New Zealand Bankers' Association

Submission to the

Securities Commission

on the

Proposed Standard Conditions for Qualifying Financial Entities (QFEs) – Disclosure and Related Matters

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SUBMISSION BY THE NEW ZEALAND BANKERS' ASSOCIATION TO THE SECURITIES COMMISSION ON THE PROPOSED STANDARD CONDITIONS FOR QUALIFYING FINANCIAL ENTITIES (QFES) – DISCLOSURE AND RELATED MATTERS

1. Thank you for the opportunity to comment formally on the Proposed Standard Conditions for Qualifying Financial Entities (QFEs) – Disclosure and Related Matters (Disclosure Paper). We also thank you for meeting with us on a continuing basis to discuss issues relating to QFE disclosure. The issues we have debated and which we raise below are extremely important for our member banks and, as discussed, require urgent resolution.

2. This submission is the collective view of the New Zealand Bankers' Association (NZBA), being the following member banks:

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

SECURITIES COMMISSION MUST ACT WITHIN ITS LEGISLATIVE MANDATE

3. NZBA member banks acknowledge the Commission's objectives of providing for flexibility in the way that QFE disclosure is made through the standard terms and conditions, and the underlying consumer protection objectives that disclosure seeks to deliver on.

4. Member banks accept that a QFE's terms and conditions as set by the Commission may contain additional requirements to those set out in the Financial Advisers Act 2008 (FAA) and Financial Advisers (Disclosure) Regulations 2010 (Regulations). However, any additional requirements must be:

    - made in accordance with empowering provisions in the FAA and Regulations – to the extent that the proposed standard conditions for disclosure are beyond the scope of such authorisation, they are ultra vires, and

    - consistent with Parliament's intentions for the regime.

    We deal with each of these matters in turn below. Insofar as NZBA suggests changes to the Commission's proposed regime for disclosure, we have taken care to ensure that our proposals remain consistent with the stated objectives of the Securities Commission in relation to consumer protection.

5. Firstly, the NZBA believes that the proposed standard conditions 4.1 and 4.2 do not meet these criteria. Accordingly, NZBA submits that standard conditions should be deleted or significantly amended so the standard terms and conditions can withstand scrutiny by the Courts or the Regulations Review Committee.

6. Secondly, any terms and conditions set by the Commission in relation to QFE disclosure must be consistent with the following fundamentals upon which the FAA and Regulations are based and which we consider are non-controversial:

    - QFE status is intended to be an efficient way for businesses to comply with the FAA.

    - Disclosure must be comparable between QFEs advising on group QFE issued/promoted category 1 products and authorised financial advisers (AFAs), and

- Disclosure must be comparable between QFEs advising on category 2 products and registered financial advisers (RFAs).

7. During our recent discussions with officials, we were concerned to hear that the Securities Commission may be interpreting the need for regulatory neutrality as requiring QFE disclosure to contain significant disclosure based on the personalised retail financial adviser service being provided by the QFE adviser. Regulatory neutrality cannot be interpreted in this manner. QFE disclosure is disclosure given by the entity, not the QFE's advisers. Section 25(2)(b) of the FAA expressly provides that disclosure about the "type of financial adviser" is to be dealt with in Regulations (and therefore must not be prescribed by the Securities Commission).

8. The clear intention is that disclosure must not be more onerous for QFEs than for RFAs or AFAs who are "only" required to make disclosure in writing. The absolute high water mark for the regulation and supervision of QFEs and QFE advisers should be the regulation of individual AFAs or registered advisers. To make disclosure more onerous negates the purpose behind the QFE status. Disclosure in addition to the requirement of AFAs and RFAs would negate a key benefit of streamlining originally thought to be gained through QFE status.

9. Consistent with this, NZBA submits the starting point for disclosure must be that, as a minimum standard, written disclosure must be sufficient for the purpose of the FAA.

10. If QFEs were to have a positive ongoing obligation to assess the adequacy of written disclosure across a products, customers and channels, in the NZBA's view that would need to be expressly provided for in the FAA.

11. In terms of **what** must be disclosed in respect of advice on category 1 and 2 products and services, the high water mark must be what is required to be disclosed by AFAs and RFAs respectively. In the Regulations, templates for disclosure have been provided. NZBA has produced a template for QFE disclosure

as part of this submission which achieves the required regulatory neutrality and objectives of the FAA.

12. NZBA does not believe it is within the Commission's powers to require QFEs to:

- have written disclosure policies (proposed standard condition 4.1) - disclosure policies must be voluntary, or

- document why their approaches for disclosure are appropriate (proposed standard condition 4.2) where QFEs choose to make disclosure in writing - unless and until a choice is made to use non-written disclosure channels, this should not be required,[1] or

- document why their approaches for disclosure are appropriate (proposed standard condition 4.2) for advice given on category 2 products. Table 1 requires consequential amendment by removing the application of point 2 to category 2 products and services.

13. In relation to the first and second bullet points we are encouraged by the indications we have received from officials that the requirements for a mandatory written disclosure policy and for documentation around written disclosure will likely be amended.

14. In relation to the third bullet point in paragraph 12 above, we would add that RFAs are not required to disclose limitations on the products they provide or conflicts of interest arising from commissions or other remunerations. However, our interpretation of Table 1, point 2 is that disclosure of these matters is specifically contemplated for QFE advisers in relation to category 2 products. This is expressly indicated in the explanatory notes to Table 1. We strongly disagree that the Securities Commission can require such additional disclosure.

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[1] This would give QFEs certainty and control over form, while still having to explain decisions where they are exercising discretion over form beyond the default position of making disclosure in writing. This may or may not be supported by an underlying disclosure policy or addressed within the broader compliance/risk management framework.

15. Also in relation to the third bullet point, we submit the definition of "Relevant Service" should be deleted or amended to recognise that disclosure should clearly be permitted in relation to a range of products, and not limited to the service "likely to be provided" to the client. This is because the definition creates significant uncertainty as drafted. It is unclear how the definition is to be interpreted and it will be difficult or impossible to predict exactly what financial adviser service may arise as a result of a particular customer interaction. In addition, the references to relevant services in the proposed standard conditions would have the potential to require a great many potential disclosures. There is, in our view no power for the Securities Commission to require multiple disclosures in this manner. This is a matter which is for the QFE to determine. In Australia, we note that entities are able to choose to give separate disclosures and many do. The most obvious example occurs where banks make separate disclosure for insurance.

16. Furthermore, the Commission cannot seek to prescribe additional requirements for QFEs relating to **how** and **when** disclosure should be made by QFEs. These are matters specifically dealt with under the FAA and Regulations, both of which indicate Parliament's intention that these matters should be left for the determination of the QFE:

    - The question of **how** disclosure is delivered is for QFEs to determine individually (section 25(3) of the FAA (which specifically notes regulations may prescribe the form of disclosure not the method of disclosure) and clause 8(4) of the Regulations (which specifically allows a QFE to disclose in "any form" so long as it is consistent with the regime)), with the only qualification as to form being that customers can elect to receive the disclosure in writing.

    - The question of **when** disclosure must be made is governed by sections 25(1) and 29 of the FAA only. There does not seem to be scope for these to be added to in the proposed standard conditions.

ADDITIONAL SUBMISSIONS ABOUT PRODUCT DISCLOSURE FOR CATEGORY 2

17. In addition to the points made above, we consider requiring different disclosure for different products and services a bank QFE may provide in relation to category 2 products was never intended. This is because reliance was placed on the specific legislation that already applies to product disclosure for category 2 products (such as the Credit Contracts and Consumer Finance Act 2003). Product disclosure was not considered necessary to due to the existing robust regulation of category 2 products and therefore such requirements would cause duplication and costs with minimal benefit.

CONSUMER PROTECTION AND REQUIRED STANDARDS

18. The QFE responsibility for consumer protection is recognised generally through section 66(1) of the FAA, and in relation to QFE advisers who provide personalised services who provide personalised services that relate to category 1 products through section 66(2). It is also recognised in the 'if not, why not' section in the ABS Guide, where a comparison of that QFEs advisers conduct and competency requirements against the Code of Conduct for AFAs, and an explanation of why they are not equivalent if that is the case, is required. This gives QFEs the ability to decide how they are going to ensure comparability, for example, by amending internal codes of conduct. If this is not achieved to the required standard of the Securities Commission, granting QFE status can be made conditional on achieving the appropriate standard.

19. Furthermore, QFEs can achieve consumer protection without making QFE disclosure product specific. The details of how a particular product works are always part of the product contract terms anyway, so saying them again in the QFE disclosure is merely repeating what is already being given to the customer. This is unnecessary and potentially distracts from the specific disclosure sought by the regime.

20. As the 'if not, why not' provisions in the ABS Guide require comparable provisions to those in the Code, banks will (and do) apply consumer protection standards

across all products and services offered. Consumer protection needs tend not to vary across the range of those products and services because banks currently set a high bar for consumer protection. It is well understood by bank customers that when they come to a bank they will be offered a range of products and services which are particular to that bank. The standards they set are heavily influenced by a long-standing commitment to good banking practice standards and the Code of Banking Practice, which often sets higher standards than contained in legislation. This is also reinforced by the other disclosures bank are either required to make or choose to make as part of product and contract disclosure.

21. Additional product-based disclosure, even if generic, would add significantly to compliance costs for large organisations like banks.

22. We note that until very recently, member banks had legitimately expected that these costs would not be incurred. They were neither flagged in the Ministry of Economic Development's work and working group, nor in Cabinet decisions on disclosure.

23. Member banks have indicated to NZBA that the Commission's currently proposed model will be significantly more expensive to implement both initially and on an ongoing basis. Increased costs will include the costs associated with:

- changes to customer interface systems so that provision is made to allow recording of multiple kinds of disclosure to consumers
- associated information technology and record keeping costs
- design, printing and postage costs
- additional staff requirements, and
- training costs.

24. We estimate the expenditure may increase by a third to implement and by a third again on an ongoing basis. However, it has not been possible to accurately quantify these costs within the timeframe given for making this submission.

DISCLOSURE SHOULD NOT DUPLICATE AFA DISCLOSURE

25. NZBA submits that the proposed standard conditions should be amended to ensure explicitly that if AFA disclosure duplicates any of the information required by the standard conditions, then no further disclosure will be necessary. We consider this is a necessary amendment as there would otherwise be significant duplication, particularly in relation to remuneration (see paragraph 5, Schedule 2 of the Regulations) and under Code Standard 7 in relation to the benefits AFAs and related persons may receive.

NO ADDITIONAL DISCLOSURE IF THERE IS AN EXEMPTION

26. We understand that regulations are being drafted to ensure that there will be an exemption for telephone disclosure for category 2 products in certain circumstances. NZBA submits that it should be made clear that where this or any other exemption applies, no further matters will be required to be disclosed other than as set out in the exemption.

A TRANSITION PERIOD SHOULD BE ALLOWED

27. NZBA requests that the Securities Commission allows a transition period for QFE disclosure to be implemented. NZBA clearly stated in its submission to the Commerce Select Committee in 2010 that the Government needed to issue all known obligations by September 2010 in order for a 1 July 2011 compliance date to be met.

28. As we have discussed with the Securities Commission, it will take banks six to nine months to roll out disclosure, and perhaps even longer if complex IT changes need to be implemented. QFEs have been able to estimate disclosure costs based on proposals in the February Cabinet Paper, consulted on through the Ministry of

Economic Development Disclosure Working Group and based on the legislative requirements. However, QFEs have been unable to prepare for additional disclosure requirements because they are still not known. Therefore compliance should not be expected until 10-12 months after final regulations have been issued.

29. In addition, we submit the Securities Commission should:

- specify one agreed template for a written document (which would cover both category 1 and category 2 products) which is able to be used for all purposes, while retaining the flexibility to develop other forms of disclosure as required: a template for discussion will be is being finalised for submission to you,

- undertake a transparent cost-benefit analysis of the likely costs involved with complying with the proposed standard conditions on disclosure, so that key decision makers, industry, officials and consumers can understand the costs of compliance, and

- plan and consult on a pathway to compliance so that QFEs are able to plan compliance accordingly.

30. In addition, it would be helpful if it the Securities Commission could clarify by way of a guidance note that disclosure may be achieved by:

- mailing to a client's last known address (including an electronic address

- making disclosure as part of another document (such as general terms and conditions)

- alerting banking clients to webpage disclosure, and

- large posters on walls in bank branches or places of business, and

- any other method the QFE considers is consistent with clause 8(4) of the Regulations.