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Financial Markets Policy
Ministry of Business, Innovation & Employment (MBIE)
PO BOX 3705
WELLINGTON

Review of the Financial Advisers Act 2008

1. **Introduction**

1.1 This submission is made on behalf of Minter Ellison Rudd Watts, a national law firm with one of New Zealand's leading financial services law practices, in relation to the Financial Advisers Act 2008 (**FA Act**) review. The submission reflects our own views, and not necessarily those of any of our firm's clients.

1.2 For the reasons outlined below, we have focussed this submission on the "advice through technological channels" section of the Options Paper or what we will refer to as "automated personalised advice". We will not comment on the other matters raised by the Options Paper, in relation to either the FA Act or the Financial Service Providers (Registration and Dispute Resolution) Act 2008.

1.3 We expect that MBIE will receive many submissions which focus on the interests of consumers who are in the Baby-Boomer or Gen-X generations[1]. That is understandable as they are either in retirement (when wealth preservation and de-cumulation are the priority), or are well advanced in the accumulation stage. They may have material financial assets already and certainly the most pressing needs. They are therefore of immediate interest to advisers and product providers. Accordingly, we assume others will address the issues for those groups.

1.4 However, we expect there may be comparatively less focus on the interests of those New Zealanders in or about to enter their 20s (late Gen-Y and early Gen-Z). Their largest (and perhaps only) asset is time - time to build assets and watch their investments grow. Yet we suspect they are much less likely to be able to rely on the level of the current state provision for their retirement and other needs.

1.5 Accordingly, we decided our best contribution to the reform process would be to look at the FA Act review from the perspective of young working law graduates, who have yet to purchase their first home. They are, we believe, a proxy for a wider group whose interests are vitally important in the longer term – for convenience we refer to this group as "**Millennial Professionals**".

1.6 We set out in the schedule our methodology for collating the findings that form the basis of this submission. Essentially, this involved an in-house survey of 80 young lawyers in our firm under the age of 30 which helped us to understand the investment decisions and behaviours of Millennial Professionals. We found that, among other things, Millennial Professionals were interested in investment options outside of Kiwisaver and the trade-off between saving for a house deposit and other forms of investments.

1.7 From there, we formed a focus group of 6 young Auckland based lawyers where we discussed in more detail their investment / financial knowledge and habits, their

[1] The terms Baby-Boomer, Gen-X, Gen-Y and Gen-Z are often used ambiguously. For clarity see http://www.talentedheads.com/2013/04/09/generation-confused/ for the sense in which we use those terms.

investment / financial decision making process and their views about obtaining personal financial advice and other sources of financial information.

1.8 Below we set out a summary of our submission, and further analysis on each of the points follows. We have not completed the template submission form because only questions 9, 10 and 11 are relevant to the matters on which we wish to make submissions.

2. Summary

2.1 The main points of our submission are as follows:

(a) automated online platforms are the best way to provide personalised financial advice to Millennial Professionals and in particular, its perceived accuracy, independence and the ability to utilise future technology such as "big data" makes it an attractive decision making tool;

(b) the current FA Act regime restricts the provision of personalised financial advice through automated online platforms leaving many consumers, especially Millennial Professionals, out of the market for financial advice;

(c) the provision of automated personalised financial advice should be facilitated by a new category of "licensed financial advice platform" being added to the regulatory regime to supplement the current AFA regime and address the needs of a segment of the market who are not currently accessing personalised financial advice;

(d) licensed financial advice platforms should be subject to a suitable licensing regime, similar to the discretionary investment management service (**DIMS**) regime and also ethical requirements comparable to authorised financial advisers (**AFAs**); and

(e) any regulatory changes should support innovation in the industry and future proof the regime to allow further developments in technology. On that basis, we consider a hybrid approach, where after using an automated platform the consumer must be given the option to talk to an AFA, to be inappropriate.

2.2 For certainty, we are not suggesting a restriction on the current ability to provide class financial advice or for issuers to advertise financial products by automated online means.

2.3 We explain the above summary points in further detail below.

3. Automated online platforms are the best way to provide personalised financial advice to Millennial Professionals and in particular, its perceived accuracy, independence and the ability to utilise future technology such as "big data" makes it an attractive decision-making tool.

3.1 Our focus group told us that they and their peer group would be likely to embrace personalised financial advice provided by technological means because Millennial Professionals:

(a) look for answers online generally in their lives;

(b) consider automated personalised advice is more likely to be reliable;

(c) expect automated personalised advice can be provided at a more acceptable cost; and

(d) consider that automation is inevitable and New Zealand's choice is whether to be at the forefront and guide its development.

Millennial Professionals look for answers online generally in their lives

3.2 The current regime has failed to capture the needs of a generation of consumers who rely on technology for everyday decision-making.

3.3 Our focus group told us that they live in a world where they look for information, advice and services of any sort via internet search and smart phone applications as a first step. In a generation where people use social media apps[2] to find their life partner, they told us it was unlikely they would sit down with an AFA to make financial decisions.

3.4 As digitisation of knowledge services and artificial intelligence becomes more prevalent, the availability of technology to assist with decision making will only become increasingly the norm. Consumers today already rely heavily on online, automated platforms for everyday decision making. For example, the success of websites such as Webjet, Trivago and Expedia have revolutionised the tourism industry. Few young consumers now go to travel agents to book their holidays.

3.5 This revolution can also be seen in other industries, such as insurance (for example, Trademe's Life Direct), dining (for example, restauranthub.co.nz) and even education (for example, edX).

3.6 Consequently, where personalised financial adviser services are not available online, many Millennial Professionals consider that service to be out of reach. In reality, it might as well be unavailable. For Millennial Professionals particularly, the nature of their lifestyles means that sitting down with an AFA for personalised financial advice is most unlikely.

Millennial Professionals consider automated personalised advice is more reliable

3.7 Our focus group told us that from the Millennial Professional's perspective, personalised financial advice provided by natural persons are not only ***not*** seen as better than an automated online platform, but are seen by them as less reliable and more susceptible to human error and misunderstanding of an individual's mentality and motivations.

3.8 Before personalised financial advice is sought, the consumer must decide whether a particular AFA has the adequate knowledge, skills and competence levels appropriate for their needs. The uncertainty as to whether a particular AFA understands the needs and wants of Millennial Professionals and the volatility in skills of each individual AFA are also disincentives for that segment of the market to seek personalised financial advice. This problem is compounded by the fact that AFAs do not all provide the same services (for example, some might specialise in insurance while others in mortgages or KiwiSaver).

3.9 Some of our focus group said that they thought Millennial Professionals would rather obtain financial "reassurance" (rather than advice) from their friends, who have minimal financial knowledge, than seek the services of an AFA due to a lack of trust and understanding of how AFAs work.

3.10 The consumer distrust of a human adviser can be seen in other industries too. For example, Webjet's recent advertising campaign shows a young woman complaining to a friend about her travel agent who found fewer flights than she did while researching

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[2] For support of what our focus group told us about how radically behaviour has changed see *Modern Romance: An Investigation by Aziz Ansari and Eric Klinenberg, published in the UK by Penguin Press* summarised by BBC World here: http://www.bbc.com/news/magazine-35535424

herself and was generally disinterested in her needs. For Millennial Professionals, online automated platforms are assumed to be more reliable, generally have wider breadth of resources and can be more easily controlled to provide unbiased results.

3.11 Given that AFAs often refer to electronic systems and questionnaires when providing personalised financial advice to a client, an automated online platform may take this process and provide it directly to consumers. All of the Millennial Professionals in our focus group considered themselves to be sophisticated enough to confidently operate and interpret the questionnaire themselves. They also liked the idea that they could change variables and see the impact on different outcomes.

3.12 This option could arguably provide better personalised financial advice than at least some AFAs. For example, in the future automated online platforms may be able to utilise resources such as "big data" to provide personalised advice for a client with access to information that the consumer himself or herself may not even be aware of. The complexity and possibilities that can be achieved by a computer algorithm even today far surpasses the capabilities of a human being. For sophisticated Millennial Professionals that is where they consider the true value add of financial advice to be.

Millennial Professionals expect automated personalised advice can be provided at a more acceptable cost

3.13 Our focus group told us that cost is a further impediment to them taking personalised financial advice under the current regime. Our focus group all had some savings and were interested in the best ways to manage their money and to invest it in higher return financial products but the idea of paying potentially hundreds of dollars for financial advice did not make financial sense to them. It would take a long time for any investments to recover that cost.

3.14 The focus group readily understood and accepted that the services of an AFA can cost hundreds of dollars, reflecting the level of personal time involved and the high level of training required for the AFA as a professional. But the difficulty was that cost is either met by:

(a) clients, for example by way of fees per hour or per item of advice, which renders personalised financial advice out of reach when the cost of advice is disproportionately high to the amount of current savings; or

(b) product providers, for example via commissions, which raised concerns for the focus group about incentives and conflicts of interest.

3.15 Additionally, the focus group said some AFAs seemed unwilling to provide advice unless it is part of a full financial plan or when other significant services are also provided to that client. Consequently consumers who are not adequately attractive clients (and most Millennial Professionals with modest savings are not attractive clients) for AFAs fall through the cracks, creating a gap in the market.

3.16 The focus group considered it self-evident that an automated solution would be less costly, because it would not require an individual human being to deliver the advice one-to-one, and could achieve economies of scale.

Millennial Professionals consider automation is inevitable and New Zealand's choice is whether to be at the forefront and guide it

3.17 Lastly, even if the regulatory regime does not keep up with changes in the market, the market will not be deterred from changing. Automated online platforms are an inevitable future. In the United States and Europe, these services are gaining momentum. Australia is also consulting on the issue.[3]

3.18 By not addressing this gap in our regulatory regime, and restricting automated online platforms to only providing class advice, it creates a risk that permitted class advice will be stretched further and further until it becomes effectively personalised advice *disguised* as class advice. That is not desirable, and it would be better to provide an avenue to provide automated personalised financial advice legitimately.

3.19 In Australia, similar tensions arise.[4] Online platforms have argued that the personal information collated from the clients is merely being used to provide "general advice" that is *more relevant* to the client. However, some commentators have expressed doubts about how robust that approach is. At least it creates a risk of confusion in the market and could lead to consumers believing they have obtained personalised advice but the platform has not been adequately regulated to provide sufficient protections for consumers.

3.20 During our focus group discussion, the Millennial Professionals were very attracted to the technological developments in the industry and the possibility of using complicated algorithms and big data to create financial advice. They expressed frustration if this technology was not available in New Zealand merely due to regulatory barriers.

4. **The current FA Act regime restricts the provision of personalised financial advice through automated online platforms leaving many consumers, especially Millennial Professionals, out of the market for financial advice.**

4.1 The Options Paper identified one of the main goals of the FA Act review is to ensure that consumers have the ability to access quality advice when they need it. It also identified that barriers to achieving this outcome include:

(a) it is hard for consumers to know where to seek financial advice from;

(b) certain types of advice are not being provided; and

(c) consumers do not always understand the limitations of different types of advice.

4.2 Currently, personalised financial advice to retail clients can only be provided by natural persons, and in relation to category 1 products, only by AFAs. QFEAs can also provide financial advice in relation to the QFE's products. As a result, automated online platforms are practically limited to providing "class advice" because no natural person is involved.

4.3 We submit that the restrictions in the current regime contribute to the barriers identified above as it is not robust enough to cater to the needs of all consumers (especially Millennial Professionals) and the developments in the industry.

4.4 The requirement that personalised financial advice can only be provided by natural persons is outdated and does not reflect the needs and expectations of a modern generation. As we explained above, seeking the services of an individual to help with financial decision making is no longer the "natural" approach for many consumers and the lack of an online option means many do not know where to find an appropriate source of reliable information. Our focus group believe that while they could benefit from financial advice, they have been left out of the market.

[3] See for example the article *UK banks set to launch 'robo-advisers* in the Financial Times: http://www.ft.com/intl/cms/s/0/afb03182-c107-11e5-9fdb-87b8d15baec2.html#axzz411QjNo16; and *Would you take financial advice from a robot* in the Sydney Morning Herald: http://www.smh.com.au/money/would-you-take-financial-advice-from-a-robot-20151125-gl7w3v.html.

[4] See article by Kate Jackson-Maynes, a partner at King & Wood Mallesons Sydney, *The rise of Robo Advice tools in financial planning*: http://www.kwm.com/en/au/knowledge/insights/rise-robo-advice-tools-financial-planning-20150716

4.5 Furthermore, by restricting the giving of personalised advice to natural persons, New Zealand is falling behind, as compared to other countries such as the UK and US, in terms of supporting innovation and using innovation and new technology to improve the efficiency and effectiveness of the financial adviser industry. For the reasons explained in section 3 of this submission, not allowing technological products participate in the personalised financial advice market may limit some consumers from obtaining financial advice.

5. **The provision of automated personalised financial advice should be facilitated by a new category of "licensed financial advice platform" being added to the regulatory regime to supplement the current AFA regime and address the needs of a segment of the market who are not currently accessing personalised financial advice.**

5.1 We agree with the Options Paper that the financial advisers regulatory regime needs to support and encourage innovation in the financial services industry in New Zealand. But one only needs to look to the US and Europe (as referred to above) to see that it is no longer just about encouraging innovation but rather meeting the needs of an industry that is ready to introduce innovative solutions into the market.

5.2 In relation to the Option Paper section on "advice through technological channels", we support option 1 where entities will be licensed to provide personalised advice through an automated platform.

5.3 We consider it is important that online automated financial advice platforms are adequately licensed and regulated to give consumers reassurance that they are using a reliable source of information. Our focus group expressed that despite that vast amount of information available online, they would still be willing to pay for financial advice from an automated online platform provided that the platform could demonstrate they were adequately regulated and there is some "guarantee" that they can provide quality and valued added financial advice.

5.4 To be clear, we are not proposing that this licensing regime should capture any sales activities or automated online platforms that only provide "class advice" or advertisements by issuers, which are already permitted in the current regime. However, it will be important that they are not misleading as to the nature of the advice given. There are existing rules in Part 2 of the Financial Markets Conduct Act 2013 (**FMCA**) and the FA Act which address that concern sufficiently.

5.5 A licensed financial advice platform regime that provides personalised financial advice would address the needs of a segment of the market that is unlikely to be currently receiving financial advice - i.e. Millennial Professionals. Yet it is this same group of consumers that would benefit from financial advice but are deterred for the many reasons addressed above. The benefit of such a regime is that it does not impinge on the current AFA regime as they have a different target audience, but actually supplements the current regime.

5.6 We submit that the current territoriality threshold in the FA Act should remain the same and the licensing regime should apply to any online platform provider where the financial advice is received by a client in New Zealand, regardless of where the entity providing the service is incorporated or carries on business. It may be possible for entities subject to comparable regimes overseas to be exempted on the basis that they are already regulated.

6. **Licensed financial advice platforms should be subject to a suitable licensing regime, similar to the DIMS regime and also ethical requirements comparable to AFAs.**

6.1 We submit that the solution is to add a new category of "licensed financial advice platform" to the regulatory regime to regulate automated online platforms that intend to provide personalised financial advice. The entity providing the platform should be the responsible body for the advice transmitted by it. This clarifies the legal status of automated financial advice platforms, allowing them to be adequately regulated and held accountable. We envision this regime to be similar to the FMCA DIMS licensing regime currently in place and would be administered by the Financial Markets Authority (**FMA**).

6.2 These platform providers will need to demonstrate to the FMA that they have the resources and capabilities to meet their legal, professional and ethical obligations in relation to providing personalised financial advice.

6.3 The FMA may be given power to consider whether the platforms are suitable for their intended purpose, meets technical requirements (i.e. the infrastructure of their website) and is attractive to the target audience, in order to adequately address the barriers to receiving financial advice identified above.

6.4 Amongst other things, the FMA should be required to consider:

(a) the operations of the platform, including whether consumers have adequate opportunities to provide details about their personal circumstances on the platform such that it is comparable to the services of an AFA;

(b) whether the platform is robust enough to cater to the needs of different consumers, including those who may have unusual circumstances or needs;

(c) whether the entity and the consumers using its platform have access to support services so that the platform can provide a reliable and trustworthy service;

(d) whether the advice is given in a "clear, concise and effective" manner;

(e) whether the entity has access to expert advice in putting together the platform, including its credentials and the basis of any questionnaire it will be using and how comparable they are to the resources utilised by AFAs; and

(f) whether the platform has processes and procedures in place to ensure that it is updated frequently and has access to appropriate and reliable sources of information and knowledge.

6.5 Additionally, we submit that as the licensed platform providers will be providing personalised financial advice, they should also be subject to comparable ethical obligations as those placed on AFAs, for example to put the interests of the clients first. This includes, where relevant, different requirements depending on whether the platform provider only provides advice or also provides links to the recommended financial products for the consumer to invest in or sign up for.

6.6 Our focus group told us that with an online automated advice platform they were concerned to know what entity would be accountable if after paying for the service they receive advice that is unhelpful or unreliable. Therefore, compared with traditional financial advice, the need is even greater that the identity of the licensed provider is very clear and that it is ensured consumers have access to sufficient means of holding that entity accountable for the services they provide. This will include sufficient disclosure as to the entities operating the platform and their licensed status.

6.7 In terms of liability, we submit that licensed financial advice platforms should be subject to similar liability provisions as DIMS providers in the FMCA.

7. **Any regulatory changes should support innovation in the industry and future proof the regime to allow further developments in technology. On that basis, we consider a hybrid approach, where after using an automated platform the consumer must be given the option to talk to an AFA, to be inappropriate.**

7.1 We do not consider option 2 is the appropriate response to address the challenges faced by the financial advice industry. The hybrid approach would place additional burdens on entities who want to provide automated financial advice (for example, they would still need to hire AFAs and in certain cases, make them available across the country). Instead of complying with only one regime (i.e. the AFA regime), they now have to comply with two regimes. This increases the cost of compliance on entities and will detract from some of the biggest positive benefits of permitting the operation of such platforms – i.e. quality financial advice at a lower cost.

7.2 Additionally, we submit that a hybrid approach does not future proof the legislation and encourage innovation. The increased cost of having available AFAs will discourage entities from investing in this industry, which would not promote the development of higher quality services.

7.3 We submitted earlier that automated financial advice could in the future have access to additional resources such as big data, completely revolutionising the resources financial advisers have access to, including data (and conclusions drawn from those data) that the consumer himself or herself are not even aware of. The legislative regime should support these innovations to ensure that consumers are given access to the best and most technologically advanced financial advice.

7.4 One of the most attractive aspects of an automated online platform from the perspective of our focus group was that consumers do not have to speak to an actual person and that these platforms have access to a broader range of information and its ability to use complex computer algorisms to provide solutions one cannot come up with on their own. We consider option 2 does not provide sufficient recognition for these considerations.

8. Conclusion

8.1 We have presented our submission at a high level at this stage of the legislative review process. We will be happy to discuss technical solutions and drafting issues in more detail in due course if this will be of assistance.

8.2 Thank you for taking the time to consider this submission. Please contact us (details below) if you wish to discuss any of the matters raised above further.

Yours faithfully
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Schedule - Methodology

Phase One – in house survey

In July/August 2015 we conducted an in-house anonymous survey of young working law graduates and lawyers in Auckland and Wellington in relation to their investment activities and expectations.

Number surveyed	80
Number of responses	42
Gender balance	37 males, 43 females
Age group	Roughly between the ages of 23 to 30 and with between 0 to 7 years of work experience.
Survey method	We set out an anonymous survey on an external website and sent an email to 80 law clerks / junior solicitors in our team. Surveys were completed and the results automatically generated by the website.

Phase Two – focus group

In February 2016 we formed a focus group of 6 young lawyers in Auckland to discuss in more detail their current investment / financial knowledge and habits, the resources they currently use to make financial decisions and the resources they would like to have available, how they compare their investment / financial knowledge to their peers in other industries, and their thoughts about "automated personalised advice".

Number of people	6
Gender balance	2 males, 4 females
Age	Between 23 to 25 years old with 1 to 2 years of work experience
Culture / backgrounds	1 person was born in New Zealand 5 people were born overseas but have lived in New Zealand from a very young age All currently live and work in Auckland but have grown up in various parts of New Zealand
Education	All 6 people have a Bachelor of Laws degree 3 people have a Bachelor of Commerce degree, 3 people have a

	Bachelor of Arts degree
Method	We set out an informal round table discussion with the focus group where we provided discussion questions including: • how would you described your investment / financial knowledge / habits? how would you compare these to your friends in other industries? • what types of investments do you have at the moment? why do you invest in those products? • do you currently use the services of a financial adviser? why / why not? what are your thoughts about financial advisers? • what resources in the market do you currently use for financial knowledge? what resources do you want to see available in the market? • are you ever frustrated that you don't have access to enough quality financial information? • what are your main concerns about getting financial advice? what do you consider to be quality advice? • what are some barriers you experience to receiving quality financial advice / being a financially aware person? • what are your thoughts towards automated online platforms vs natural persons providing financial advice? how do they compare? • would you pay for an automated online platform for financial advice? if so, how much? • what kind of automated online platform would be attractive for you to use?