Financial Services Council
of New Zealand
Level 33, ANZ Centre,
23-29 Albert St, Auckland 1010
P: +64 9 985 5762
E: fsc@fsc.org.nz
www.fsc.org.nz

26 February 2018
To the Economic Development, Science and Innovation Committee

Submission: Financial Services Legislation Amendment Bill

This submission is from the Financial Services Council of New Zealand Incorporated (**FSC**) and Workplace Savings NZ (**WSNZ**).

We wish to appear before the committee to speak to our submission, being represented by:

- Richard Klipin, FSC Chief Executive Officer
- and colleagues, based on availability

The FSC represents New Zealand's financial services industry having 32 members at 31 January 2018. Companies represented in the FSC include the major insurers in life, disability, income, and trauma insurance, and some fund managers and KiwiSaver providers plus law firms, audit firms, and other providers to the financial services sector.

WSNZ represents the interests of employers who offer workplace retirement savings schemes, their trustees and their members, other retirement scheme managers and supervisors, retirement savings industry service providers and professional advisers.

Our submission has been developed through consultation, and represents the views of our members and our industry. We acknowledge the time and input of all our members in contributing to this submission. This submission builds on our earlier submissions in response to the review of the Financial Advice Regime.

The FSC and WSNZ's guiding vision is to be the voice of New Zealand's financial services industry and we strongly support initiatives that are designed to deliver:

1. Strong and sustainable consumer outcomes;
2. Sustainability of the financial services sector; and
3. Increasing professionalism and trust of the industry.

We therefore support the intent of this Bill because the Bill is directed at improving access to high quality financial advice for New Zealanders. We believe changes driven by the Bill will help consumers make good choices about their financial wellbeing and develop a trusted industry where participants put the consumer first with transparent, simple, disclosure of interests.

We have six recommendations that we believe will strengthen the final form of the Bill and we expand on these recommendations below.

I can be contacted on 021 0233 5414 or richard.klipin@fsc.org.nz to discuss any element of our submission.

Yours sincerely
Richard Klipin
Chief Executive Officer, Financial Services Council

Recommendations

1. Giving priority to client's interests

We support the overall intent of the client-priority duty (new section 431J), acknowledging that the supporting detail will be critical to consistent interpretation and enforcement. We submit the supporting detail should be set out in the Code, given this will provide opportunity for further consultation on how the duty will work in practice, for different business models and market segments. We submit the further detail should also provide guidance on the interpretation of 'material influence'.

We repeat the request from our 31 March 2017 submission, for MBIE to provide clear guidance, together with safe harbour examples, on how to interpret the client-priority duty. This will be particularly helpful in the circumstance where a client's interests and the adviser's interests effectively align, but may result in a technical conflict.

We also note that, although the current drafting refers to a conflict situation, application of the section is likely to be broader because the majority of interactions have an element of conflict and choice. For example, hardly anyone in New Zealand offers all products, and some only offer one provider's products (particularly in the case of nominated representatives).

Additionally, we submit that the duty to give priority to the client's interests must be limited to and by the nature and scope of the advice and any limits disclosed under the proposed section 431I. The financial advice provider, financial adviser, and nominated representative should be required to go no further than the scope set under that section.

If consumers and advisers cannot agree to limit scope then there is a potential damaging effect on the ability for consumers and advisers to work together, and therefore an unintended impact on the provision of advice. For consumers, being unable to limit scope may force them to choose between an advice engagement that is unnecessarily large (and costly) and perhaps choosing not to take advice.

Consideration should therefore be given to:

- Supplementing section 431J with a subsection clarifying that giving priority to client's interests does not require a financial advice provider, financial adviser or nominated representative to consider products on offer from another financial advice provider. The alternative would be a potential requirement on financial advice providers to ensure their financial advisers or nominated representatives are across all products available in the market; and
- Renaming section 431J to 'Duty in relation to conflicts of interest' to better reflect the conflict management nature of the section and avoid an implication of a broader best interests duty.

2. Supporting documents and regulations needed urgently and more time needed to evolve

It is difficult to respond on the draft Bill in isolation from the Code and the detailed regulations. Our experience is that the industry is tending to take a cautious approach in the interpretation of the draft Bill.

This means there is a risk for consumers that the industry may choose to defer decisions such as launching new products and making price changes, which may have the unintended consequence of reducing consumer choice and competition.

Our members request guidance on what the duties actually mean, and we highlight that risks exist for the industry during the transition period if further clarity is not provided. For example, specific information is needed on what enforcement may look like during the transition period.

It is important that the Code and regulations be finalised in a timely manner so that financial advice providers can put appropriate compliance and transition processes in place. In the absence of a draft Code, regulations, disclosure requirements and licensing requirements, there is a risk that the transition period may not be long enough.

While the Code and regulations are being developed, our members are supportive of a regime that provides flexibility in the application of principles and allows advice providers to meet their obligations in a manner appropriate for their business.

Further, some of our members have complicated business models which, although they superficially may seem simple to transition, are significantly challenged by changes in the Bill. For example, QFEs today may have nominated representatives who are AFAs (and sometimes not directly employed). The Bill removes this construct requiring an exclusive role (either financial adviser or nominated representative). Addressing this and other changes is not a trivial exercise and for that reason more time to apply for a transitional licence should be provided.

3. Clarifying the definition of financial advice

We note the proposed addition to the Financial Markets Conduct Act 2013 section 6(1) of a definition of 'financial advice product' that includes 'a renewal or variation of the terms or conditions of an existing financial advice product'. However, the proposed section 431C interprets a person giving financial advice as making a recommendation or opinion about 'acquiring or disposing of (or not acquiring or disposing of) a financial advice product'.

We recommend clause 431C be amended to include 'renewing or varying a financial advice product' to bring consistency with the proposed addition to section 6(1). The financial services industry operates by providing financial advice and products not just to new customers, but also to existing customers who wish to vary, retain or replace their products.

If the Bill goes through unchanged, then unintended consequences could include a narrowing of advice scope, confusion for consumers and the industry, and ultimately a reduction in the quality of advice received by consumers.

Further, we are aware of uncertainty around whether advice on switching between investment funds in a retirement scheme (i.e. a KiwiSaver, superannuation or workplace savings scheme) is financial advice, with some views being that a switch is a variation of the terms or conditions of a financial advice product. In light of the consumer-impact from switching funds in an investment product, we recommend that consideration be given to clarifying this point by including in the 'financial advice product' definition an addition explicitly capturing switches between funds in retirement schemes.

4. Excluding wholesale clients from section 431J

The objectives of the reform, set out in the consultation paper, are to ensure consumers can access advice they need, to improve their financial outcomes and make them better off. The reforms were not intended to give extra protection under law to wholesale clients such as investment businesses and large entities.

We consider that many wholesale clients are sophisticated and do not need the specific protections proposed in the Bill. As stated in the Explanatory Note to the Bill, 'Wholesale clients are generally large or sophisticated clients such as banks, investment businesses, or high net worth individuals who do not require or benefit from the same degree of protection as retail clients'. Extending the duty to give priority to clients' interests would significantly increase compliance costs without any clear benefit. Extending the duty would also divert attention away from those the regime should protect – retail consumers.

Our members have two recommendations on this topic.

A. The duty in the proposed section 431J should not extend to <u>many</u> wholesale clients, considering that in most cases wholesale clients can rely on their contractual terms. An exception, however, should be 'investment activity criteria' clients (FMCA, Sch 1, cl 38). This would ensure that investment businesses (cl 37), large (cl 39), government agencies (cl 40) and eligible investors (cl 41) remain

outside of the scope of section 431J, maintaining the policy purpose of protecting retail clients plus individuals who have not explicitly opted to be eligible investors.

B. The duty in the proposed section 431J should not extend to any wholesale clients, and that in all cases wholesale clients can rely on their contractual terms.

5. Proposed sections 431P, 431Q and 431T

Our members acknowledge the steps toward creating a level playing field for financial advisers and nominated representatives. Financial advice providers will play a critical role in ensuring good conduct and enforcement of the duties of their advisers and representatives.

We note that section 431Q means that financial advice providers must design payments and incentives in such a way that their nominated representatives will not breach sections 431H to 431O. Care should be taken to ensure that the playing field remains level for all types of advice and adviser categories.

Moreover, the addition of an 'all reasonable steps' defence for financial advice providers regarding financial advisers is welcomed. However, members remain concerned that the defence does not extend to Nominated Representatives. We submit that it is important to appropriately incentivise financial advice providers to ensure that their processes and controls are adequate for both nominated representatives and financial advisers to ensure that all advisers comply with the legislation. From a practical perspective, the current proposal has the potential to cause financial advice providers undue compliance costs and complexity. For example, in light of the different risk profiles of financial advisers compared to nominated representatives, financial advice providers may create two separate sets of compliance frameworks, which may lead to different internal processes, controls and limitations, with a consequent impact on customer experience.

For sections 431P and 431Q to operate effectively and consistently throughout the financial services industry, guidance is required. We submit this guidance should come via the Code.

6. Financial advisers who work for more than one financial advice provider

Our understanding is that a nominated representative can only be engaged by one organisation, although a financial adviser can be engaged by multiple organisations.

It is commonplace for 'independent' financial advisers to have agreements with multiple product providers to distribute products (for example, in small towns across the regions it is common for advisers to represent different product providers, or different advice providers). Consideration needs to be given to the potential that a financial adviser may be engaged by more than one financial advice provider and the operational impact of this on financial advisers and financial advice providers, particularly on how the licensing and civil liability provisions would be applied. Our members request further guidance on the consequences of a financial adviser being engaged by more than one financial advice provider. This guidance should be provided as a further example under the proposed section 431D.

Given that manufacturers have multiple agreements with financial advisers to distribute their products, our members also request further guidance on the definition of engaged – as relates to a non-employee relationship. For example, it should be clear that when a manufacturer contracts with an independent financial adviser to distribute products, whether or not it is caught by section 431D(1)(a).