

Submission

to the

Financial Markets Authority

on the

Consultation paper: Regulatory
returns for licensed Class 3 financial
advice providers

4 November 2022

About NZBA

1. The New Zealand Bankers' Association (**NZBA**) is the voice of the banking industry. We work with our member banks on non-competitive issues to tell the industry's story and develop and promote policy outcomes that deliver for New Zealanders.
2. The following eighteen 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
 - 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.
 - KB Kookmin Bank Auckland Branch
 - Kiwibank Limited
 - MUFG Bank Ltd
 - Rabobank New Zealand Limited
 - SBS Bank
 - TSB Bank Limited
 - Westpac New Zealand Limited

Introduction

NZBA welcomes the opportunity to provide feedback to the Financial Markets Authority (**FMA**) on the Consultation paper: Regulatory returns for licensed Class 3 financial advice providers (**Consultation Paper**). NZBA commends the work that has gone into developing the Consultation Paper.

Contact details

3. If you would like to discuss any aspect of this submission, please contact:

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General Comments

Our detailed responses to the FMA's questions and the proposed regulatory return questions are contained in the tables at Appendices 1 and 2. We also make the following general comments:

1. Financial Advice Providers (**FAPs**) should be given sufficient notice of the final form of the regulatory return once it is finalised by the FMA. Implementation will require a substantial amount of work, including systems changes, and FAPs will need as long as possible to prepare for reporting. Please see further information on this in our response to question 1 in the Appendix below.
2. The FMA should only require information that is necessary for the FMA to monitor FAPs' ongoing capability to effectively perform the financial advice service. These returns should not create an undue compliance burden. Furthermore, sufficient responses to some questions could be provided without reference to some of the detailed information requested by the return. We also question the usefulness of FAPs providing this information in parts and in an assessment of whether they have complied with the conditions of their FAP licence. Please see further on this point in our comments below on question 2 in Appendix 1 and, in Appendix 2, see our specific responses to sections of the return.
3. Overlapping obligations with other licences or regulatory requirements should be managed in a way that also reduces any unnecessary compliance burden. Relevantly, for some banks, the RBNZ's BS11: Outsourcing Policy includes an assessment of the supplier's BCP and DR so that use of their services does not adversely affect a bank's ability to carry on all or part of their business. Some of the information requested by the return therefore creates a duplicative effort for relevant banks. If information relating to outsourcing is required, we would suggest that a simplified approach was taken (in respect of registered banks) to recognise the existing framework that governs affected outsourcing requirements. Overlapping outsourcing regulatory regimes could create a heavy compliance burden.
4. It would be helpful if supplementary guidance was included in parts to ensure consistency in the application of the questions between Class 3 FAPs. Please see our comments on section 10, Appendix 2 as an example. Additionally, a space to add further comments would be helpful where a response may not be straight forward. A business could add comments as they correspond to each question at the end of the return (for example, an explanation why the requested information cannot be provided or why the response may be 'nil' if that's the case).
5. We note that many of the questions in the Consultation Paper are subjective in nature. For example, the 'self-assessment' questions. We suggest these need to be more objective or fact based so that providers are clear on what is being asked and secondly, so the FMA obtains meaningful and comparable data. As drafted, there is a risk that providers interpret questions differently or make different assumptions in the process of determining the required information. Additionally, we consider it would be difficult to evidence/verify the response to these subjective questions.

6. We encourage the FMA to align its regulatory reporting periods with other regulators to the greatest extent possible, in order to minimise duplication and regulatory burden.

Appendix 1: FMA Questions

#	Question	Response
1	Do you agree with the proposed reporting period for the regulatory returns? If not, what is your preferred reporting period, and why?	<p>Please see point 1 of our general comments above.</p> <p>Expanding on that, the first regulatory returns will be due by 30 September 2024, for the year 1 July 2023 to 30 June 2024. FAPs will need to undertake a substantial amount of work prior to the start of the reporting period to enable them to collect and report the requested information to complete the regulatory return. Significant time and resource will need to be invested to build the necessary reports, make process changes and test the integrity of the data, as well as verify the information using appropriate governance frameworks. We suggest some discretion is allowed for the first reporting period to allow for estimations or exceptions given the tight timeframe.</p> <p>It is critical the regulatory return questions are finalised as soon as possible, and any necessary clarification and guidance is provided by the FMA well in advance of the start of the reporting period. We consider the requirements should be finalised by the end of 2022 for FAPs to have sufficient time to prepare for the first reporting period.</p> <p>We also suggest the FMA considers whether this reporting period aligns with reporting obligations across other regulators.</p>
2	Do you believe the requested information is appropriate and sufficiently well defined? Is there any information we shouldn't be asking for, or any clarifications we should make? Please give your reasons for this.	<p>Please see points 2, 3 and 4 of our general comments above. Please see Appendix 2 for our comments on the specific information requested.</p> <p>At a general level, we consider that some of the requests are likely too granular to assist the FMA to build a risk model for determining which entities the FMA wish to monitor.</p> <p>In addition, it is important that the questions asked in the offline version match exactly those asked in the online version. Our members have experienced discrepancies with other annual returns and this discrepancy can create issues.</p> <p>Clarity is also needed in relation to whether each question relates to the FAP licence holder, the authorised bodies or the licence holder and authorised bodies as a whole.</p>
3	Is there any other information we should ask for? If so, please state what, and how it would improve the returns?	<p>As noted in point 4 of our general comments above, we consider it would be useful for FAPs to have the ability to provide additional contextual information in response to some questions, especially for the questions requiring the FAP to self-assess maturity of systems and processes,</p>

#	Question	Response
		and questions relating to revenue types (question 25) and outsourced services (question 32). Giving FAPs the option to provide further context improves the quality of the FMA's data, enables FAPs to clarify any pertinent information which is not captured by the regulatory return questions, and will give further insight into issues faced by the industry.
4	Does providing the suggested information involve any systems changes or major costs for your organisation? If so, please outline these costs or changes	Our members will need to build system reporting and allocate additional resources to data collection, reporting, analysis and integrity testing. It is difficult to accurately estimate the cost involved in advance of the questions and FMA guidance being finalised.
5	We want the market to benefit from this information too. As such, are there any aggregate reports that could be generated from the data that would be useful for the industry (while maintaining the confidentiality of commercially sensitive data)?	We consider insights would be valuable. When the FMA publishes information and aggregate reports generated from the regulatory return data, it is critical confidentiality is maintained, especially for all commercially sensitive information FAPs are required to report.
6	We want to consider whether regulatory returns could be used to gather demographic information for FAPs advisers or their retail clients (or both). What demographic information do you hold that could be provided for a) those engaged under your FAP licence, and b) your retail clients?	We consider it is outside the purpose and scope of the regulatory return mechanism to collect demographic information from FAPs (both from an FMCA and Privacy Act perspective). We do not consider this information will assist the FMA to monitor a FAP's ongoing capability to effectively perform the financial advice service in accordance with the applicable eligibility criteria and other requirements in the FMC Act. We question the appropriateness of the mandatory regulatory return to collect demographic information, which will impose an additional regulatory burden on FAPs.
7	Do you have any concerns about the proposed timeframe for gathering and submitting regulatory returns (i.e. a three-month window)? If so, please specify.	<p>It is difficult to provide a more detailed response without being clear on nature of questions. However, we have two observations:</p> <ul style="list-style-type: none"> • Firstly, if we compare to the timeframe for completing the previous Advisor Business Statement, this was done over a nine-month period, including five months for data generation and validation. A preliminary review of the information required for the FAP regulatory returns suggests that at least the same amount of time will be required for completion. • Secondly, the three-month window aligns with the timeframes for Managed Investment Scheme (MIS), Discretionary Investment Management Service (DIMS) and Derivatives Issuer (DI) licence annual returns. On the face of it some of the proposed information for the FAP licence will be more difficult to obtain. Questions in the MIS/DIMS/DI annual returns are largely fact based and therefore relatively easy to source. In addition, the

#	Question	Response
		FAP return question are more comprehensive and broad ranging. Therefore, we suggest a longer window is warranted.
8	Do you have any other comments on the proposed regulatory returns?	<p>We consider the information a FAP is required to provide in the regulatory return should not require it to capture information that is additional to what the FMA needs to monitor the FAP's ongoing capability to effectively perform its financial advice service.</p> <p>The regulatory reporting proposal is comprehensive and much of the information will be labour intensive to obtain. We consider it critical the questions are aligned to the statutory requirements and the questions are proportionate and do not create an unnecessary regulatory burden.</p>

Appendix 2: Regulatory return information

#	Response
1a	We consider this question unnecessary and suggest it is removed. All Class 3 licence holders will be structured as FAPs 'operating as an entity' rather than as an individual.
4b	<p>This is an example of a subjective based question that is open to interpretation as FAPs will each assess themselves differently. We suggest that this question be removed or replaced with an objective question.</p> <p>If the question remains, it would be useful for the FMA to provide further guidance about how issues identified during a review affect the 'maturity' status of the processes and controls and the FAP's response to this question. For example, it should be made clear whether a FAP can select one of the options in the first two rows where it has reviewed its controls and control uplift has been identified.</p> <p>In addition, we consider it would be beneficial to have a 'free text' box added to all these questions which require a 'maturity' self-assessment (4b, 5b, 9, 17b, 20, 34, 37) so the FAP could provide additional context to its response.</p>
5a	It would be helpful for the FMA to clarify whether the questions in the return apply to the licence holder and its authorised body, i.e. are organisations required to provided cumulative data for all entities and is an organisation required to file the return on behalf of its authorised bodies?
8	<p>Part 1 refers to the competency of the FAP itself, but as the FAP is an entity, it is therefore not appropriate to ask whether the FAP demonstrates competency by way of holding the New Zealand certificate in financial services. Advice given directly by a FAP entity (for example via a robo tool) meets the competency standards because its personnel who sign-off on the advice meet the necessary competency requirements.</p> <p>We would welcome clarification of whether the text in red is related to the table above the text or below it.</p>
10a	This question is subjective and hard to substantiate. A FAP may be fully resourced to manage compliance with its FAP licence obligations, but it is not clear how this would be substantiated. Each FAP's response will be based on an undefined and unique list of variables, resulting in inconsistent data which cannot be compared across the industry.
10b	<p>We appreciate that the FMA want to be assured that Class 3 FAPs understand their level of cover for compliance purposes. However, given the varying sizes of each FAP, we question how the FMA will determine what sufficient resource for each FAP is.</p> <p>Additionally, Class 3 FAPS are typically large entities made up of many nominated representatives and a variety of different roles which play a part in oversight of our financial advice service. We query how a FAP would pro rata the time of all their compliance staff and a range of other staff (including management) to determine the proportion of their time that they spend on FAP licence compliance. If the question remains, we suggest the guidance includes wording that might assist Class 3 FAPS to define how many other roles across an organisation take part in compliance other than the designated 'compliance team'. This will ensure consistent application of the question across FAPs.</p>

#	Response
	<p>We also consider that self-assessments made earlier in the return relating to a FAP’s level of maturity (4.b.) and competency of oversight (8.), provide the FMA with the necessary information. We question the usefulness of providing this information to the FMA considering those self-assessments.</p>
<p>11a 11a(i), 11b 11b(i)</p>	<p>The definition of retail client does not align with the way most FAPs categorise and record client information. The FMA’s guidance for this question requires FAPs to count individuals who are joint borrowers and joint trustees as separate retail clients. This approach will likely require FAPs to build additional systems to collect and report the requested information to the required level of detail.</p> <p>There is inconsistency in what the question is asking for retail clients versus wholesale clients. For retail clients it asks how many clients received financial advice, whereas for wholesale clients, it asks how many clients the FAP has. We query whether this is intentional? We recommend that the question asks for total retail clients as opposed to those who received financial advice.</p> <p>We also consider that guarantors and people who hold powers of attorney should not be included in number of retail clients, unless they have received the financial advice service directly. It would be useful if guidance on the return could confirm this.</p> <p>We query the relevance of the questions relating to wholesale clients and whether the FMA requires this information to supervise FAPs given a FAP licence is only required in relation to financial advice given to retail clients. If the FMA retains this question, it is important additional guidance is provided to help FAPs interpret the FMA’s requirements and accurately report this data. For example, it should be clarified whether ‘group’ wholesale clients should be counted at the group, or individual entity level. Will the FMA require a regulatory return from entities who only provide financial advice to wholesale clients (noting these entities are not required to be licensed)? If not, this creates an unfair burden on those who offer financial advice to both retail and wholesale clients.</p> <p>11a(i) and 11b(i) will potentially require system build to report to this level. We would like to understand the value to the FMA of data distinguishing between types of clients, to assist a cost benefit analysis particularly as under the Financial Markets Conduct Act 2013, the definition of ‘retail clients’ extends to all entities (trusts, companies and associations included) who are not wholesale clients.</p>
<p>12</p>	<p>The responses include a category “provides financial planning” which is only relevant if prescribed by the regulations. If nothing has been prescribed by the regulations yet, we suggest omitting this category to avoid confusion.</p>
<p>13c</p>	<p>This question may lead to a variety of interpretations by different FAPs and would benefit from being more explicit in what it is looking for. Some specific comments/examples include:</p> <ul style="list-style-type: none"> • It is not clear whether the question is asking for Funds Under Advice (FUA) specific to debt securities, equity securities, derivatives and managed investment products or total FUA of the FAP. • Likewise, further guidance is required with respect to how the FMA would like to see derivatives “valued” in this section.

#	Response
	<ul style="list-style-type: none"> • By way of example, an organisation (licence holder) may offer advice to customers on KiwiSaver, however the KiwiSaver Funds are the authorised body's products. Therefore, the licence holder could include the full KiwiSaver FUM managed by the authorised body, however not all customers want or need advice. • We also note that account or lending values may differ at the date of filing the return compared with when the original advice was given, and guidance should be provided about when to assess the relevant the FUA figure. • In addition, it is difficult to estimate FUA for a large organisation where the financial advice business is only a part of their overall business. For example, a bank's customers can obtain a product either after receiving advice or without receiving advice. Savings and transactional accounts are debt securities, but it would be very difficult to distinguish FUA for these products. • Where the financial advice service is only part of the overall business, it will be difficult to ascertain whether or not a product has been obtained as a result of advice, or whether funds in a client's savings or transactional account are 'under advice' or not.
13d	<p>We suggest that the FMA should ask about replacement business during the period rather than as a result of the advice given by the FAP. Splitting information in this fashion is problematic as even if customers enquire after an insurance product an advice conversation will be required. This means data work will be undertaken to split the information out which will unlikely be very meaningful. The ability to add comments would be useful for this question.</p> <p>The note states that this question will only appear if the FAP provided regulated financial advice on contracts of insurance. It is not evident why this question goes on to ask for data about replacement consumer credit contracts. Replacement consumer credit contracts do not raise the same potential risks for consumers as replacement life insurance. Where an entity doesn't give replacement advice it is difficult to know in all circumstances whether a customer has acted on advice or not. We suggest removing this question from the regulatory return (or including a 'not applicable' response if a FAP does not actively provide replacement advice).</p>
13e	<p>Similar to above, where an entity doesn't give replacement advice it is difficult to know in all circumstances whether a customer has acted on advice or not. The regulatory return should also consider matters of scalability in relation to this particular data i.e. it is onerous and difficult for larger providers to accurately answer this question. We suggest removing this question from the regulatory return if a FAP does not actively provide replacement advice. In addition, we consider the wording of question 13e ambiguous. It is unclear whether the FMA is asking for information about the number of clients who have transferred away from, or to the provider the advice was provided about. We suggest the question is rephrased to make this clear.</p>
17a	<p>We suggest that the FMA should specifically enquire about customers who have used the digital advice tool from the point of the initial enquiry to completion of a transaction with a FAP, i.e not interacted with intermittently or a one off but completed the process from start to finish. We note that some tools are very basic and do not identify the customer or allow fulfilment. The FMA should clarify what information they are seeking in relation to digital tool users</p>
18a	<p>It is unclear why this information is required. If it remains, we suggest that the FMA should amend this to the number of certificates valid at the end of the period. We do not consider questions 18a and 18b are relevant to enable the FMA to monitor a FAP's ongoing capability to effectively perform the financial advice service.</p>

#	Response
	<p>Within each FAP, there are typically processes in place to ensure certificates are appropriately reviewed by trained staff. Additionally, it is unclear why the enquiry is about financial advisers when this is not a requirement under the legislation.</p> <p>Further, it is also the understanding of some FAPs that a Financial Adviser engaged by the FAP cannot sign off the confirmation of an eligible investor certificate for clients of that FAP. As such, the only time a FAP would be signing off on an eligible investor certificate would be if they don't have a relationship with the client and aren't going to give them advice or sell them a product. We would appreciate clarity on this.</p>
21	<p>The question refers to 'retail investors' and the corresponding guidance refers to 'retail customers'. These words carry different meanings under the FMC Act. We presume the question should refer to retail clients but would appreciate clarification.</p> <p>Further, this question is also an example of needing to provide information that may be difficult to obtain and verify. As an example, marketing by way of 'word of mouth' would be hard to quantify.</p>
23	<p>For large banks, there are ongoing campaigns to retain customers (not just financial advice customers). Whilst our members are happy to answer this question, we caution against asking for more granular information which would impose a high compliance burden on the FAP without a clear rationale.</p>
24	<p>Customers may receive financial advice through a variety of different channels. For example, a conversation in a branch, via a bank's call centre or online. It isn't always possible to say with certainty how much of that advice translates to a sale and resulting revenue, particularly given that some sales may not occur contemporaneously with the advice given.</p> <p>Aside from challenges in linking direct revenue to advice by product, we question the usefulness of a comparative assessment like this in assessment of whether banks are complying with their FAP licences. We question what this information will help the FMA understand, particularly given the existing and clear understanding by banks that frontline staff and managers cannot receive sales incentives. Therefore, we would suggest removal of this question from the return.</p>
25	<p>Response to this question will likely give a skewed view for entities that do not have any relevant fees for a portion of their financial advice business. Also, it should be made clear that the question is only referring to revenue derived from the financial advice service. This question is another that would benefit from a space to provide some context.</p>
26	<p>For some entities it won't be possible to dissociate the financial advice business from the overall business, and therefore answering this question in relation to the entities' financial advice business would seem very challenging. Class 3 licence holders will typically be large financial institutions and therefore the information regarding the overall business is already available publicly online if they are a registered company.</p>
27b, c, d	<p>It is unclear whether this question relates to all complaints or only advice related complaints. As a bank there are a number of operational matters (e.g. ATM out of commission) which are captured, however not related to advice. This distinction should be made clear.</p>
27e	<p>Complaints can often be resolved very quickly, therefore we caution drawing strong conclusions from this number.</p>
27f - j	<p>As above, it is unclear whether these questions are limited to advice-related complaints or refer to all complaints. Additionally, we suggest guidance should be provided to clarify whether these questions relate to:</p>

#	Response
	<ul style="list-style-type: none"> complaints the DRS is actively investigating, or whether it also includes complaints which have been reported in the first instances to the DRS (rather than having been escalated to the DRS by the FAP); and/or complaints the DRS receives (and refers back to the FAP to resolve), or only disputes which are complaints the DRS is formally investigating if the FAP has not met the client's resolution expectations.
28	<p>We suggest allowing FAPs to provide context to this answer.</p> <p>The Banking Ombudsman Scheme (BOS) uses different complaint categories which members must use to categorise complaints. The BOS list differs from the FMA's list, which we anticipate will lead to confusion and categorisation error. Where possible, we would consider it useful complaint categories to align to encourage consistent data reporting through the industry. The advice categories BOS uses are:</p> <ul style="list-style-type: none"> Advice & information other Failure to update information Non-disclosure of contractual terms Poor or misleading information/promotional material Poor or unsuitable advisory process Records inaccurate or stored insecurely Unsatisfactory correspondence Unsuitable or unsolicited sales/correspondence Withholding information <p>If the FMA's complaint categories remain unchanged, it would be useful to have greater clarity on the types of complaints which fall under the different categories, especially the differences between 'advice execution issues', 'service issues' and 'transaction and money handling errors'. Accurately categorising complaints across these categories may present challenges for some FAPs, especially banks, where these types of complaints are common and there is often significant overlap across the categories.</p>
31 - 33	<p>Please refer to our general comments relating to outsourcing and the duplicative work that will be undertaken by the relevant banks given their existing obligations under BS11.</p> <p>We consider it likely FAPs will take a conservative view to reporting its outsourced services, and will likely over-report services as being outsourced due to their misunderstanding of the FMA's definition and the possible consequences associated with the failure to report an outsourced service. This will result in inflated and unreliable data.</p> <p>In order to obtain more reliable information, we consider it would be useful to include a 'free text' box under 32d to enable the FAP to provide additional context about the extent of the services it has reported as being outsourced to a third party. We consider there is still confusion in the</p>

#	Response
	industry about what services are outsourced, and this additional contextual information will give the FMA insight into the issues FAPs are facing in accurately defining their outsourced services
36	<p>Considering ongoing conversations with other regulators and large entities on cyber reliance and cyber events, and the sensitive nature of the information requested, we'd suggest the FMA reconsider this question and whether the return is the appropriate forum to receive this information.</p> <p>Section 412 of the FMC Act contains an obligation to notify the FMA with respect to contravening licensing obligations of a material respect. Given this existing obligation, we consider that material breach reporting should be excluded from the regulatory return.</p> <p>We'd also appreciate clear guidance on scale. There is a lot of scope between a phishing email that did not result in a breach (the example provided in the guidance) and a material event. For clarity, we would like to understand whether the format of response for this question will simply be yes/no? Alternatively, will further detail of the events be requested if a FAP responds with 'yes'.</p>