Financial Services Legislation Amendment Bill

Submission by Bell Gully

Dated 31 March 2017

This submission has been prepared by Bell Gully in response to the Ministry of Business, Innovation and Employment's February 2017 consultation paper (**Consultation Paper**) on the exposure draft of the Financial Services Legislation Amendment Bill (the **Draft Bill**), proposed transitional arrangements and policy issues raised in the Consultation Paper.

We agree with the approach proposed by the Draft Bill of repealing the Financial Advisers Act 2008 (**FAA**) and having the regulation of financial advice sit within the Financial Markets Conduct Act 2013 (**FMC Act**).

Our submissions are set out in the table below. We have not answered all of the proposed questions, as we have focussed our comments on those questions which we consider particularly relevant to our areas of expertise and have limited our submissions to provisions of the Draft Bill which we believe require further consideration or amendment before the Draft Bill is introduced to the House.

We have no objection to our submission being published on the Ministry's website.

If you wish to discuss any aspect of our submission please do not hesitate to contact Haydn Wong or Rachel Paris. Haydn and Rachel's contact details are as follows:

Haydn Wong
PARTNER

REDACTED

Rachel Paris
PARTNER

REDACTED

Submission form

Question		Response
Part 1 of the Bill amends the definitions in the FMC Act		
3.	Do you have any other feedback on the drafting of Part 1 of the Bill?	(a) As section 5(2) of the Draft Bill provides a new definition of "controlling owner" as opposed to amending the current definition in the FMC Act, we suggest that the existing definition of "controlling owner" should be included in the list of definitions being repealed in section 5(1) of the Draft Bill. (b) We suggest that a definition of "client" should be inserted into section 5(2) of the Draft Bill, by cross referring to the definition of "client" proposed to be inserted as clause 1 of Schedule 5 of the FMC Act. (c) The term "contract of insurance" is used in the definition of a "financial advice product". However, a definition of "contract of insurance" is not included in the Draft Bill and is not currently defined in the FMC Act. We suggest that a definition be inserted into section 5(2) of the Draft Bill and that this be defined by reference to the definition of a "contract of insurance" in section 7 of the Insurance (Prudential Supervision) Act 2010. (d) We are unsure why the definition of "financial adviser" in section 5(2) of the Draft Bill does not refer to the financial adviser being engaged by a "financial advice provider" (similar to paragraph (a) of the definition of "financial advice representative"). We assume this may be because a "financial adviser" is able to provide financial advice to wholesale clients only without being engaged by a "financial advice provider", based on the definition of a "wholesale client". If this is the case, we do not believe that this is very clear in the Draft Bill. The Consultation Paper does not distinguish between the circumstances in which a "financial adviser" must be engaged by a "financial service provider" and the circumstances in which it can provide financial advice on its own account (e.g., to wholesale clients). The Consultation Paper suggests that financial advice may only be given by a "financial adviser" if they are engaged by/working for a "financial advice provider". See for example, pages 12 and 18 of the Consultation Paper and page 2 of the explanatory note for the Draft Bill. We would be grateful if this could be clarified.
Part 2 of the Bill sets out licensing requirements		
4.	Do you have any feedback on the drafting of Part 2 of the Bill?	Please see our response to question 14.

Part 3 of the Bill sets out additional regulation of financial advice		
5.	Do you agree that the duty to put the client's interest first should apply both in giving the advice and doing anything in relation to the giving of advice? Does this make it clear that the duty does not only apply in the moment of giving advice?	We submit that the drafting is sufficient to make clear that the duty to put the client's interests first does not only apply in the moment of giving advice. However we believe that this makes the duty very broad because the requirement to put the client's interests first in considering whether to give advice or provide an information-only service may result in financial advisers having to give advice, as that is in the client's best interests. This may be the case even if the adviser only wants to provide an information-only service to that client. We submit that the references in the new sections 431H(1)(b) and 431H(2) of the FMC Act to the interests of "any other person" are too broad. It would be more appropriate to narrow this concept to a person related to "A". We also submit that the duty to put the client's interests first in section 431H should not be defined solely by reference to conflicts. To address this, we submit that the core duty to put client's interests first should be included in the FMC Act and for the Code to address the content of this duty in more detail.
6.	Do you have any comments on the proposed wording of the duty that a provider must not give a representative any kind of inappropriate payment or incentive? What impacts (both positive and negative) could this duty have?	It would be helpful for there to be further clarification/consideration of what payments or incentives would be "inappropriate", as it is likely to be difficult for a financial advice provider to determine what remuneration/commission structures are inappropriate. It is not clear how the linkages back to the other duties will apply in practice.
7.	Do you support extending the client-first duty to providers who do not provide a retail service (i.e. those who only advise wholesale clients)? Why or why not?	We do not believe that the duty to put the client's interests first should be extended to apply in respect of wholesale clients. As wholesale clients are sophisticated investors, they do not need the protections that the duty of putting client's interests first is designed to protect. We note that other duties, for example those in the new sections 431F, 431G and 431J of the FMC Act only apply to a retail service.
8.	Do you have any other feedback on the drafting in Part 3 of the Bill?	(a) The new section 431E(4)(b) of the FMC Act implies that there may be instances where a "financial adviser" may not be acting on behalf of a "financial advice provider". We assume this is because a "financial adviser" can provide advice to wholesale clients without being engaged by a "financial advice provider". However, we do not believe this is clear from the Consultation Paper and the Draft Bill (see our response to question 3). It would be helpful if this could be clarified. (b) We query how the duty to agree on the nature and scope of advice in section 431G applies in relation to advice which would constitute "class advice" under the FAA. In circumstances where there is no engagement with the client (for example through a website or other advertisement), it is unclear how this duty can be fully complied with. (c) In relation to section 431L, we submit that the regulations should not require any disclosures to be made to wholesale clients. Given wholesale clients are sophisticated clients, we do not believe they need to receive disclosures outlining the implications of the service being provided not being a retail service. This will add an extra compliance burden for financial advisers that we do not consider is necessary.

		(d) We suggest that the following amendment be made to the new section 431O(1)(b) of the FMC Act (see section 24 of the Draft Bill): (b) must not give, or offer to give, (whether conditionally or unconditionally) to any of its ~~representative~~ financial advice representatives any kind of inappropriate payment or other incentive.
Part 4 of the Bill sets out brokers' disclosure and conduct obligations		
9.	What would be the implications of removing the 'offering' concept from the definition of a broker?	We do not anticipate any material implications. In our view, the proposed change is welcome as it will improve the certainty of the regime's application.
10.	Do you have any other feedback on the drafting of Part 4 of the Bill, for example any suggestions on how the drafting of broker provisions could be simplified or clarified?	We note that Part 4 is substantially the same as the broker regime in the FAA. However, we are supportive of the minor clarificatory changes that have been made in Part 4.
Part 5 of the Bill makes miscellaneous amendments to the FMC Act		
14.	Do you have any feedback on applying the concept of a 'retail service' to financial advice services? Is it workable in practice?	In our view, the service provided to clients should be distinguished by whether the client is a retail client or a wholesale client, not whether the service is provided to at least one retail client. We believe that requiring retail service obligations in respect of wholesale clients (just because there is at least one retail client covered by the service) undermines the purpose of the distinction between wholesale clients and retail clients. Wholesale clients do not need the same protections as retail clients and therefore a financial advice provider should not be required to provide retail service obligations in respect of wholesale clients. The proposed drafting in the Draft Bill could potentially disadvantage those financial advice providers whose businesses are structured so that an entity might give financial advice to select retail clients as well as wholesale clients (meaning the retail service obligations apply in respect of the wholesale clients), as opposed to financial advice providers whose businesses are structured so that one entity provides financial advice only to retail clients with a separate entity providing advice only to wholesale clients. This structural distinction does not appear to be justified.
Part 6 of the Bill amends the Financial Service Providers (Registration and Dispute Resolution) Act 2008 ("FSP Act")		
16.	Does the proposed territorial application of the Act set out above help address misuse of the FSPR? Are there any unintended consequences? How soon after the passing of the Bill should the new territorial application take effect?	Yes. The current territorial application of the FSP Act is particularly problematic for legitimate offshore lenders who offer consumer credit to New Zealand borrowers but which do not have a place of business in New Zealand. At present, because they fall outside the territorial scope of the FSP Act, those lenders are unable to register on the FSP Register or join an approved dispute resolution scheme (**ADRS**) even when they seek to do so. The proposed test in the new sections 6A(1)(a) and 6A(1)(c) of the FSP Act would enable those lenders to be registered and to be ADRS members, for the benefit of New Zealand borrowers, because they provide their service to retail clients in New Zealand, even though they do not have a place of business here. This seems to us to be the correct policy outcome. In relation to the new section 6A(2)(a) of the FSP Act, it would be helpful to understand what is intended by "reasonable steps". For instance, is the inclusion of selling restrictions sufficient?

17.	Do you support requiring further information (such as a provider's AML/CFT supervisor) to be contained on the FSPR to help address misuse?	In principle, yes, although we foresee two practical challenges: (1) There is no official "registration" obligation or process for reporting entities under the AML/CFT Act. Rather, reporting entities either pro-actively initiate contact with the AML/CFT supervisor that has jurisdiction over their business or, alternatively, the AML/CFT supervisors "sweep" the FSP Register to identify companies that they consider are reporting entities and which they determine are within their supervision. Accordingly, if a new entity is required to name its AML/CFT supervisor as part of its FSP Register registration application, this could lead to confusion unless a mechanism is introduced by which that entity can receive official confirmation of its AML/CFT supervisor prior to commencing the FSP Register registration process. (2) The territorial application of the FSP Act and the territorial application of the AML/CFT Act are not entirely aligned, and the application of the AML/CFT Act is open to interpretation in some respects (refer to the December 2012 supervisors' guidance note). Therefore, to create certainty for willing compliers, one option might be for the FSP Register to accommodate entities that are required to register on the FSP Register but which are outside the AML/ACT Act's scope – for example, a company which provides a financial service to one retail client in New Zealand, but which does not have a place of business in New Zealand and which has formed the view that it is not required to be registered under the Companies Act 1993 because it is not "carrying on business in New Zealand". (3) Furthermore, if individual financial advisers are required to register, it is unclear whether they will need to list the AML/CFT supervisor of their employer (i.e. the relevant financial advice provider).
19.	Do you have any comments on the proposed categories of financial services? If you're a financial service provider, is it clear to you which categories you should register in under the proposed list?	The present mismatch between the section 5 list of "financial services" and the current registration options on the FSP Register website is unhelpful and causes users great confusion. The proposal on page 30 of the Consultation Paper to categorise services into three sections is helpful. If the intention is to reduce multiple registrations (for example, for a "broker" to only register under category B(15) and not also under categories C(21) and (24), using the Consultation Paper references) then this would need to be expressed very clearly as part of the registration process. In terms of the specific financial services in section 5, the following limbs can be ambiguous in their application and would benefit from regulator guidance as to their correct interpretation: • (1)(d): "*keeping, investing, administering, or managing money, securities, or investment securities on behalf of other persons*" – on its face, this would apply to a very broad range of routine corporate activities, but there is some uncertainty in the market as to whether this limb is intended to apply only to DIMS, managed funds and equivalent activities. It would be helpful if the application of this limb could be clarified in regulator guidance. • (1)(g): "*issuing and managing means of payment*" – specifically, if a person issues a means of payment but does not actively "manage" it (because it has contracted out the management function), this limb would not be triggered on a strict interpretation. Is this intended? Also, is "issued" to be interpreted strictly in the sense of section 11 of the FMC Act, or more broadly to capture any provision of a means of payment? We assume the latter but suggest this could be clarified in regulator guidance.

		While we appreciate that the AML/CFT Act list of financial activities in the definition of "financial institution" is based on the FATF list, more consistency between that list and the list of financial services in the FSP Act (and exceptions/exemptions) would be a helpful development.
21.	Do you have any other feedback on the drafting of Part 6 of the Bill?	(a) It would be helpful if the meaning of "place of business" could be clarified. The market interpretation is that this requires some *physical* place of business but the ambiguity does create uncertainty in practice. (b) We suggest that the following amendment be made to the new section 22C(3) of the FSP Act (see section 66 of the Draft Bill): (3) However, after the expiry of 3 months after registration, A must not be treated as being in the business of providing a financial advice service (and, accordingly, may be deregistered under section 18(1)(b)) if…. (c) In addition, the language in sections 61, 62 and 66 of the Draft Bill suggests that a "financial adviser" will not always be engaged by a "financial advice provider". See our response to question 3 above, where we seek clarification of the circumstances in which a "financial adviser" can provide financial advice without being engaged by a "financial advice provider" (i.e., providing advice to wholesale clients).
Schedule 1 of the Bill sets out transitional provisions relating to DIMS and the code of conduct		
26.	Are there any unintended consequences resulting from the minor amendments to the exclusions from regulated financial advice, as detailed above?	The exclusion from regulated financial advice set out in the new section 7(1) of Schedule 5 (*Ancillary services and other occupations*) of the FMC Act is materially narrower than the existing exemption for incidental service set out in section 13(1) of the FAA (*Exemption for incidental service*). Consequently, we expect there could be material consequences of the narrowing of this exemption. Specifically, the FAA currently excludes financial advice given to *facilitate the carrying out of* another business, or which is ancillary to another business, that is not otherwise a financial service or which does not have, as its principal activity, the provision of another financial service. The Consultation Paper comments that the words "to facilitate the carrying out of another business" were not included in the new section because the term "facilitate" may be unduly broad. Consequently, the proposed revised exclusion applies where the financial advice is given "only as an ancillary part of a business the principal activity of which is not the provision of a financial service". We are aware that many market participants currently rely on the section 13 exemption on the basis that the provision of any advice which may fall within the ambit of regulated financial advice *facilitates* their retail core business (rather than being ancillary to it). For example, retailers whose shop floor staff sell goods on hire purchase where the credit is provided by third parties. As the Consultation Paper acknowledges, "ancillary" is a narrower concept and is defined in the Oxford Dictionaries to mean "[p]roviding necessary support to the primary activities or operation of an organisation…". It is not clear that financial advice provided by shop floor staff selling (e.g.) white-wear on finance terms is "necessary support" for that core retail business. Accordingly, those businesses may not be able to rely on the new exemption.

		We are aware that the current section 13 exemption was designed to exempt such retail staff from having to otherwise comply with the FAA regime. Accordingly, we query whether the amendment proposed in section 7(1) of Schedule 5 reflects a deliberate change in policy, or whether it is envisaged that the retail staff described above would still be able to rely on the current exemption on the basis that any such advice is "ancillary". If the latter, it would be helpful to clarify this through regulator guidance.
32.	Do you have any other feedback on the drafting of Schedule 2 of the Bill?	The definition of "wholesale client" refers to a "wholesale client" being a client of a financial adviser (whereas the definition of "retail client" does not). We assume this is because a "financial adviser" may provide advice to wholesale clients on its own account (i.e., without being engaged by a "financial advice provider"). See also our response to question 3 above. We do not believe this proposition is clear from the Consultation Paper or the Draft Bill itself. It would be helpful if this could be clarified.
Proposed transitional arrangements		
34.	Do you support the idea of a staged transition? Why or why not?	Yes, as with any regulatory reform, the process of adjustment for industry participants can be complicated and expensive, therefore, allowing them to make changes over a period that allows them to continue to operate their business is of considerable benefit.
36.	Do you perceive any issues or risks with the safe harbour proposal?	We query whether a distinction needs to be made in terms of disclosure between those advisers who are operating under a full licence and those relying on the "safe harbour" given the later has not met some aspect of the Code's competence, knowledge and skill standards.
Demographics		
49.	Name: Enter your name and/or the name of the group of people, business, or organisation you are providing this submission on behalf of.	Bell Gully
50.	Contact details	Haydn Wong and Rachel Paris (see contact details on page 1)
51.	Are you providing this submission: ☐As an individual ☐On behalf of an organisation (Describe the nature and size of the organisation here)	This submission is provided on behalf of Bell Gully. Bell Gully is a corporate law firm with over 200 lawyers.
52.	Please select if your submission contains confidential information	We have no objection to our submission being published.