Submission on exposure draft "Financial Markets Conduct (Regulated Financial Advice Disclosure) Amendment Regulations 2019" (Draft Regulations) and accompanying consultation paper

8 November 2019

Introduction

1. This is a submission on behalf of **Nikko Asset Management New Zealand Limited** (Nikko AM). No part of this submission is confidential.

2. Most of the Financial Services Legislation Amendment Act 2019 (FSLAA) was settled before there were any live digital advice services in New Zealand. This potentially includes the "new disclosure requirements that will apply in the new regime" in the Draft Regulations. The consultation paper notes that the policy decisions were made in February 2019, whereas Nikko AM's digital advice platform GoalsGetter (the first digital advice service in New Zealand) did not go live until March 2019.

3. We ask that MBIE is open to making some changes to the Draft Regulations so that at least this part of the regime, which has not yet been finalised, can properly be informed by some real life experience of the thing being regulated.

Why digital tools will require a different approach to regulation over the long term

4. After approximately 7 months of operating our digital platform, four things have become apparent to us:

    a. Some of the risks presented by digital advice tools and the harm that can flow from them are very different to the risks presented by human advisers. Therefore the regulatory solutions that we will need are different in those areas. The risks from human advisers primarily lie in how the advisers choose to behave given the human traits they have e.g. their incentives, their conflicts of interest, their competency etc. The FLSLAA regime, including the Draft Regulations, focus on these human behavioural risks. In contrast, digital tools follow the instructions they have been given to the letter so human behavioural risks are not relevant. Instead there are risks around how a tool is designed in the first instance,

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how to maintain quality assurance that an algorithm will not deliver an unintended outcome in a scenario that has not been anticipated, and about the security of information that is input into a system. The FLSLAA regime (including the Draft Regulations) does not appear to fully address these risks.

b. Further, the end user experience of receiving advice via an online tool is in some ways different to receiving face to face information. In particular:

   i. The online format lends itself to providing layers of information i.e. short punchy information in the first instance, but with the ability for the receiver of the information to drill into areas of greater interest and follow links to explanatory materials. (It does not lend itself well to lengthy legal documents - this impacts on how disclosure should be provided);
   ii. The online format lends itself to receivers of information being able to visually see the likely impacts of changes in their decisions e.g. as they dial up or down their contributions they can see visually the changes to their projected outcomes;
   iii. There is potentially convergence between product and advice, for example the advice that GoalsGetter provides will include parts of the product PDS; and
   iv. It can be anonymous. Any person can log on to GoalsGetter and receive advice/information without us knowing who that person is. The provision of information therefore needs to be far more careful as there is no ability to explain or to put it into context. A human adviser providing a regulated disclosure document for example, would be able to explain any aspects of a prescribed document that were more difficult or potentially confusing.

c. As time goes on the gap between human advice and digital advice will likely increase because of the capacity for digital tools to collect and use significant amounts of data from different sources, so that digital tools of the future may for example:
   i. Help people search for products that exactly match their ethical values;
   ii. Automatically manage the switching of products to lowest cost providers; and

iii. Collect much more information about the person e.g. through their banking transactions. (This will create moral and regulatory challenges that are not conceived of by the provision of human advice.)

d. We do not believe that digital advice solutions will replace the need for human advisers. Instead digital tools will provide a different kind of service that hopefully helps those who would not go to a human adviser and they will also provide a range of calculation and data aggregation functions that a human adviser could not provide.

5. Where we find ourselves now is that we will have a regime with rules that address the risks of human advisers. This regime has been made “technology neutral” by the FSLAA simply by broadening the wording of the obligations (and the adviser Code) so that there is a plausible way for digital tools to claim that they comply. However, because some of the key risks of digital advice tools, the end user experience of using digital advice tools and the evolution of digital advice tools are so different to the provision of advice by humans with different problems to solve for, we consider that this regime will not be fit for purpose over the long term and is not “technology neutral” in the sense of addressing risks arising from provision of advice in all mediums.

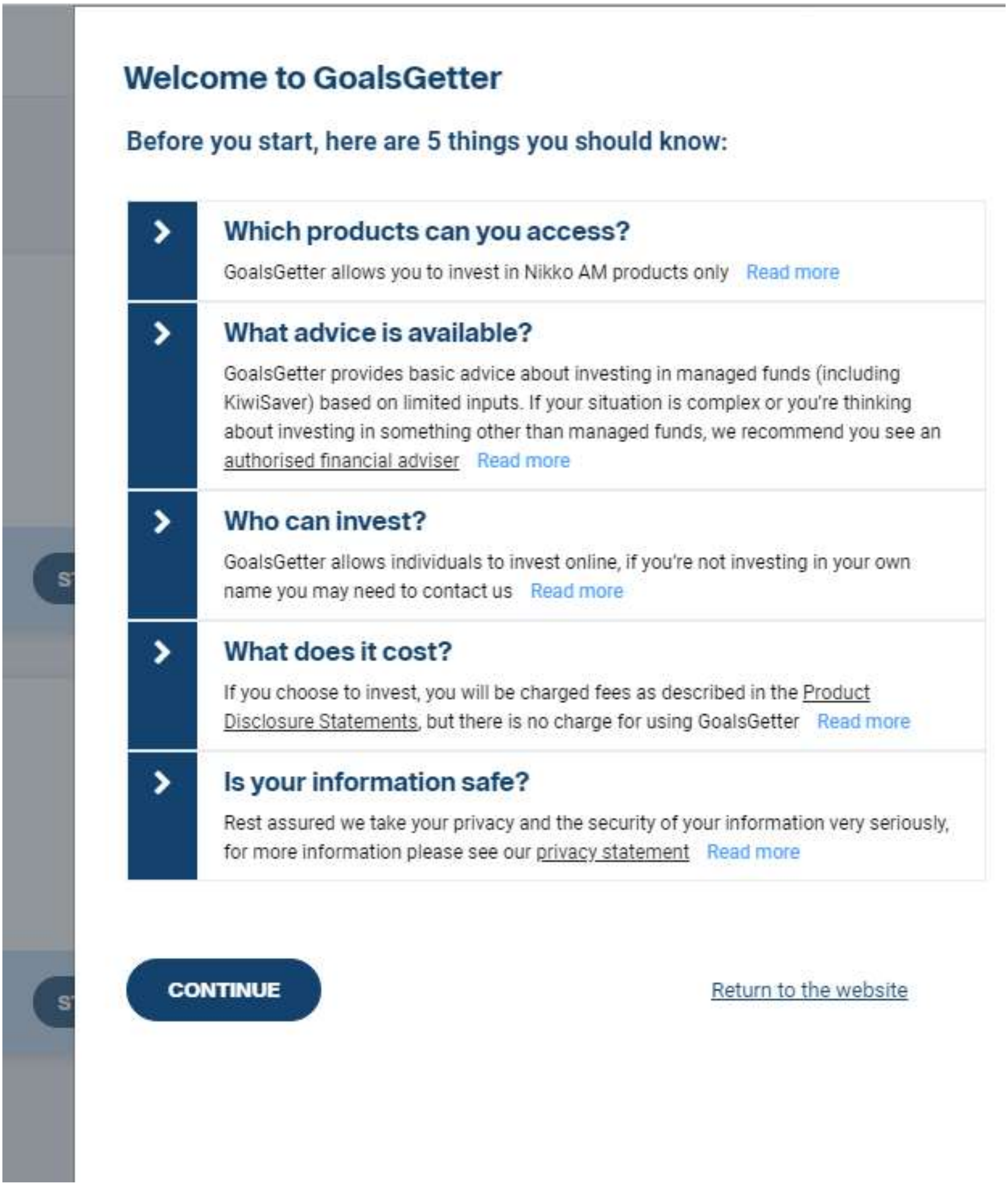
6. Currently there are only two digital platforms in New Zealand, so we are not proposing that the FSLAA as a whole needs to be reconsidered today. However, it is probable that within five years digital tools will have gained a very significant impact on the market. Therefore it is useful to begin think about what a digital focused regime might look like in the future. (We note that a digitally focused regime need not relate to the provision of advice only, but it could also rethink the approach to product disclosure. We consider that the current rules relating to the disclosure of products is sub optimal because it has been designed around a linear paper based format and does not take advantage of online ways of presenting information. This is unfortunate because most people will access disclosure documents online today.)

7. In the meantime, we seek what we see as being minimum changes to the Draft Regulations so that they at least take into account some of the system design features of digital tools, they exclude some of the human behavioural risks that are not relevant to a “machine”, and enable disclosure to be delivered in a more appropriate way for the digital format.

<u>Flow through into the Draft regulations:</u>

<u>Question 1- Will the proposed record-keeping requirement be workable in practice?</u>

8. GoalsGetter has been designed so that before a person can access the tool they are taken to a “filter” page which they have to click through to proceed. The “filter” page covers off the compliance disclosure issues that would be the equivalent of what we would be asked to keep records for under 192A the Draft Regulations. A screen shot is set out below:


Welcome to GoalsGetter
Before you start, here are 5 things you should know:
Which products can you access?
GoalsGetter allows you to invest in Nikko AM products only Read more
What advice is available?
GoalsGetter provides basic advice about investing in managed funds (including KiwiSaver) based on limited inputs. If your situation is complex or you're thinking about investing in something other than managed funds, we recommend you see an authorised financial adviser Read more
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GoalsGetter allows individuals to invest online, if you're not investing in your own name you may need to contact us Read more
What does it cost?
If you choose to invest, you will be charged fees as described in the Product Disclosure Statements, but there is no charge for using GoalsGetter Read more
Is your information safe?
Rest assured we take your privacy and the security of your information very seriously, for more information please see our privacy statement Read more
CONTINUE
Return to the website

9. At the point that a customer clicks through this page he or she is entirely anonymous to us. Therefore we cannot keep any meaningful record of disclosure statements being given to customers as proposed regulation 192A requires.

10. However, we have confidence that any person who receives advice via the GoalsGetter tool will have received this statement, as the system has been designed so that it is simply not possible to enter the tool without going through the "filter" page.

11. We note that the reason for the Draft Regulations asking advisers to keep a record that disclosure has been given reflects the behavioural risks of humans, who can choose to omit or forget to give disclosure, despite there being a rule requiring them to give disclosure. These behavioural risks are not relevant in the digital format, instead the issue of whether a person receives disclosure is a matter of how the tool has been designed in the first instance.

Proposed redraft of reg 192A

12. We propose a reworking of draft regulation 192A so as to be workable in the digital context:

    A market services licence for a provider of a financial advice service is subject to a condition that the financial advice provider (P) must keep ~~a~~ records that together, in the case of digital advice providers, with relevant policies, records of systems rules and processes, demonstrate compliance with P's ~~of each disclosure~~ obligations [under regulation 229D, 229E, or 229F]. ~~that is given by P or by any person engaged by P to give advice to P's clients on P's behalf~~.

13. We also consider that there may be merit in using broader words than those in square brackets.

Question 2 - Do you have any comments on the drafting of the Regulations that will require information to be made publicly available?

14. We have no issues with providing the information described in 229C on our website. However, as an entity that only provides advice in the digital context, it is inappropriate to require us to make

information available in hard copy format. (We make this comment in relation to every instance where the Draft Regulations would ask us to provide hard copy documents.)

<u>Disclosure when the nature and scope of advice is known and disclosure when financial advice is given</u>

Question 3 - Do you have any comments on the draft Regulations that will require the disclosure of information when the nature and scope of the advice is known?

Question 4 - Do you have any comments on the draft Regulations that will require the disclosure of information when the financial advice is given?

15. In the digital format, there is generally no separation between the two steps because a person comes onto our website and either chooses to use it or they do not based on our filter page that they have to click through. Therefore we are choosing to answer this question as though they are one combined set of requirements.

16. Our overarching point is that in the digital format a short and very punchy disclosure statement is something that a customer may engage with, whereas with a more lengthy statement the customer is less likely to engage, which defeats the point of the disclosure.

17. To illustrate the point, we invite MBIE to compare the likely impact of our current short disclosure statement with our disclosure statement that we initially had on GoalsGetter. The initial statement addressed the requirements of the digital advice exemption that we operate under in a more literal way:

    <u>Current statement:</u>

Welcome to GoalsGetter

Before you start, here are 5 things you should know:

Which products can you access?

GoalsGetter allows you to invest in Nikko AM products only Read more

What advice is available?

GoalsGetter provides basic advice about investing in managed funds (including KiwiSaver) based on limited inputs. If your situation is complex or you're thinking about investing in something other than managed funds, we recommend you see an authorised financial adviser Read more

Who can invest?

GoalsGetter allows individuals to invest online, if you're not investing in your own name you may need to contact us Read more

What does it cost?

If you choose to invest, you will be charged fees as described in the Product Disclosure Statements, but there is no charge for using GoalsGetter Read more

Is your information safe?

Rest assured we take your privacy and the security of your information very seriously, for more information please see our privacy statement Read more

CONTINUE

Return to the website

Previous statement

Is GoalsGetter right for you?

This tool...

- Enables you to set and manage investment goals in your own online account. You can select a retirement goal, which may also include KiwiSaver, as well as other types of goals such as building wealth, saving for a holiday or a custom goal you decide.
- Will demonstrate what your goal may be worth in a specified time frame, when you provide a specific series of inputs.
- Can provide recommendations regarding the amount you should consider saving for your retirement.
- Can provide recommendations, based on your risk tolerance, of what type of fund(s) you should consider to achieve your goal and which of the Nikko AM funds you could invest in to achieve this.
- Calculates the amount you would need to contribute to achieve your chosen goal.
- Relies on a limited number of inputs provided by you to deliver recommendations.
- Enables to you to invest in the Nikko AM Investment Scheme and the Nikko AM KiwiSaver Scheme.
- Does not charge a fee for using it there is however fees charged when investing in the funds/schemes. More information on fees can be found in the relevant Product Disclosure Statement.

This tool doesn't...

- Provide a comprehensive financial planning service taking into account debt, ownership structures, asset protection, your insurance needs, taxation or your wider circumstances.
- Take into account your circumstances outside of the limited inputs you provide.
- Assess whether you can afford the calculated contribution to achieve your goal.
- Assess whether investing in Nikko funds is the most appropriate investment for you.
- Recommend any non-Nikko AM funds.
- Guarantee future returns or prevent you from losing some of your capital.
- Provide a comprehensive assessment of your risk tolerance and attitude. The risk assessment questionnaire is limited to assessing the risk relating to investing into the limited range of Nikko AM products made available.

Still not sure? Do any of these apply to you?

- You have **high interest debt** which you'd like to be taken into account in any investment recommendations
- You are looking to use this platform to invest in **securities** directly, for example buying shares in companies, bonds or term deposits
- You require your **overall financial situation** to be included in any advice you may receive from this tool
- You want to invest into **managed funds that are not provided by Nikko AM**
- You are intending to use the **KiwiSaver Scheme funds to purchase your first home**
- You are wanting an investment similar to a **bank savings account or term deposit**

RETURN TO THE WEBSITE | CONTINUE TO GOALS GETTER

18. Given that context, we comment below against each of the items of information required to be presented with a view to keeping the overall disclosure requirements as short as they can possibly be:
    a. Safety of information – this is a key issue that would influence a person as to whether to access a free digital tool and so should be covered by the upfront statement but it is not provided for in the Draft Regulations.
    b. Nature and scope of advice- We agree this is important. We provide advice on Nikko products only and that is the first of our five points. There are also limitations around what a digital platform can do and that is the second of our five points.
    c. Licensing information – we are happy to mention that we hold a licence but the detail of any licence conditions ends up being an input into what the nature and scope of the service is. Therefore if the nature and scope of the service is well articulated, we query whether licence condition information adds value.
    d. Reliability history – If Nikko were to have any "reliability event" that was required to be disclosed as a 6^{th} bullet on our currently 5 bullet statement, we believe it would be extremely prejudicial to our ability to operate our advice tool. With a human adviser there is the opportunity to explain face to face the context for any reliability event, but in the digital format any issue will be the first thing that a person sees and there will be no opportunity to explain.

       We also note that businesses are required to invest a significant amount of money to create a digital tool, which could effectively all be lost in the event of a requirement to publish a reliability event.

       To have such a sword hang over a business is unjust if it can fall heavily despite a potential transgression being very minor and/or not in any way relevant to the provision of financial advice. For example, if a provider was to receive an infringement notice for late filing of its financial statements for its funds (which is a very low level breach because funds already provide value transparency via their unit pricing and not relevant to our reliability as a provider of digital advice), then that would fall within the definition of regulation

3(1)(b)"…regulatory action… in relation to the contravention… of any… financial markets legislation".

Not only is this regulation unreasonable in terms of its disproportionate impact (given that there appears to be no minimum threshold or relevance threshold) but we also question whether it is legal or necessary in general for all advice providers, not just digital providers:

As context to our comment we make three observations:

- The FSPR Act already disqualifies persons from registration if they have committed offences at the more serious end of the spectrum of "reliability events" e.g. dishonesty crimes within 5 years. Therefore the provision in the Draft Regulations is in fact more relevant to contraventions at the lower end of the spectrum.
- The FMA already has a statutory power in section 49 of the FMA Act 2011 to require persons to disclose FMA warnings that have been given (including requiring an entity to publish the warning on its website, or to give copies of the warning to certain persons). This power can be used in situations where an adviser should not be barred from acting but there is merit in warning people the adviser is dealing with about the person.
  It should be noted that the statute provides rules around when this power should be exercised. It can only be exercised if the FMA has considered the impacts on the market (as per s49 (5)(a)) and has followed a consultation process with the person on the receiving end of the decision (as per s 49(5)(b) and (c)). This emphasises the point that requiring a person to publish adverse regulatory findings can be both contrary to the welfare of the market and be disproportionate to the subject, and provides a mechanism for requiring such disclosures where it is helpful; and
- The obligation could fundamentally alter the consequences of a breach, where the consequence has already been determined by statute. We question whether the general regulation making powers in s 546 allows for the changing of the punitive consequences for breaching the legislation.

Overall, we believe that if there is any requirement for publishing information about adverse decisions:

- There should be relevance to the provision of financial advice and materiality thresholds; and

- The prejudicial impact of the publication should not be disproportionate in the circumstances.

e. Identifying information - No issues

f. Fees or expenses – No issues.

g. Conflicts of interest – In theory this should not be relevant, but there is no materiality threshold. We consider that it would be unhelpful if we were required to confuse our disclosure statement with very obscure non material information, if we were to discover that there was some remote conflict.

h. Complaints handling and dispute resolution – we agree this should be available somewhere on the website but it is not a key piece of information that a customer needs to know upfront before they enter a free to use tool. Publication somewhere on the website should be sufficient.

i. Availability of information – customers should not be able to request hard copies of information free of charge from a provider that is operating in an exclusively digital format (hard copy requests for a suitable fee would be reasonable).

j. Duties information – we consider this to be low value information that will distract from the key points that a customer should actually know, particularly as many of the ethical duties relevant to human advisers are not really relevant to a digital tool for the reasons given in paragraph 5(a) above.

Question 5 - Do you have any comments on the draft Regulations that will require the disclosure of a provider's complaints handling and dispute resolution processes when a complaint is received?

19. We agree that if a complaint is received it is helpful to provide an outline of how it will be handled.

20. However, in many circumstances it is not appropriate to lay out a full process in a lengthy or formal way, especially if a complaint is likely to be resolved swiftly.

21. We suggest instead a requirement to provide links to where a customer can look at external dispute resolution processes if they wish to but without making a response unduly formal in the circumstances.

Question 6 - Do you have any comments on the draft Regulations that set the manner in which information must be disclosed?

22. We agree with the principles of 229G, except we do not agree that the information should be provided in hard copy format where the adviser is offering a digital advice service and all engagement is electronic or by telephone.

Question 7 - Are there instances in your business when regulation 229D might apply to someone who is not the one to give advice to the client? Please give examples and provide any comments on how the draft Regulations apply in such scenarios.

23. There may be instances where staff at Nikko AM receive calls from customers who need financial advice. As none of our staff currently provide advice to the public they may refer the person calling to use GoalsGetter.

24. Depending how the regulations are interpreted there may be obligations on those staff to provide the information in 229D. We think this would be unhelpful as customers would receive that information via the GoalsGetter filter page.

Question 8 - Do you have any further comments on new regulation 229A to 229H of the draft Regulations?

No

Question 9 - Do you have any further comments on new Schedule 21A in the draft Regulations?

No

Question 10 - What (if any) transitional provisions should be included in the regulations?

25. It would be useful to have a reasonable lead time between the final version of the regulations and them coming into effect as they may require changes to our filter page in our digital tool and possibly to staff training.

26. Whether or not this requires a transitional provision would depend on how far before June 2020 the final version of the regulations are published.

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