4 June 2021

Financial Markets Policy
Commerce, Consumers and Communications
Ministry of Business, Innovation & Employment
PO Box 1473
Wellington 6140

By email: financialconduct@mbie.govt.nz

Dear Financial Markets Policy Team

Securities Industry Association submission: Treatment of intermediaries under the new regime for the conduct of financial institutions

Please find attached the submission prepared by the Securities Industry Association (**SIA**) in response to the Consultation Paper: *Treatment of intermediaries under the new regime for the conduct of financial institutions (April 2021).*

Thank you for the opportunity to present our comments on this consultation paper.

About SIA
SIA represents the shared interests of sharebroking, wealth management and investment banking firms that are accredited NZX Market Participants.

SIA members employ more than 500 accredited NZX Advisers, NZDX Advisers and NZX Derivatives Advisers, and more than 400 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. Members also work with local and global institutions that invest in New Zealand.

No part of this submission is required to be kept confidential. Note, some SIA member firms may make an individual firm submission based on issues specific to their firm's business. Those issues and views may not be reflected in this submission.

If you have any questions about this submission or require further information, in the first instance, please contact:

Bridget MacDonald, Executive Director, SIA
T: Privacy of natural persons E: bridget@securities.org.nz

Yours faithfully

Privacy of natural persons

David Fear
Chair
SECURITIES INDUSTRY ASSOCIATION
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Treatment of intermediaries under the new regime for the conduct of financial institutions

Your name and organisation

Name	Bridget MacDonald
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Organisation/Iwi	Securities Industry Association

[Double click on check boxes, then select 'checked' if you wish to select any of the following.]

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Option 1: Amend definition of intermediary to focus on sales and distribution	
	Do you have any comments on Option 1: 'Amend definition of intermediary to focus on sales and distribution'?
1	The proposed amendment to the definition of "intermediary" in Option 1 to capture sales and distribution activities only does not change the concern raised by the SIA in its submission dated 30 April 2020, as SIA members would continue to be intermediaries when distributing to their clients financial products such as fixed interest securities issued by financial institutions, given that these issuers typically pay brokerage on such issues. As noted in our earlier submission, SIA members are already regulated by the NZX Participant Rules and related Guidance, and those providing DIMS and/or financial advice to retail clients are also subject to the licensing regime and statutory duties of the Financial Markets Conduct Act 2013 and Regulations (as amended), including the Code Of Professional Conduct For Financial Advice Services where applicable (**Current Regulatory Requirements**). The Current Regulatory Requirements that each SIA member is required to adhere to, and are subject to audit requirements with respect to, are extensive. The conduct provisions being proposed in the conduct of financial institutions regime essentially duplicate those already included in the Current Regulatory Requirements and will only cause a greater compliance burden on SIA members. The SIA members deal with multiple Financial Institutions (**FI**) for the purposes of sales and distribution activities. The interpretation of the conduct provisions by each Financial Institution will differ and therefore cause each SIA member to maintain internal compliance processes that provide for the compliance with the Current Regulatory Requirements and each Financial Institution, i.e. multiple compliance processes for the purposes of compliance with the same conduct obligations. All of this takes place in circumstances where the financial products issued by financial institutions are a part of a much wider range of investments advised on and managed for clients by SIA members. In accordance with our previous submission, it is the SIA's opinion that NZX Market Participants, and those operating under financial advice or Discretionary Investment Management Services (**DIMS**) licenses, should be expressly excluded from the definition of "intermediary" on the basis that the conduct requirements of the conduct of financial institutions regime are in effect already met by each SIA member by virtue of compliance with the Current Regulatory Requirements.
	Do you think the scope of the proposed definition of an intermediary is comprehensive enough to capture the variety of sales and distribution methods and to avoid gaps and risks of arbitrage?
2	The scope of the proposed definition of an intermediary is comprehensive. As drafted, it is sufficiently comprehensive to capture the variety of sales and distribution currently in the market. As above, NZX Market Participants should be expressly excluded from the definition.
Option 2: Refine scope of who is covered as an agent	

3	Do you have any comments on Option 2?
	No submission.
4	Do you think Option 2 would adequately exclude advisory services (e.g. lawyers, accountants) and other service providers to the financial institution who are not involved, directly or indirectly, in providing any part of the financial institution's relevant service or associated products to consumers?
	No submission.
5	Do you think any explicit exclusions are needed for particular occupations or activities? If so, which ones, and why?
	No submission.
Objectives	
	Do you have any comments on the objectives regarding the treatment of intermediaries?
6	The objectives are acceptable. The concern that we maintain, as noted, is that the proposed amendments do not efficiently implement the objectives. The Bill continues to impose a further layer of regulation and compliance on a section of the industry that is already subject to licensing under the Financial Markets Conduct Act, and for SIA members, the NZX Market Participant Rules.
Option 3: Minimal changes to intermediaries obligations (remove 446M(1)(b) only)	
7	Do you have any comments on Option 3: 'Minimal changes to intermediaries obligations'?

Option 3 removes the requirement to strictly comply with Financial Institution (**FI**) procedures and processes, which, as noted in the paper, may reduce the ability for the FI to impose very wide obligations on intermediaries and move full liability with regard to compliance to the intermediary. However, the amendment is minimal in nature and accordingly limited in effect. The intermediary will be subject to the 'management and supervision' of the FI – the parameters of the 'management and supervision' by the FI will be subjective and determined by the FI. It is reasonable to expect that each FI will look to mitigate any risk and liability of the FI with respect to the intermediary's adherence to the FI's Compliance with the fair conduct principle. How each FI chooses to mitigate this will be different, but it will likely lead to a high degree of control and/or intervention and restriction on the intermediary by the FI.

As noted in previous submissions and paragraph 57 of the Discussion Document, this will duplicate a significant amount of the financial advice and DIMS regimes, which are already supervised by the Financial Markets Authority (**FMA**). For SIA organisations that engage with multiple FI's for the purpose of sales and distribution of product, that would be multiple lines of supervision and management which all, other than by the FMA under the Financial Markets Conduct Act, will be focussed on mitigating the risk and liability of the FI with respect to the intermediary's adherence to the FI's Compliance with the fair conduct principle, and not the fair treatment of consumers – which is the very premise of the regime.

Option 3 is not supported by SIA members.

8	If Option 3 were pursued, do you think any other obligations in section 446M(1)(bb), (bc), (bd) or (bf) would need clarifying or amending? Why/why not?
	We submit that SIA members should be excluded – other than confirmation of compliance with legal and regulatory obligations.

Option 4: More significant changes to intermediaries obligations

9	Do you have any comments on Option 4: 'More significant changes to intermediaries obligations'?
	Option 4 is an improvement, as removing a number of the provisions will remove duplication with the Financial Markets Conduct Act. However, this Option is looking to impose a 'one size fits all' approach on an industry that is most certainly is not one size fits all. The failure to differentiate between Financial Markets Conduct Act and non-Financial Markets Conduct Act regulated intermediaries is a significant flaw in this option. As noted in paragraph 65, it will set the bar very low for non-Financial Markets Conduct Act intermediaries – but for SIA members, it will continue to impose an unnecessary level of duplication and compliance burden.

	What do you think the level of responsibility should be for financial institutions' oversight of intermediaries? For example, "*managing or supervising* the intermediary to ensure they support the financial institutions compliance with the fair conduct principle", or "*monitoring* whether the intermediary is supporting the financial institution's compliance with the fair conduct principle", or something else?
10	In the event the management and supervision is preferred, the level of responsibility needs to be clearly articulated to ensure that FIs do not overreach in a bid to mitigate the FI risk and liability regarding the client outcomes. For intermediaries that are NZX Market Participants, licensed and subject to the Financial Markets Conduct Act financial advice and DIMS regimes, any management and supervision should be limited strictly to confirmation that the intermediary is in compliance with its legal and regulatory obligations. This would provide for a consistent approach across the industry for all FIs.
	What standard do you think financial institutions should have to oversee their intermediaries to?
11	SIA recommends that the level of management and supervision permitted by the FI over any intermediaries should be dependent on the categorisation and regulatory obligations of that intermediary. Furthermore, we recommend that intermediaries are categorised based on their current legal and regulatory requirements, as this would then permit different levels of management and supervision – for example, a much higher level for those intermediaries that are not Financial Markets Conduct Act regulated, and very little management and supervision of those that are Market Participants, licensed and subject to the Financial Markets Conduct Act financial advice and DIMS regimes – as above limited to confirmation.
Option 5: Distinguish between FSLAA and non-FSLAA intermediaries	
	Do you have any comments on Option 5: 'Distinguish between FSLAA and non-FSLAA intermediaries'?
12	The SIA prefers Option 5. However, there remains concern with how FIs will interpret 'setting conduct expectations' and what would constitute 'monitoring'. As noted above, the tiered system could be introduced for this purpose. On this basis, it is the SIA's opinion that NZX Market Participants are already required to have in place and accordingly comply with processes outlined under Option 5 pursuant to the Current Regulatory Requirements, and therefore should not have this additional layer of compliance.

13	How far do you think financial institutions' oversight of FSLAA intermediaries under Option 4 should extend? For example, should it cover the general conduct of the intermediaries, or more narrowly on product performance and related consumer outcomes (or something else)?
	The SIA suggests that the focus should be on adherence with legal and regulatory obligations as this would eliminate duplication.
Obligations in relation to employees and agents	
14	Do you have any comments on the proposals regarding obligations in relation to employees and agents?
	No submission.
15	Do you think there should be a distinction drawn between employees and agents? Why/why not?
	No submission.
16	Do you think any amendments should be made to the obligations in 446M(1) that would apply to employees and agents?
	No submission.
17	Do you have any other comments or viable proposals?
	No submission.
Other comments – **PLEASE SEE NEXT PAGE**	

Unintended consequences

As noted, SIA members are NZX Market Participants and highly regulated, licensed, and required to meet their duties and obligations under the Current Regulatory Requirements for competence, ethical behaviour, conduct and client care standards, as well as working fairly, with integrity and in the interest of their clients. There is a high level of oversight of NZX Market Participants, who are regularly and closely monitored by both the NZX and FMA.

The transparency requirements of FSLAA also requires that fees and incentives are fully disclosed. The proposed legislation seeks to mitigate perverse commission and incentive structures. In the context of working with Financial Institutions, NZX Market Participants may charge a transparent brokerage fee for a transaction, but this is by no means a commission nor tethers the Participant to the Financial Institution.

However, Financial Institutions required to upweight their compliance and monitoring of intermediaries may choose to operate differently than they do currently to minimise their own compliance burden. For example, rather than deal with multiple SIA firms on distributing a debt deal, the bank may decide to limit distribution to one or two selected firms, thus narrowing availability for retail clients. The consequence of this would be that retail clients would miss out on investment opportunities.

Cost burden to firms and potentially customers

The cost of meeting the complexities of multiple compliance systems will be an additional resource-intensive compliance cost burden to firms and likely not deliver any greater assurance than can already be achieved by the Current Regulatory Requirements.

The purpose of the new regime is to encourage consumer confidence and trust in financial advice. A further concern is how a duplicative compliance requirement will encourage or enable any better consumer outcomes than can be achieved under the existing requirements. A greater concern lies with the potential for significant costs to be passed on to consumers. If there are concerns, then the additional compliance requirement should be targeted toward the entities or persons with whom that risk lies with.

There needs to be confidence in the conduct and monitoring regimes already in place, rather than creating duplicative processes that may also become an unnecessary and resource-intensive burden to the regulators. Furthermore, will this cost burden be passed to the financial sector?

Conclusion

SIA supports an approach that recognises the stringent conduct regime that some financial services are already subject to. The simplest way to address this would be to carve out NZX Market Participants from the definition of intermediary in this instance. SIA appreciates that the discussion paper distinguishes between FSLAA and non-FSLAA intermediaries, and should the former suggestion not be possible, then the approach of Option 5 would recognise the duplicative compliance requirements and help to minimise the burden to firms.

We welcome further engagement on this consultation should there be any questions or if further information is required.