NEW ZEALAND BANKERS ASSOCIATION

Submission

to the

Economic Development, Science and Innovation Committee

on the

Financial Services Legislation Amendment Bill

23 February 2018

NEW ZEALAND BANKERS ASSOCIATION
Level 15, 80 The Terrace, PO Box 3043, Wellington 6140, New Zealand
TELEPHONE +64 4 802 3358 EMAIL nzba@nzba.org.nz WEB www.nzba.org.nz

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 seventeen 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
- China Construction Bank
- 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 Economic Development, Science and Innovation Committee (**Committee**) on the Financial Services Legislation Amendment Bill (**Bill**) and commends the work that has gone into developing the Bill.

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

Antony Buick-Constable
Policy Director & Legal Counsel
04 802 3351 / 021 255 4043
antony.buick-constable@nzba.org.nz

Introduction

5. NZBA broadly supports the legislative reforms proposed in the Bill. In particular, NZBA would like to endorse the following measures:

(a) repealing the Financial Advisors Act 2008 (**FAA**) assists in creating a more cohesive legislative framework for financial products and services;

(b) requiring Financial Advice Providers (**FAP**) under s 431J to give priority to clients' interests is a pragmatic move, which aligns with conduct work undertaken by the Financial Markets Authority (**FMA**), noting that NZBA suggests some amendments to this duty in respect of wholesale clients;

(c) narrowing s 431I to require FAPs to ensure the customer understands the nature and scope of advice helps to ensure customers will be able to access services in a natural and efficient manner;

(d) maintaining the exemption in s 34 of the Financial Markets Conduct Act 2013 (**FMCA**) via clause 11 (to allow FAPs to make offers during unsolicited meetings in the ordinary course of business) takes into account the practical realities of customers often seeking multiple products during a single interaction;

(e) we support moves for the Code Working Group (**CWG**) to draft an updated Code of Conduct (**updated Code**) in parallel to this legislative reform process; and

(f) bringing existing Authorised Financial Advisers (**AFA**) within the two year transitional licence reduces the inconsistency of compliance obligations under the new regime.

Interpretation

Meaning of 'financial adviser'

6. We acknowledge the extensive consideration, during the consultation process, given to the descriptors for those giving financial advice. However, we would like to make the following comments.

7. Regulated financial advice may be given on behalf of an FAP by a nominated representative or a financial adviser. Section 431F prohibits an FAP from holding out that a nominated representative is a financial adviser. This means that a nominated representative may give financial advice but cannot be referred to as a financial adviser.

8. This subtlety of language ignores the commercial and practical reality of everyday interactions with customers; customers will not understand why the person giving them financial advice is not a financial adviser, which, in common parlance the person obviously is.

9. One of the criticisms of the current law is that it is difficult for customers to understand. The terminology used in the Bill perpetuates this problem. Both financial advisers and nominated representatives act on behalf of their FAP. NZBA submits that it would be much simpler for customers, and consistent with the overall framework of the Bill, if the two categories were referred to as 'nominated representatives' and 'registered representatives'. Collectively, 'financial advisers'.

Nominated Representative

10. Section 431S(1)(b)(i) provides that an FAP may nominate an individual (B) as a nominated representative if B is 'engaged (whether as an employee or otherwise) by [the FAP] to give financial advice on [the FAP's] behalf'. This requirement is unnecessarily narrow in that it links an individual's precise terms of engagement to their ability to be nominated as a nominated representative. NZBA recommends that section is redrafted as follows:

> (b) B-
>
> (i) gives financial advice on A's behalf (whether as an employee or otherwise); and

11. The Bill allows the FMA to determine the manner in which nominations of nominated representatives may be made. NZBA support this approach which allows further time for discussion and will enable an efficient approach to the nomination of employees. However, we note that the process for revocation is fixed (requiring written notification). This would mean that a person leaving employment with an FAP would need to be provided with a written notice even though it would be clear that the nomination ceases. We suggest that the Bill be amended to allow both the nomination and the revocation to be made in a manner determined by the FMA so that an appropriate approach can be determined.

12. In this regard, NZBA submits that the FMA should permit FAPs to keep an internal record of nominations and, where appropriate, to nominate by position title rather than by individual name. In addition, NZBA submits that an FAP should be permitted to refer to existing nominated representative records (eg employment contract) to comply with the up-to-date record obligation in s 431S(4).

Definition of 'financial advice'

13. NZBA considers that the definition of 'financial advice' in s 431C lacks certainty in that it does not clearly capture a recommendation to switch from one fund to another in a KiwiSaver scheme. That is because:

    (a) The definition of 'financial advice' turns on (paraphrasing) 'a recommendation or opinion about acquiring or disposing of a financial advice product'. In the case of a KiwiSaver fund switch, there is no such acquisition or disposal. The fund is not a financial advice product.

    (b) Arguably, an instruction to switch funds is not a renewal or variation of the terms or conditions of an existing financial advice product; the original terms of a KiwiSaver scheme usually contemplate such a switch.

    NZBA considers the decision on whether to switch funds, for example from a conservative fund to a growth fund, is one of the most important financial decisions a customer can make and, accordingly, the decision should be subject to the regime. NZBA therefore recommends that the definition of financial advice product be amended to include a fund in a KiwiSaver scheme.

Duties on persons giving regulated financial advice

Duty to give priority to the client's interests

14. As noted in NZBA's earlier submission to the Ministry of Business, Innovation and Employment dated 4 April 2017, we consider that those FAPs contracting with wholesale clients should not be subject to the duty to prioritise a client's interests (s 431J).

15. Wholesale clients are sophisticated and therefore typically negotiate bespoke contracts. Accordingly, they do not need the protection of s 431J. NZBA considers that if that duty were to apply to wholesale clients this may have the unintended effect of directing efforts and resources away from its intended focus (retail clients). Applying this duty to wholesale clients (as defined in the Bill) would also have the effect of making the 'wholesale' categorisation redundant as it fails to recognise those clients' own abilities to protect their interests in the manner that best suits their particular needs. We also note that all clients can choose to be deemed 'retail' and receive those protections if they wish.

16. Further, this duty may result in the provision of more conservative advice to wholesale investors such that they do not receive the same quality of advice that they would have in the absence of regulation. That does not accord with the objectives of the Bill.

17. Additionally, wholesale client contracts typically contain conflict management procedures. NZBA considers that the overlay of an additional statutory duty could create uncertainty around these provisions. If the Committee chooses to retain the application of this duty to wholesale clients, we suggest that the duty in s 431J should not apply where an FAP has a conflict management agreement with a wholesale client, and the FAP complies with that agreement.

18. We also note that to the best of our knowledge no other jurisdiction takes this approach to wholesale financial advice.

19. NZBA also considers that this duty should not require FAPs to consider or recommend the products of another FAP. Otherwise, FAPs will need to ensure that their financial advisers and nominated representatives are familiar with all relevant products available in the market, which is impractical. Accordingly, NZBA considers that s 431J should be amended to clarify that giving priority to clients' interests does not require an FAP, financial adviser or nominated representative to consider products offered by other FAPs.

20. Finally, NZBA notes that the duty to prioritise a client's interests is absolute – a person providing regulated financial advice *must* give priority to the client's interests where there is a conflict. However, we seek guidance on how to manage situations where there is alignment between the interests of the client and the person providing regulated financial advice. We consider that FAPs should not be precluded from recommending products where there is a clear benefit for both the client and the person providing the advice.

Duty to ensure client understands nature and scope of advice

21. Code of Professional Conduct for Authorised Financial Advisers (**existing Code**), Code Standard 8, provides that the AFA must ensure that the client is 'aware of' the

extent of limitations on the scope of the personalised service. NZBA submits that the Bill should mirror that language (ie substitute 'understands' with 'aware of').

22. NZBA also considers that the requirement to take 'reasonable steps' to ensure a client understands the nature and scope of advice will be difficult for some channels, for example digital and high volume channels used for simple products such as call centre discussion of bank accounts.

23. In addition, what constitutes 'reasonable steps' may be interpreted differently by different advisers. NZBA submits that the CWG could publish guidance on what constitutes 'reasonable steps' before the Bill comes into force. NZBA submits that this guidance should be flexible so as to allow for meaningful interactions with advisors, and encompass a common set of principles that will permit compliance to be calibrated in a way that ensures positive customer experiences.

24. Finally, we consider that there should be alignment between the duties contained in ss 431I and 431J; the client first duty should be expressly limited by the duty to ensure the client understands the nature and scope of the advice. Otherwise, there is a risk that the legislation might be interpreted as requiring an adviser to provide advice on other products that are beyond the scope of the advice.

Duty to meet standards of competence, knowledge and skill

25. NZBA understands that the standards of competency will be set out in the updated Code, but emphasises that the CWG needs to ensure that they are clearly defined. The updated Code must strike a balance ensuring that advisers are appropriately regulated, without being unnecessarily burdensome. NZBA considers that there is a risk that advisers will be overregulated, a consequence being that retail customers may not have access to advice (as appears to have been the situation under the current regime).

26. NZBA also notes that where the new qualification standards are too highly calibrated, or require material re-qualification, there is a risk that current advisers may choose to leave the industry. This outcome does not accord with the policy objectives of the Bill, and will have adverse consequences for consumers.

27. In addition, NZBA recommends that the updated Code allow FAPs the flexibility to determine how its advisers will achieve the new competency standards. Where training options are limited to professional external training providers, this is likely to compromise the cost and efficiency of adviser training.

Liability for duties

28. Section 431T provides a limitation on pecuniary penalty orders against FAPs (amongst other things) if it can be established the FAP took all reasonable steps to ensure the financial adviser did not contravene the duty provisions (as defined). The current drafting does not provide an equivalent limitation for breach of a duty provision by a nominated representative. The duty provisions apply to nominated representatives and accordingly, NZBA submits that an equivalent limitation for contravention by a nominated representative is appropriate.

Financial advice exclusions

Exclusion for advice given for the purpose of complying with lender responsibilities

29. NZBA supports the inclusion of a carve-out in relation to advice given for the purpose of complying with lender responsibilities.

30. However, the exclusion should not be limited to a lender under a consumer credit contract, or relevant insurance contract, for the purpose of complying with the lender's responsibilities under s 9C(3)(a) to (e) of the Credit Contracts and Consumer Finance Act 2003 (**CCCFA**). This is likely to require lenders of consumer credit contracts and relevant insurance contracts to conduct an in-depth gap analysis between the requirements under this Bill, and the CCCFA to ascertain what, if any, other requirements a lender needs to comply with in relation to consumer credit contracts which fall outside this exclusion.

31. NZBA submits that the exclusion should be broadened to cover advice given by a lender to a borrower, about a consumer credit contract or relevant insurance contract when complying with the CCCFA. This will ensure that all relevant obligations under the CCCFA are covered, whilst also avoiding difficulties that are likely to arise in determining whether advice is given 'for the purposes of complying with' the relevant CCCFA obligations (and which will mean that the exclusion is unlikely to be relied upon in practice). Accordingly, we suggest that Schedule 5, cl 10 should read:

> **Advice given when complying with Credit Contracts and Consumer Finance Act 2003**
>
> (1) Financial advice is not regulated financial advice if:
>
> (a) a lender gives the advice to a borrower, guarantor, or security provider about:
>
> (i) a consumer credit contract, or
>
> (ii) credit related insurance, a security interest, or a guarantee entered by any party in connection with a consumer credit contract; and
>
> (b) that lender gives that advice when complying with the Credit Contracts and Consumer Finance Act, including any of the lender responsibilities in section 9C of that Act. "

32. If the current drafting of the exemption is retained in the Bill, the reference to the lender's responsibilities under s 9C(3)(a) to (e) will need to be amended to include s 9C(5). This will give effect to the policy intention that relevant insurance contracts are also captured by the exemption.

33. NZBA also notes that this provision may be difficult to navigate in practice. That is because under the CCCFA the lender is obliged to ensure that the customer chooses a product that suits their needs and financial status, while also ensuring that the customer understands the advice is not regulated financial advice and the implications of that. This will be particularly difficult where the advice simultaneously

relates to several different products, some of which may attract the exclusion and some which may not.

Exclusion for advice provided to meet the suitability assessment requirements for offers of derivatives to retail customers

34. Similarly, we consider there should be an exclusion for advice provided to meet the suitability assessment requirements for offers of derivatives to retail customers under the FMCA. In this instance, we believe that retail customers are already sufficiently protected by this piece of legislation.

Exclusion for providing factual information

35. Schedule 5, Part 2, s 7(a) provides an exclusion for 'providing factual information'. That section of the Exposure Draft previously referred simply to 'providing information'. NZBA considers that the exclusion as currently drafted is narrower and therefore slightly widens the definition of financial advice. The consequence of that drafting change may be that there is less scope for informal conversations with customers about products. Accordingly, NZBA seeks to understand the reason behind the change from 'providing information' to 'providing factual information'.

Disclosure obligations for services for retail clients

36. NZBA understands that disclosure obligations will be set by way of regulations. We would like to take the opportunity to emphasise that disclosure should be simple, clear, concise and meaningful for consumers. In this respect, NZBA recommends that the disclosure model ensures flexibility regarding how and when disclosure is made, in order to allow advisers to communicate with customers in sensible and relevant manner. It is also important that the disclosure model is able to cater for developments in technology. In addition, the disclosure regulations will need to reflect the nuances of the existing Code and updated Code. It is important that the content and timing of these two elements of the regime align.

37. The Bill clearly signals that the disclosure obligations will apply to both wholesale and retail customers. NZBA submits that it is not appropriate for the same disclosure obligations to apply to wholesale customers (for the same reasons as set out above in respect of the obligation to give priority to the client's interests). NZBA submits that, generally speaking, disclosure obligations should be more prescriptive in their application to retail customers than wholesale customers.

38. NZBA submits also that regulations should permit reduced or tailored disclosure in certain circumstances, or for certain groups of adviser engagement (eg telephone disclosures and generic advice by nominated representatives). An additional provision should be added to s 431N and s 431W to make clear that regulations can prescribe or allow different disclosures for different products or channels.

Transitional provisions

39. The success of the Bill will be in part dependent on:

    (a) The development of an updated Code, in particular, the competence requirements. Certainty around the standards set by the updated Code will be necessary before FAPs can develop courses, finalise training materials, and training/qualifying advisers.

(b) The development of disclosure requirements that are useful for customers and are practical for a wide range of products, channels, etc.

It is important that there is enough time between the finalisation of the updated Code and regulations and their coming into force to ensure the industry can comply in a proper manner. Accordingly, NZBA supports that the Bill allows for a longer implementation period, up to 3 years (Schedule 1, cl 86) as set out in the regulations. Setting a shorter deadline would risk putting unrealistic pressure on CWG, legislators and FAPs.

40. Additionally, NZBA notes that certain simple products are currently excluded from the scope of disclosure requirements under the FMCA. This includes certain bank term, PIE and notice products. Clause 54(1) indicates that the intention is to retain the exclusions from the FMCA, but this is reliant on the finalisation of regulations. The transitional arrangements (or commencement order) should ensure that the exclusion remains in effect until the regulations are finalised (to avoid the relevant products being brought temporarily within the scope of the disclosure and advice requirements).

41. Finally, NZBA considers that that the transitional period may create some barriers to entering the financial advice industry. The Bill appears to contemplate different treatment of new advisers compared with existing advisers. The explanatory note states that 'existing industry participants who do not meet the competence standards in the code of conduct will be protected by a safe harbour, recognising that it may take time for some to meet any new competence standards'. QFEs can also nominate new nominated representatives during the transitional period and will not have to meet the new competence standards.

42. However, it appears that new financial advisers and any new advisers for non-QFE entities (ie people who have not worked in the industry before in some capacity) will have to comply with the new competence standards during the transitional period.

43. NZBA considers that there should be relief for new financial advisers and new representatives of FAPs with transitional licences during the transitional period until there is training available to meet any new competence standards/continuing professional development and time has been allowed for qualification. It would also be problematic and inefficient for providers to have two different standards applying to two groups of financial advisers.

44. Barriers to entry could cause a shortage of investment advice, or shortage of advisers equivalent to registered financial advisers with a knock on impact, for example to the ability to access home loan finance.

Code of Conduct and the Code Working Group

45. NZBA submits that the functions of the CWG should make clear that it can provide guidance on the updated Code on an ongoing basis; in the absence of guidance from the CWG the FMA is the sole interpreter of the updated Code, and interpretation may diverge from the intention behind matters included. While the FMA will need to make judgements in the exercise of its supervisory function, there is also benefit to be gained from the knowledge and expertise of the CWG. Any guidance published by the CWG should be subject to consultation, including with FMA, but should not be subject to Ministerial approval.

Miscellaneous

46. NZBA also has the following further comments on the Bill:

- We note that the repeal of the FAA effectively removes the ability for a 'related body corporate' to also qualify as a wholesale client in their own right (as was the case under s 5C(1)(e) of the FAA). Given that there is also a material increase in the qualifying wholesale criteria to be classified as 'large' under the FMCA, many locally incorporated subsidiaries controlled by global multi-nationals will no longer meet the proposed wholesale classification in their own right. Despite this, the level of effective control imposed by their parent entity (or entities) should be taken as justification for them to also appropriately qualify as being a wholesale client.

  Accordingly, NZBA recommends that Schedule 1, cl 3(3) of the FMCA is revised, or that provision for related bodies corporate of qualifying entities is included. This is in line with equivalent legislation out of Australia, and other countries.

- It appears that during the transition period, holders of transitional licences will be able to continue to provide financial advice services under the current competence, knowledge and skill requirements for two years, and that other transitional arrangements may apply. This includes the provision of 'digital advice' (via a 'digital advice facility') in accordance with requirements of FMA's digital advice exemption notice. Given that the detail of the new requirements which may apply to digital advice is currently unknown, NZBA considers that it should also be made clear that new digital advice services may be permitted during the transition period on a footing equal to the current FAA exemption, in order to maintain a level playing field and facilitate digital advice. For example, the FMA might be permitted to vary or apply appropriate conditions to a transitional licence to require an FAP to comply with the existing FAA exemption. This arrangement should allow:

  - Exemptions for additional entities within a Group, where one entity had an exemption at the time the transitional licence was granted, but other(s) did not.

  - Exemptions for additional products or services (if applicable).

- NZBA considers that there should be alignment of the regime regulating advertising. Section 89 of the FMCA regulates advertisements for 'financial products' that are 'regulated offers'. That is a lot narrower than 'financial advice products' (eg credit contracts, insurance, etc). The section does not cover advertisements for non-regulated offers of financial products such as on call debt securities (eg regular bank accounts). The consequence is that an advertisement for KiwiSaver is exempted from being characterised as financial advice, but an advertisement for a home loan or an everyday bank account is not. That mismatch is carried through into the Bill. NZBA submits that this should be aligned.

- NZBA considers that staff should be permitted to continue to use their day-to-day job titles when interacting with customers, rather than the descriptors of 'financial adviser' and 'nominated representative'.

- With the abolition of the FAA regime, NZBA would encourage the FMA not to re-introduce a requirement for an adviser business statement. The compliance burden involved is not justified, given the relative benefits of that document. Licensed entities should have the same obligations as currently exist under the FMCA to ensure there is sufficient public information about the regulated entities.

- NZBA does not support the requirement that dispute resolution scheme (**DRS**) providers disclose all material complaints, rather than just a series of material complaints. Complaints may not be well founded and so it should only be when a series of material complaints have been upheld that the duty applies. NZBA therefore submits that the appropriate threshold should be a 'series of material complaints that have been upheld'. Additionally, NZBA considers that FAPs should be given an opportunity to comment before it is reported to the regulator.

- NZBA notes that the Bill proposes a compulsory reporting obligation on an approved DRS where that DRS believes that a relevant registered or licensed entity may have contravened, or is likely to contravene, relevant legislation. NZBA questions the appropriateness of this obligation, given the highly regulated nature of the entities that will be subject to s 67 and the additional strain that the obligation will impose on DRSs.

- NZBA notes that s 431G(6)(a) contemplates that a nominated representative could face civil liability where he or she is 'involved in a contravention'. As a result, this may compromise the availability and quality of advice provided by front line advisers. NZBA submits that this liability extension is unnecessary – an FAP has primary liability, and the regime also allows for the residual ability for a nominated representative to have individual criminal liability for knowing and reckless behaviour. Where this accessory liability is retained in the Bill, NZBA submits that a defence should be available for nominated representatives in respect of accessory liability, where that nominated representative has acted in accordance with the processes, controls and limitation of the FAP.