circumstances. This exception should be drafted more widely, to ensure that the concept of product provider is defined as including entities responsible for distributing products, to allow the product provider itself to make investment management decisions (if that provider is an entity) and to allow for additional sub-delegation to subject matter experts. Accordingly we submit that the following wording should be adopted:

   (i) *any product provider making an investment management decision in relation to the relevant financial product, or any person making an investment management decision in the course of an appointment, delegation or sub-delegation (of that person or that person's employer or principal) by or from a product provider to undertake all or any part*

of the investment management functions of the product provider in relation to the relevant financial product.

2. **Broking service definition requires amendment:** The definition of "broking service" in new section 77B(2) excludes the "mere transmission of a non-negotiable instrument payable to another person". The aim of this drafting is to overcome the problems inherent in the existing definition of "investment broker" in the Securities Markets Act 1988 (**"SMA"**). The benefit of the exclusion in the SMA in respect of transmission-only transactions potentially is potentially unavailable where a person has a right of set off against client funds. This issue is not remedied by the proposed wording in section 77B(2) and, further, we believe that a focus on the payment method is not the appropriate way to determine the issue. For example, a reference to a "non-negotiable instrument" will include a cheque in some circumstances but not others (depending on whether the cheque contains an endorsement that it is not intended to be transferable). Accordingly, we submit that the following definition should be adopted:

77B What is a broking service

(1) A broking service is the receipt, holding, or payment of client money or client property by a person acting on behalf of a client.

(2) A person does not perform a broking service if that person merely transmits client money or client property to another person without the authority or right to apply the money or property for any other purpose other than pursuant to a lawful lien or claim against the money or property.

3. **Client advisers or other representative should be able to instruct brokers:** The new section 77S needs to be amended so the section will apply to circumstances in which a broker receives instructions from a client's agent (such as a lawyer or financial adviser), rather than directly from the client (as often occurs in practice). Also, the section should not require separate directions for

every individual transaction where the client has given general instructions. This would be cumbersome and unnecessary.

4. **Holding funds in overseas banks should be permitted:** The new section 77P(1)(b) needs to be amended to allow banks to hold client funds in overseas banks if requested to do so by the client.

5. **Securities Commission power to exempt financial advisers from conduct obligations:** The SOP proposes that the Securities Commission have the power to exempt brokers from both disclosure and conduct obligations. New section 148(1)(a) should similarly give the Commission the power to grant exemptions for financial advisers from conduct as well as disclosure obligations. Further, it would be preferable if the Securities Commission had a general power to grant exemptions from any or all of the requirements of the FAA. As the new regulatory regime for providers of “financial advice” is so far-reaching, equivalent flexibility is required to ensure the regime can be effectively operationalised and appropriate relief may be tailored where required. This type of exemption power has operated successfully under the Securities Act 1978 and the SMA, and has enabled New Zealand law to adapt to changing circumstances and developments. Similarly, in Australia, the Australian Securities & Investments Commission has a broad power to grant exemptions for a person or class of persons from the requirement to obtain an Australian financial services licence in order to provide financial product advice and dealing services.

6. **The financial advice definition is too wide:** The NZBA and others have consistently submitted during the consultation processes relating to the introduction of the new financial advisers’ regime that the definition of "financial advice" under section 11 of the FAA is too wide. The majority of the NZBA’s member banks consider it inadvertently captures conversations which neither customers nor advisers intend to be "financial advice". This is because the definition does not contain the concept of an “intention to influence the customer (either subjectively or objectively) and contains the word “guidance”. These are two of the main factors that contribute to the broad application of the FAA. This is also the main difference between the definition of “financial advice” in the FAA and

the definition of “financial product advice” used under the Australian regime. Another key difference with the Australian regime are the concepts of “personal advice” and “general advice” – concepts introduced by the Code of Conduct.

The definition of “financial advice” should be narrowed so it does not apply in circumstances where advisers make general comments about financial services and products, but do not intend to influence a customer to acquire or dispose of a financial product. This is where the comment given is of a general nature and not intended to be applied to personalised circumstances. To achieve this, the definition of financial advice should be amended by:

- removing the word “guidance” (as it sets too high a standard)
- including the concept of “intention to influence”.

If this is not done an unnecessarily large number of financial advisers will be required to become “authorised financial advisers” (**“AFAs”**) who will require considerable training and monitoring, without any commensurate improvement in the protection of consumers. It will also unduly constrain legitimate business conversations. This would have a significant and adverse effect on the sector and the wider New Zealand economy resulting from higher costs to customers and a potential reduction in access to services and products for consumers.

If the breadth of section 11 is narrowed, the need for a variety of exemptions under section 12 will be obviated.

A specific example identified as being currently caught by “financial advice” in section 11 is:

- While general commentary about the financial market is not financial advice (section 12(t) of the FAA), where a banker presents on the economy and discusses, the advantages or disadvantages of some products and markets, for example shares in infrastructure companies, comments on a specific type of shares may constitute financial advice.

> Further, if the presentation is specifically tailored, for example to infrastructure customers, the commentary exemption will not apply.

The NZBA submits that section 11 of the FAA define "financial advice" as:

> *A person (A) gives financial advice (and so performs a financial adviser service) if A makes a recommendation or gives an opinion in relation to acquiring or disposing of (including refraining from acquiring or disposing of) a financial product that –*
>
> *(a) is intended to influence the person making the decision about that financial product; or*
>
> *(b) could reasonably be regarded as being intended to have such an influence.*

The revised definition removes the word "guidance". The threshold for what might amount to "guidance" is unclear and may inadvertently capture what would be considered to be 'normal business chatter' (akin to 'mere puffery' under the Fair Trading Act 1986).

The requirement for an "intention to influence" a particular person would further ensure that the definition is better targeted to what a reasonable person would consider to be "financial advice".

The removal of the word "guidance" and the addition of the concept of "intention to influence" is in line with the approach taken under the Australian legislation, the Corporations Act 1991. In that Act reference is made to "recommendations" and "statements of opinion" but not to "guidance". Plus the Act requires that the adviser have an intention to influence a customer's decision (either actual or reasonably implied).

The solution proposed for amending the definition of "financial advice" would better align the New Zealand financial advisers' regime with the position in Australia.

This supports the New Zealand Government's trans-Tasman harmonisation objectives.

7. **Additional exclusions**: We have already commented in our 25 March submission on the need for the FAA to include a specific exemption for directors giving advice to shareholders of that company (or another company group member) in relation to their shares. As well as amending the definition of financial advice, the NZBA also submits that the following additional exclusion in section 12 of the FAA is necessary:

- **Parity between employees and nominated representatives:** Significant amendments have been proposed in the Bill that would place nominated representatives in the same position as employees in respect of financial advice. The NZBA supports these changes, but notes that not all concessions for employees in the FAA, the Bill or the SOP have been extended to nominated representatives. These omissions would lead to anomalous results in practice. For example:
    - An employee does not provide a financial adviser service if he or she provides assistance to a fellow employee with the implementation of a decision to acquire or dispose of a financial product made available in the workplace, provided that the assistance is not accompanied by a recommendation or opinion as to the suitability of the financial product (FAA section 12(p)). There is no equivalent recognition for a nominated representative such as an employee of a sibling company providing assistance to an employee of another group company in relation to financial products made available on a group-wide basis.
    - If a broking service is provided by an employee in the course of the business of his or her employer, the employer (and not the employee) is the broker (new section 77A(2)). There is no equivalent recognition for a nominated representative such as a contractor providing broking services in the course of the business of the QFE that has nominated them.

Nominated representatives are like staff of the business, so should be placed in the same position as employees in respect of financial advice and broking services.

The NZBA submits that the exceptions in section 12(o); (p) and (q) of the FAA and new section 77A(2); section 77C(i), (j) and (k); and section 77U as proposed in the SOP should be extended to nominated representatives.

The majority of NZBA's member banks also consider the following exclusions are necessary to address areas that were not intended to be "financial advice":

- **Debt recovery:** There is a concern that staff dealing with debt recovery may be captured by the definition of financial advice. There is a conflict of interest between the roles under the FAA and those applying to debt recovery roles within an organisation. For instance, debt recovery relates to acting in the creditor's interest to reduce the level of bad debts, whereas financial advice relates to helping a customer make the best decision for themselves. We also note other legislation imposes conduct obligations in this area that may conflict with the FAA (eg Credit (Repossession) Act 1997, Property Law Act 2007). Therefore, debt recovery does not need to be covered by the FAA. This needs to be clarified in the FAA
- **Customer complaints:** Staff dealing with customer complaints may be captured by the definition of financial advice, if they suggest another product or a change in an option for a product feature to resolve the complaint. Internal complaints departments would need to be staffed by financial advisers. This would not result in any improved outcomes for customers. The NZBA submits that employees or nominated representatives dealing with customer complaints be exempted from the FAA.

8. **Term life insurance definition:** The NZBA supports the intention of the legislation to treat risk-based life insurance policies as Category 2 products. For these risk-based life insurance policies customers do not require investment strategy advice as the product is simple (just as a call debt security is simple) and the advice process is less complex.

The definition of "term life insurance policy" contained in the Financial Service Providers (Pre-Implementation Adjustments) Bill is not ideally suited for use in the FAA regime and, in particular, the unambiguous allocation of products as either category 1 or category 2.

There are deficiencies in the current definition. While those deficiencies might not be material in the context for which the definition was originally developed, when the definition is transplanted into a different context the effect of those deficiencies is magnified. There is a view within the industry that, if definition in the Bill remains unchanged, some simple, risk-only products might be classified as category 1 products notwithstanding the underlying policy intention that they be category 2 products. There will be a lack of clarity amongst advisers as to whether particular products are category 1 or category 2 and it is even possible that two products that are equally simple and both suitable for a customer's insurance needs would be classified differently. The opportunity should be taken to remove, rather than perpetuate, the current lack of clarity. Clear rules from the outset will benefit both consumers and advisers.

The NZBA submits that the definition of “term life insurance policy” in the Bill should be replaced. The NZBA would be pleased to work with officials to draft a suitable alternative.