

Submission on the Conduct of Financial Institutions Options paper

Submitted Friday 7 June to <https://www.mbie.govt.nz/have-your-say/financial-institutions-conduct-review/quick-feedback-form/>

Quick submission form: Conduct of financial institutions

What is your feedback on the overarching duties? Which option do you prefer and why?

Please refer to our response to the general feedback question below.

What is your feedback on the options to improve product design? Which option do you prefer and why?

Please refer to our response to the general feedback question below.

What is your feedback on the options to improve product distribution? Which option do you prefer and why?

Please refer to our response to the general feedback question below.

What is your feedback on the options relating specifically to insurance claims? Which option do you prefer and why?

Please refer to our response to the general feedback question below.

What is your feedback on the options for tools to ensure compliance? Which option do you prefer and why?

Please refer to our response to the general feedback question below.

What is your feedback on who the conduct regulations should apply to? Which option do you prefer and why?

Please refer to our response to the general feedback question below.

What is your feedback on the initial preferred package of options?

Part 4 – Who should the conduct regulation apply to?

Application of options to banks, insurers and other financial institutions

We support option 1 (applying the preferred package of options to retail banks and insurers only). In summary, this is because:

- The problems identified in the banking and insurance sectors are as a result of the particular circumstances in those sectors. Those circumstances do not exist more widely in the financial services industry, and in particular, do not exist in the securities industry.
- There is no clear evidence of poor customer outcomes and practices outside banking and life insurance.

- The financial services providers identified in option 2 as delivering services that are “similar” to the services provided by banks and insurers (in particular, discretionary investment management services (**DIMS**) and managed investment scheme (**MIS**) providers) are already well-regulated.
- As a result, it would be disproportionate to impose additional regulation any wider than banks and insurers.

We expand on these points in turn below.

Banking and insurance industries

There is a unique combination of factors at play in the banking and insurance industries:

- Banks and insurance companies in effect operate with a vertically integrated model, focusing on both product manufacturing and sales. The salesperson or adviser is paid by the product provider not the consumer, and the consumer receives little or no information about what that is costing them. That gives rise to conflicts of interest that are not easily managed.
- Banking and insurance are essential services for consumers, who have no choice but to engage with the providers. That gives rise to cross-selling opportunities where again sales/adviser remuneration structures can create conflicts of interest.
- Consumers face difficulties in comparing providers and their products and as a result, face high switching cost.
- The industries are characterised by a small number of large providers, leading to weak competition.

The combination of these factors means that customers can be vulnerable to the conduct of these service providers and their salespeople.

By comparison, NZX firms focus on delivering securities advice and providing execution and wealth management services directly to consumers. The firms are intermediaries, and not tied to a single product provider, and management of conflicts of interest is much more straightforward as a result. Consumers engage with securities firms by choice, not because they have to. Switching costs are low and consumers are more likely to experience better competition and can more easily ‘shop around’ for a service that best meets their requirements. It is clear from the initial engagement that they are paying for any contracted financial advice, transaction and management services and what those costs might be, and these costs are clearly disclosed to consumers.

No clear evidence of poor customer outcomes and practices

As noted in the consultation paper, there is no clear evidence of poor customer outcomes and practices outside banking and life insurance.

In particular, the conduct of the securities industry was not identified as a part of the financial sector needing to be examined through the Australian Royal Commission review process, nor has there been any evidence or concerns about the industry raised by its regulators in New Zealand.

SIA members belong to an independent dispute resolution scheme, Financial Services Complaints Limited, and it is our understanding that complaint levels have been very low in our industry for many years.

DIMS and MIS already well-regulated

The financial services providers identified in option 2 as delivering services that are “similar” to the services provided by banks and insurers (in particular, DIMS and MIS providers) are already well-regulated under the Financial Markets Conduct Act (**FMC Act**). The FMC Act provides for specific conduct obligations for firms and their directors and senior managers, as well as restrictions on related party transactions.

We note that while many of the large banks and insurers also hold MIS and DIMS licenses, only a small part of their business is regulated from a conduct perspective, not the business as a whole.

Disproportionate to impose additional regulation any wider than banks and insurers

As a result of these factors, the SIA is of the opinion that there are already sufficient legislative and regulatory frameworks in place to ensure that sufficient systems and processes are operating and good conduct standards are maintained. The addition of a new conduct regulatory regime is likely to result in a burden of duplicated compliance requirements and disproportionate increases to regulatory costs for firms.

We agree that if option 2 (apply preferred package of options to all those financial services providers similar to banks and insurers) was adopted that it would be best to consider this after a regime was implemented to banks and insurers, firstly to assess whether it was necessary to apply it more broadly, and secondly, to ensure the regime was effective and fit for purpose.

Overlap with existing regulation

As explained above, the SIA does not support extending a new conduct regime to the securities industry.

However, should a new conduct regime be broadened to include other financial institutions, then we would strongly support the approach outlined in option 2 (carve out overlaps from existing regulation).

Given the sufficient and effective regulatory frameworks already in place, SIA would expect appropriate carve-outs for the securities industry to reduce duplication and to ensure that customers were not burdened with any flow-on effect as a result of increased costs from an additional and unnecessary layer of compliance arising from dual regulation.

Do you have any other general feedback?

Competitive, healthy and highly-regulated industry

Customers benefit from a highly competitive securities industry. There are 15 NZX trading and advising Market Participant firms, and new participants are encouraged. A competitive, well-regulated and transparent industry strengthens the quality of service delivered, engenders confidence in the industry, and ultimately benefits customers.

NZX Market Participant firms are already highly regulated. They are accredited by NZX and required to adhere to the NZX Participant Rules and Guidelines. Firms are also monitored regularly and NZX’s regulatory arm also carries out frequent inspections of NZX Market Participant firms.

There are already significant mechanisms in place for the Financial Markets Authority (**FMA**) to regulate effectively under the new Financial Services Legislative Amendment Act. Retail client advisers already adhere to the Code of Professional Conduct for Authorised Financial Advisers and firms and

advisers will also be required to meet the requirements of the Code of Conduct for Financial Advice Providers when it comes into effect.

An additional layer of compliance and regulation would duplicate processes and systems already in place, and without delivering any additional benefits to customers. However, it would likely result in an increase in compliance costs that may then be passed on to customers. In an industry that is already highly and effectively regulated, the additional layer of duplicated regulation would not likely result in an increase in positive outcomes for consumers.

The very nature of our industry is based on promoting good customer outcomes and good conduct through trust, professional advice, transparency, managing conflicts of interest, and ensuring customers receive appropriate information to make decisions that are in their best interest.

We suggest any new regime should focus on the identified issues with the industries that are of concern and that it is not necessary to apply the regime to the wider industry where there is no evidence of the same issues.

Should any gaps in the existing legislation and regulations be identified during the process of considering a new regime, then changes should be made to make them more effective.

Your details

Your name Bridget MacDonald

Your email address **Privacy of natural persons**

Your organisation

The Securities Industry Association (SIA) is the voice of New Zealand's securities industry and represents the shared interests of sharebroking, wealth management and investment banking firms that are accredited NZX Market Participants. We support initiatives that deliver investment opportunities for New Zealanders, promote the success of New Zealand's financial markets, and contribute to the sustainability of the economy.

SIA provides a forum for the industry to discuss issues and developments, engage with stakeholders, and manage industry change. As advocates for trusted, vibrant and resilient financial markets, we represent the industry non-competitive operational, policy, regulatory and legislative matters to strengthen and grow New Zealand's financial market ecosystem.

SIA members employ more than 500 accredited NZX Advisers, NZDX Advisers and NZX Derivative Advisers, and more than 400 Authorised Financial Advisers nationwide. The combined businesses of our members work with over 300,000 New Zealand retail investors with total investment assets exceeding \$80 billion, including \$40 billion held in custodial accounts. Our members also work with local and global institutions that invest in New Zealand.

In what capacity are you making this submission?

Industry group

Use and release of information

The *Privacy Act 1993* applies to submissions. You may choose how your personal information is used.

Unless otherwise requested, we may also share submissions received with relevant government agencies such as the Financial Markets Authority.

Can we include your name or other personal information in any information about submissions that we may publish?

Yes

We intend to upload submissions to our website. Can we include your submission on the website?

Yes

You may ask us to keep your submission, or parts of your submission, confidential. If so, you'll need to attach reasons and grounds under the Official Information Act 1982 for consideration.

No, I do not wish for my submission to be kept confidential

PROACTIVELY RELEASED