# TO: MINISTRY OF BUSINESS, INNOVATION & EMPLOYMENT

# SUBMISSION ON CONSULTATION PAPER – NEW FINANCIAL ADVICE REGIME

www.chapmantripp.com


## INTRODUCTION

1 The Ministry of Business, Innovation and Employment (*MBIE*) has sought feedback on the issues raised in the Consultation Paper – New Financial Advice Regime (*Consultation Paper*).

2 The matters covered by the Consultation Paper are of direct interest to Chapman Tripp as legal practitioners and to our clients.

3 Our submission follows the structure of MBIE's template for submissions and, where appropriate, includes some general comments.

4 We have no objection to our submission being published on MBIE's website.

5 This submission reflects the views of the following specialists in our financial sector regulation team:


BRADLEY KIDD – PARTNER
T: +64 4 498 6356
M: +64 27 224 1271
E: bradley.kidd@chapmantripp.com

PENNY SHEERIN – PARTNER
T: +64 9 358 9817
M: +64 27 556 6516
E: penny.sheerin@chapmantripp.com

ALAN LESTER – SPECIAL COUNSEL
T: +64 4 498 4959
M: +64 27 285 0160
E: alan.lester@chapmantripp.com

PHOEBE GIBBONS – SENIOR ASSOCIATE
T: +64 9 357 9887
M: +64 21 775 859
E: phoebe.gibbons@chapmantripp.com

ASHA TROTTER – SENIOR ASSOCIATE
T: +64 4 498 6389
M: +64 27 383 3663
E: asha.trotter@chapmantripp.com

NATAN KARON – SENIOR SOLICITOR
T: +64 4 498 4983
E: natan.karon@chapmantripp.com

TIM WILLIAMS – PARTNER
T: +64 9 358 9840
M: +64 27 243 1629
E: tim.williams@chapmantripp.com

ROGER WALLIS – PARTNER
T: +64 9 357 9077
M: +64 27 478 3192
E: roger.wallis@chapmantripp.com

EMMA DALE – SENIOR ASSOCIATE
T: +64 9 357 9291
M: +64 27 589 1978
E: emma.dale@chapmantripp.com

SANNA BOOW – SENIOR LEGAL ADVISOR
T: +64 9 357 9627
M: +64 27 528 2822
E: sanna.boow@chapmantripp.com

BRENDON ORR – SENIOR SOLICITOR
T: +64 9 357 2713
M: +64 21 0271 1885
E: brendon.orr@chapmantripp.com


## ABOUT CHAPMAN TRIPP

6 We have been at the forefront of advising on the Financial Advisers Act 2008 (*FAA*), the Financial Service Providers (Registration and Dispute Resolution) Act 2008 (*FSPA*) and the Financial Markets Conduct Act 2013 (*FMCA*).

7 Our clients include major banks, retail and wholesale managed funds, KiwiSaver and superannuation schemes, brokers, insurers, adviser networks and providers of other financial products such as custodians and wrap account operators.

8 We also act for a range of corporate trusts, equity and debt issuers, investors, arrangers, trustees/supervisors, derivative market participants and other intermediaries on a broad range of domestic and international capital markets transactions.

9 We have been exposed to the full spectrum of compliance issues from the FAA and FSPA and understand the issues, challenges and frustrations the industry has faced.

10 We have discerned a number of themes from our experience. We summarise these in the “Key Points” section below, before turning to answer the questions in the Options Paper.

## KEY POINTS

11 At the outset, we commend MBIE for constructive and collaborative consultation it has provided on the reforms and on the expansive and far-reaching nature of the proposal. We believe MBIE has made a real effort to understand the concerns of the industry with the existing regulatory settings, and to address those concerns rather than retain sub-optimal elements of the status quo.

### Terminology

12 In our view:

(a) while the term “financial adviser” is appropriate and unobjectionable, the views of existing AFAs and the industry should be influential in determining whether to retain the current AFA title. We do see some merit in retaining that title or changing it to ‘qualified financial adviser’ if a distinction based on qualifications is useful to consumers.

(b) financial advice providers should be able to call their representatives by whatever name is most appropriate to their role. We believe that the term "financial advice representative" would confuse customers and is not necessary in light of the other duties which underpin the service that those representatives provide. Any distinction between financial advisers and other representatives need only be made in the legislation.

(c) if a title needs to be attached to financial advice representatives, it should be descriptive of the purpose of the relevant category in a manner that is meaningful from a consumer perspective. For example, if it is desirable to indicate that an adviser represents a licensed FAP, the title should be '[the name of the FAP] advice representative'.

### The client first duty needs refinement

13 The client first duty should:

- be limited to the giving of advice. Extending it to "doing anything in relation to the giving of advice" would create uncertainty as to the scope of the duty and generate unpredictability as to how the duty will be enforced by regulators. This could in turn lead to providers taking a cautious approach to the detriment of consumers

- extend only to conflicts between the client and the advice provider or associated person, not to "any other person" as currently drafted as this would create a duty to identify others which could be potentially burdensome, and

- not apply to simple banking and insurance products, consistent with the position in Australia.

### The client first duty should apply only to matters within nature and scope of advice sought

14 The client first duty should be limited by the nature and scope of the advice sought and agreed between the client and the adviser. Such a limit would:

- prevent a situation in which the adviser might be required to nevertheless provide advice on other products that are beyond the agreed scope in order to meet their client first obligations;

- clarify that the client first duty does not extend beyond the products and services the client has sought advice on (and does not extend to an indeterminate range of products or services on which the adviser might possibly be qualified to advise).

### The inappropriate incentives duty should be clarified

15 The duty on a FAP to ensure that "inappropriate" incentives are not paid should specify that an incentive is only inappropriate where it is likely to materially influence the advice given (as opposed to the current formulation where an incentive will be inappropriate if it is likely to have the effect of encouraging a breach of duty, which would include the client first duty). Otherwise it could create a de facto prohibition on commissions, or any remuneration structures with an element linked to sales, which would undermine the policy decision recognising that commissions are an important remuneration tool in the industry.

### The duty to agree on nature and scope of advice should be calibrated carefully

16 The duty to agree the nature and scope of the advice should be framed to ensure that it does not inadvertently act to the detriment of consumers. Financial advisory engagements are often "fluid" so to have a duty that is so rigid as to disrupt the client experience and risk deterring customers from seeking advice or providers from providing it would be counterproductive.

### Individuals should not have civil liability for "involvement in a contravention"

17 Individual financial advisers are more likely to be "involved in a contravention" than other employees under other breaches of the FMCA given the highly "personal nature" of financial advice. In light of that, we believe that financial advisers:

(a) should not be exposed to civil liability for being

involved in a contravention, or

(b) should have a specific defence available where they have acted in accordance with the processes, controls and limitations of the relevant FAP.

### Retail duties should apply at a client level – not at a service level

18 The Bill states that if a financial advice or broking service is provided to any retail clients, the entire service will be deemed to be a retail service. This means that FAPs who offer a service to as few as one retail client, would have to comply with the full suite of retail obligations in relation to their wholesale clients. In our view:

- duties that apply to retail clients should apply only when regulated financial advice is given to a retail client (i.e. they should apply at the client level), and

- the concept of a 'retail service' is workable in relation to financial products and DIMS services, but is not appropriate for advisory services, where firms do not separate their advisory businesses into divisions for retail and wholesale clients (as such it is impossible to delineate between retail and wholesale services in the way the Bill presupposes).

### The wholesale / retail divide should be maintained

19 We submit that:

- there should be no requirement to provide any form of disclosure to wholesale clients,

- there should be no extension of the client interest first duty to wholesale clients as, in our view, that could be detrimental to those wholesale clients, and

- The FAA should regulate financial advice to retail clients only. The Part 2 fair dealing provisions of the FMCA provide sufficient regulation for financial advice provided to wholesale clients.

### The wholesale / retail tests should be rationalised

20 In addition, we consider that:

- the different wholesale/retail tests under the FAA, FSPA, FMCA and Financial Advisers (Custodians of FMCA Financial Products) Regulations 2013 (FAA Custody Regulations) should be rationalised, and

- the wholesale/retail boundary in the FAA Custody Regulations should also be extended to include all categories of wholesale client in clauses 3(2) and 3(3) of Schedule 1 to the FMCA.

### Financial advice should not be subject to prohibition on offers of financial products in unsolicited meetings

21 Applying the prohibition on offers of financial products in the course of unsolicited meetings by or on behalf of FAPs could be detrimental to consumers and should not apply where regulated financial advice is given.

### Transition should permit personalised robo-advice

22 We submit that:

- licensing of robo-advice providers should be fast-tracked (provided the applicant has met the relevant criteria), and supplemented by targeted exemptions from the current regime if necessary, and

- AFAs should not be required to requalify, given the significant qualification requirements that have already been imposed on them and the ongoing CPD requirements to which they are subject.

### The FSPR registry categories should be rationalised

23 It is vital that Parliament take the opportunity through this reform process to:

- align the categories of "financial service provider" with the categories of "financial institution" in the Anti-Money Laundering and Countering Financing of Terrorism Act 2009 (*AML/CFT Act*). This could be best achieved by amending the AML/CFT Act to align

with the ultimate position reached in these reforms, and

- require the Registrar to change the categories of registration so that they align exactly with the categories in the legislation.

## Territorial scope

24 The territorial scope of the FAA should be amended by creating an "approved list" of offshore jurisdictions. Qualified providers located in these jurisdictions would not have to comply with additional requirements under New Zealand law (with some tolerance for where there are gaps – for example, European jurisdictions where the concept of holding assets "on trust" does not exist).

The creation of such a list would recognise that the rules of certain other jurisdictions are sufficiently robust or like New Zealand's to provide adequate consumer protection. And the need for jurisdictional approval will ensure that consumers will be protected by New Zealand regulation where that is superior.

We also support targeted exemptions to address certain "false positives" resulting from the territorial scope, for example relieving the need for compliance when a client is in New Zealand on a temporary basis only.


## SCHEDULE – ANSWERS TO QUESTIONS

### PART 1 – AMENDMENTS TO THE DEFINITIONS IN THE FMCA

**1 If an offer is through a financial advice provider, should it be allowed to be made in the course of, or because of, an unsolicited meeting with a potential client? Why or why not?**

**Yes. Subjecting FAPs to the unsolicited offer regime could be detrimental to consumers by limiting FAPs' opportunities to offer financial products and provide financial advice**

1 Applying the prohibition on offers of financial products in the course of unsolicited meetings may result in suitable products not being put in front of consumers.

2 Suppliers of financial products, particularly banks and fund managers, regularly encounter scenarios in which consumers would benefit from having an alternative product suggested to them. For example:

2.1 a financial adviser (*FA*) may realise in the course of a meeting with a customer that a product not thereto discussed might be suitable, or

2.2 a financial advice representative (*FAR*) employed by a fund manager might in the course of a phone call to a long-standing client to discuss that client's financial goals, realise and wish to discuss alternative product offerings that are more suitable to that client than an existing product.

In both cases, it would be beneficial to the customer for the provider to be able to have the discussion. A prohibition on offers in unsolicited meetings would preclude that.

3 Neither scenario is likely to result in customer harm. In fact, as described above, the consumer interest would be better served by permitting FAs and FARs to offer alternative financial products or services in an unsolicited context.

4 The potential harm to investors of being mis-sold or pressured into purchasing financial products and services is already addressed through the FAP's obligations to comply with the Code of Conduct (*Code*); exercise care, diligence and skill; provide disclosure; meet its licencing obligations, and establish processes, controls and limitations on the advice provided by its FARs.

5 For these reasons, subjecting FAPs to the unsolicited meetings regime is unnecessary and would not serve consumer interests (particularly given the overlay of the other duties in the Bill).

### Prohibiting unsolicited meeting offers would conflict with changes made to the Uninvited Direct Sales regime

6 Prohibiting FAPs from making offers in unsolicited meetings would also conflict with the rationale given for the recent exemption for AFAs and QFE Advisers from the Uninvited Direct Sales (*UDS*) regime in the Fair Trading (Uninvited Direct Sales – Financial Products) Regulations 2014.

7 The Regulatory Impact Statement for those Regulations states that the policy decision underpinning both the existing FMCA exemption for AFAs and QFE Advisers from the unsolicited meeting prohibition and the justification for aligning the UDS regime by exempting AFAs and QFE Advisers from the UDS provisions, was that:

7.1 there are certain circumstances where the risks of pressure selling are low, for example, because the offeree is sufficiently experienced in investment or has a relationship with the issuer, and

7.2 AFAs and QFE Advisers are already subject to disclosure and other obligations under the FAA [and that] these obligations likely take sufficient account of the risks of pressure selling. Further, there is an expectation in the context of a financial adviser relationship that financial advisers will be selling and advising on a range of products. The nature of financial products and financial advice is that advisers may discuss products other than the ones that the customer originally had in mind.

8 In our view, those policy rationales are equally (if not more) forceful under the current Bill, where FAPs, FAs and FARs would be subject to even more stringent regulation with correspondingly lower risks of pressure selling.

**2 If the exception allowing financial advice providers to use unsolicited meetings to make offers is retained, should there be further restrictions placed upon it? If so, what should they be?**

### No. FAPs are subject to several obligations that already control mis-selling

9 The Bill already places a number of obligations on FAPs which are, in our view, sufficient to address the prospect of FAPs and their personnel “mis-selling” financial products.

**3 Do you have any other feedback on the drafting of Part 1 of the Bill?**

### The definition of Financial Advice Product should exclude switching

10 We note that guidance from the FMA contemplates that advice on switching between investment funds within a single financial product (e.g. a KiwiSaver scheme) is regulated by the FAA. As the same wording is used in the Bill, we assume that the same approach will apply.

11 This rationale for this position is that advice on a switch is captured by virtue of it being “a renewal or variation of the terms or conditions of an existing category 1 product”.

12 If it is intended that this advice be captured, then the definition of “financial advice product” in part 1 of the Bill should be amended to explicitly capture switches between funds in Retirement Schemes (KiwiSaver schemes, superannuation schemes and workplace savings schemes).

13 In the context of these schemes, a decision to switch funds within a scheme is not in our view a “renewal or variation”, because:

13.1 there is only a single financial product – an interest in the scheme (see section 11(2)(a) of the FMCA, which makes it clear that the interest is issued when a person becomes a member)

13.2 further contributions to and investments in the relevant scheme do not result in the issue of further financial products (see section 11(2)(c)(i) of the FMCA)

13.3 a switch between funds within the scheme does not result in a variation to the terms and conditions of that single financial product. The rights that a member has in relation to the scheme are governed by the trust deed and the terms of the offer documents applying to the scheme, and the switch is an exercise of those existing rights

13.4 a switch similarly does not constitute a “renewal” of the membership interest in the scheme, and

13.5 before the FMCA provisions referred to above became law, it had already been well accepted that membership of a superannuation or KiwiSaver scheme was a single security and that an exercise of choice (including investment choice) in the member capacity was not a variation to membership terms or conditions.

14 All that has happened is that the member has directed (by exercising a power already available to them) that the funds they have invested in the relevant scheme – in respect of which they have the same rights both before and after the switch – be invested in a different investment option or options.

**Terminology – The AFA title should be retained and FAPs should determine the title used by their FARs**

15 The terminology contemplated by the Bill has already been the subject of sustained debate and we maintain that the term “salesperson” would be a preferable title (over financial advice representative) for those people who are in effect merely salespersons, as it would better reflect the level of skills and the type of advice

being provided by those types of advisers. It also indicates transparently a sales motivation and a limited scope of products that those advisers may sell.

16 However, for the reasons given below, we think it may be preferable that no title be applied to those representatives, at least in terms of the way they are presented to customers.

17 We consider that clients, particularly at the retail level, are unlikely to appreciate that FARs differ from FAs and are subject to a lower level of accountability.

18 It may be that there is no combination of terminology that:

18.1 universally captures this class of adviser

18.2 does not risk confusion with the concept of a “financial adviser”, and

18.3 could be readily understood by customers.

19 That being the case, one option is to retain the current AFA title for FAs which, while cumbersome, may be understood by the market. It is also a “brand” in which AFAs have invested heavily in terms of qualifications, professional development and compliance. We believe it will be important to consider industry feedback on this point, particularly from AFAs.

20 Alternatively, if emphasis is to be placed on the fact that the advisers are qualified, “qualified financial adviser” (*QFA*) would be suitable. Whatever title is chosen, there must be an alignment of the title with the purpose of delineating the category of persons.

21 AFAs (or QFAs) could conceivably expand the number of AFAs to capture the current complement of registered financial advisers – though they would be subject to limitations under the Code as to the types of services they could provide and the financial products they can advise on.

22 In our view, FAPs should be permitted to call their FARs whatever is most appropriate to their role. There are protections available through a combination of section 431D(b) of the Bill (prohibitions on holding out), the Code and the disclosure regime to ensure that clients are able to have confidence in the credentials of the person advising them and are adequately informed of the nature of the services which a FAR is able to give them. If concerns arose as to the titles given to FARs within organisations (e.g. that titles were misleading or confusing), then FMA could address this in licensing requirements or through guidance.

23 Alternatively, if a title needs to be attached to financial advice representatives, it should be descriptive of the purpose of the relevant category in a manner that is meaningful from a consumer perspective. For example, if it is desirable to indicate


that an adviser represents a licensed FAP, the title should be '[the name of the FAP] advice representative'

24 There are other considerations form a policy perspective:

24.1 clients will be able to expect a baseline level of treatment and competence from all financial advisers regardless of their title (so there may be less need to distinguish between FAs and FARs for accountability purposes)

24.2 the overlay of the new duties in the Code and the Bill, and the "primary" liability that the licensee carries for compliance, means that titles are less relevant (and consumers will be entitled to that baseline level of conduct), and

24.3 consumers are more likely to be able to recognise a "higher" level of qualification that attaches to an FA (AFA or QFA) if the FAR term is not used.

**The definition of 'contract of insurance' should be clarified**

25 The definitions to be added to section 6 of the FMCA in clause 5(1) of the Bill refer to 'a contract of insurance' in the definition of product provider and financial advice product. The FMCA does not contain a definition of 'contract of insurance' and the two most relevant definitions, being the definitions in the FSPA and the Insurance (Prudential Supervision) Act 2010 (*IPSA*) differ. The FSPA definition and the FMCA definition (if included) should, in our view, cross-refer to the IPSA definition of 'contract of insurance'. This is considered the most accurate definition (albeit one that may change as a result of the Reserve Bank of New Zealand's review of IPSA).


## PART 2 – LICENSING REQUIREMENTS

**4 Do you have any feedback on the drafting of Part 2 of the Bill?**

**The territorial scope of the Bill should be clarified for offshore services through an approved list of offshore jurisdictions**

26 The proposed territorial scope of the Bill – to apply where a service is "received by a client in New Zealand" - mirrors that in section 157 of the FAA.

27 Usual practice where a client is physically present or incorporated in New Zealand is to treat any service they receive as "received by the client in New Zealand" and therefore subject to the FAA. This is despite the fact that all other aspects of the service are provided offshore, and are often (sometimes heavily) regulated in those offshore jurisdictions. In our experience, this can result in dual regulation and unnecessary compliance costs.

28 One consequence is that the FAA applies even where, for example, a service is provided electronically to a New Zealand client in circumstances where the client has sought the service and the service provider has not solicited that client in New Zealand. We have experience with this where New Zealand residents have formed business relationships with providers while offshore and then sought to continue those relationships once they have returned to New Zealand, thereby bringing the relevant service provider into the New Zealand regulatory regime.

29 This issue can be particularly acute in the broker context, where the relevant financial products are held offshore and the only "link" to New Zealand is the location of the client here.

30 We have previously submitted that the territorial scope of these provisions should be amended, or supplemented by regulation, to create an "approved list" of offshore jurisdictions so that qualified providers located in those jurisdictions do not have to comply with the additional requirements under New Zealand law (with some tolerance for where the offshore requirements may differ from New Zealand requirements – for example, European jurisdictions where the concept of holding assets "on trust" does not exist).

31 We believe that the creation of an "approved list" of this nature will recognise that, in many cases, consumers can be adequately protected under the rules of foreign jurisdictions and the requirement for approval means that New Zealand consumers will still be protected by New Zealand regulation where a country is not on the approved list.

32 If this approach is not supported then the precise territorial scope of the FMCA as it applies to the giving of financial advice should ideally be clarified in the Bill by using the phrase "where a service is provided to a client or an investor located in New Zealand…".

33 The relief currently provided for Australian advisers has been achieved through the use of two exemptions covering reasonably specific matters (including relief from AFA qualifications for Australian advisers in certain circumstances). We see this as a matter that should be dealt with as part of the regulatory framework not sporadically through exemptions.

**The exemptions in section 389 should apply based on the retail / wholesale status of the client – not on whether a service is a retail service**

34 The exemptions for financial advice services in section 389 of the Bill should apply on the basis of whether a client is or is not a retail client – they should not apply on the basis of whether a service is a or is not a retail service (i.e. they should apply depending on the status of particular clients, not on the basis of whether or not a service 'as a whole' is a retail service or not).

35 The section as drafted effectively means that, unless a FAP has segregated all retail services from any wholesale services, the full ambit of retail obligations will apply to all customers (irrespective of their status), and more importantly, that a single mis-categorisation would have significant consequences on the treatment of wholesale clients and the regulatory burden to which their advice services are then subject.

36 Section 389(4) in particular, is based on an assumption that services within FAPs operate in a "compartmentalised" manner (i.e. retail services are distinct from wholesale services). Our understanding from discussions with clients is that this is not the case, with the same advisers advising both wholesale and retail clients (though on a different regulatory basis). See our response to **Question 14** in paragraphs 93 to 99 below for further discussion of this issue.

**The Bill should contain a clear statement on who can provide regulated financial advice**

37 As with sections 17 to 20 of the FAA, the Bill should include a clear statement that only a FAP, an FA or an FAR, is permitted to provide regulated financial advice to a person in New Zealand.

**PART 3 – 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 <u>and</u> 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?**

**No. We consider that extending the client first duty beyond the point that the advice is given is unclear and potentially too broad**

38 Extending the client first duty beyond giving advice to 'doing *anything in relation to the giving of advice*' would create considerable uncertainty and could inadvertently extend the duty to potentially cover *all* aspects of the client engagement.

39 The lack of precision in the expression "*anything* in relation to the giving of advice" conflicts with the desirability of sufficient clarity so that the willing compliant persons know what is expected of them. In our view, the client first duty should apply only in relation to the provision of advice because:

39.1 the duty would appropriately focus on the consideration of the client's circumstances within the agreed nature and scope of the advice (discussed below), the steps taken as a result of that consideration, and any resulting conflicts that the adviser may know or ought reasonably know about when providing the advice sought;

39.2 the duty would appropriately **not** extend to 'anything in relation to the giving of advice' – and would therefore not include matters outside the agreed nature and scope of the advice sought; matters that are unrelated to the client's circumstances; unknowable matters that may arise in the future; or execution or remuneration related matters, which may conflict with the client's interests.

40 If the duty to put the client's interests first were extended beyond the provision of advice to '*doing anything in relation to the giving of the* advice', then this extension would potentially capture:

40.1 the rebating of fees or revenue in relation to a product recommended by the adviser, where there will inherently be a conflict between retaining the fees earned and reimbursing the client;

40.2 research on products for a client by a provider, where 'doing anything in relation to the advice' might compel the adviser to review all similar products available on the market and recommend an alternative in order to place that client's interests ahead of their own;

40.3 execution situations where the provider might be required to put the competing interests of a number of clients first; for example where a financial


product has a limited supply, where an advisor would not be able to place every client's interest first in allocating the financial products.

41 Similarly, it could compel FAPs, FAs and FARs, in some cases, to give financial advice (rather than provide 'information only') in order to put the client's interests first. As the Consultation Paper notes, in determining whether to give 'information only' or 'financial advice', the adviser must put the client's interests first, notwithstanding that this may be beyond the agreed nature and scope of the advice sought (a matter we comment on below).

42 Limiting the client first duty to the provision of advice would avoid this unintentional overreach, avoid any *ex ante* lack of predictability as to how the duty would be applied and enforced by regulators, and reduce the prospect of uncertainty which may inhibit positive behaviours from those seeking to comply.

**The client first duty should apply only to matters within the nature and scope of advice sought**

43 The duty to place the client's interests first should be limited by the nature and scope of the advice sought and agreed between the client and the adviser.

44 Put another way, advisers should be required to put the client's interests first only insofar as doing so would fall within the agreed nature and scope of the advice sought. This would ensure that the client first duty aligned with the obligation in section 431G to agree the nature and scope of advice sought.

45 Without this limitation, if a customer seeks advice on one particular type or product only, the adviser may nevertheless be compelled to go outside the agreed scope to persuade the customer to expand the agreed scope in an attempt to put the customer's interests first, contrary to the customer's choice.

46 For example, if a customer seeks advice on a home loan product, and agrees the nature and scope of the advice sought should be limited only to home loan products offered by the advice provider, then the adviser should not be obliged, in putting the client's interests first, to advise on alternative products offered by third parties which may have different (possibly more attractive) features.

**The client first duty should be limited to associated parties of the adviser**

47 The client first duty should be confined to conflicts between the client and advice provider or any associated person of the advice provider. To extend it so that the client's interests must be put ahead of the interests of 'any other person' where the adviser knows of reasonably ought to know that there may be a conflict would establish what is, in many ways, an impossible standard.

48 A tidier solution would be to align the client first duty with the equivalent provision in Australia. There, the conflicts priority rule in [section 961J](section 961J) of the Corporations Act 2001 (Cth) requires that an advice provider know, or ought reasonably know, that there is a conflict of interest between the client's interests and their own interest (or the interests of some of their specified associated parties).

49 Extending the duty to require providers to take account of the interests of 'any other person' that they know, or *ought* to know, conflict with the interests of their client, could result in advisers being held civilly liable for conflicts beyond their control by an indeterminate class of persons that they ought to have known about. This is, in our submission, an untenable position to place advisers in, as they have no means of controlling the third parties, or mitigating the effects of any potential conflicts that they knew or ought to have been aware of. Canvassing all potential conflicts could be grossly inefficient.

**The client first duty should not apply to certain simple banking products**

50 We also submit that the client first duty should not apply to advice provided to retail clients on basic banking products (such as bank deposits, term deposits, stored value instruments and travellers' cheques).

51 In our view such products are unlikely to result in material conflicts between the advice provider and the customer, and requiring banks to take account of the client first duty in relation to these products may result in customers not receiving advice on a product that may be suitable for them.

52 An exclusion for simple banking products would align with the client first standard in Australia. Specifically, section 961F of the Corporations Act 2001 defines a basic banking product as:

52.1 a basic deposit product (defined in section 761A)

52.2 a facility for making non-cash payments (e.g. a stored value instrument)

52.3 a facility for providing traveller's cheques, and

52.4 any other product described by regulations.

53 The exclusion for simple banking products should also exclude the duty to agree the nature and scope of advice in relation to these types of products.

**The client first duty should be limited to giving regulated financial advice**

54 Finally, the duty should be limited to situations where an adviser gives *regulated* financial advice to retail clients. The current wording would extend this duty to situations where an adviser gave regulated financial advice to both retail and

wholesale clients. We have addressed this point in our response to **Question 7** in paragraphs 60 to 62 below.

### Our preferred drafting of the client first duty

55 Based on our submissions above, our preferred drafting of the client first duty provision in section 431H of the Bill is:

> **431H Duty to put client's interests first**
>
> (1) This section applies if a person who gives regulated financial advice (**A**) knows, or ought reasonably to know, that there is a conflict between the interests of the person to whom the advice is given (**B**) and the interests of:
>
> ~~(a) the interests of the person to whom the advice is given (**B**); and~~
>
> (a) A's own interests ~~or the interests of any other person.~~; or
>
> (b) the interests of any person who is associated with A.
>
> (2) In giving ~~the~~ advice within the nature and scope agreed between A and B, ~~or doing anything in relation to the giving of the advice,~~ A must give priority to B's interests ahead of the interests described in subclause (1)(a) and (b) above, including by taking all reasonable steps to ensure that A's own interests or the interests of any ~~other person~~ person who is associated with A do not materially influence the advice.
>
> (3) This section applies only to a retail service.
>
> (4) Subsection (2) does not apply to the extent that the advice provided by A relates to a basic banking product, provided that A is satisfied that its own interests have not materially influenced the advice given.

## 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?

### The use of the term 'inappropriate' is should be clarified

56 We support a provision which restricts the payment of incentives which would materially compromise an adviser's ability to discharge their duties. This position would be consistent with the Bill's consumer protection focus while acknowledging the previous policy decision to retain commissions.

57 Given that one of the purposes of the Bill is to improve the availability of financial advice, we expect that the intention is not to prohibit the payment of commissions

to FARs. As MBIE identified in its previous consultations, consumers are often not willing to pay directly to receive advice. Effectively banning one of the primary ways in which advisers are currently remunerated would restrict their willingness to provide advice without access to some other form of remuneration.

58 Section 431O should restrict remuneration where that remuneration would be likely to materially influence the advice given (i.e. use a similar threshold as in the proposed section 431H). In our view, this would strike an appropriate balance between protecting the consumer and accommodating a remuneration structure which (as is evident from MBIE's comments described in paragraph 57 above) is still relevant and important to the functioning of the New Zealand financial advisory industry.

59 Reference to 'intended or likely to encourage conduct that contravenes a duty' (presumably most relevantly the client first duty) could be construed as preventing any form of personal benefit to the adviser as remuneration, which ultimately comes at the cost of the customer in some form.

**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?**

**No. The client first duty should not be extended to providers who do not provide a retail service**

60 Wholesale clients (particularly institutions and professional investors) have sufficient sophistication and knowledge available to them to understand the products and services they are obtaining. Imposing client first duties on providers who provide advice to wholesale clients would impose increased compliance costs and introduce complexity in advising wholesale clients in New Zealand and overseas.

61 The imposition of the client first duty is not appropriate in the truly wholesale context (i.e. those persons who fall within clause 3(2) of Schedule 1 of the FMCA)

61.1 Truly wholesale clients, who choose to receive a wholesale service rather than a retail service, are in a position to negotiate their own protections or are afforded them by providers as a matter of market practice, so generally would not expect to be afforded the protection of this type of duty

61.2 in any event, wholesale clients have the protection of the fair dealing provisions in Part 2 of the FMCA, as well as the Fair Trading Act 1986, overlaid by the general appetite providers will have to protect their brand and reputation, and

61.3 we are not aware of other jurisdictions which impose such a duty on the providers of wholesale advice services. The imposition of a client first duty on wholesale market participants would require overseas financial advisers who advise on global transactions (who would be captured by the territorial scope of the FMCA) having to comply with specific New Zealand standards that are not imposed by any other jurisdiction.

62 More importantly, we do not see that extending the duty to wholesale clients will be of significant benefit to them. Indeed, it could be to their detriment:

62.1 given the potential for issues to arise as a result of the new statutory duty, advisers may well provide more conservative advice, or refrain from giving advice at all, leading to wholesale clients receiving a limited or sub-optimal service, and

62.2 the "overlay" of the client-first duty could cause confusion, particularly where a provider has standard commercial terms with different wholesale clients which would typically deal with conflicts as between clients (e.g. product allocation where there is a limited amount available, such as an IPO or placement that is scaled back due to excess investor appetite). The presence of an overriding statutory duty to act in *every* client's best interest could lead to irreconcilable duties owed to multiple clients, which is sub-optimal.

**The exclusion in clause 13(3) of Schedule 5 of the Bill would mitigate this issue only for the provider's own products – not third party products**

63 Clause 13(3) of Schedule 5 provides that financial advice given by a person is not "regulated" financial advice if:

63.1 it is given in connection with an offer of a financial product by or on behalf of the offeror, and

63.2 the offer does not require disclosure under any of clauses 3 to 5 of Schedule 1 (i.e. "wholesale investors" under the FMCA).

64 This exclusion alleviates the issue somewhat but only applies to the provider's own products (or advice given on behalf of the provider), not to the large number of advisers who advise wholesale clients on third party products.

65 This inconsistency of treatment would not be justified as a matter of policy – hence (along with the reasons above) our submission that the client first duty should not apply to wholesale clients.

**8 Do you have any other feedback on the drafting in Part 3 of the Bill?**

**Protection of financial adviser or financial advice representative reporting breach should align with the original FAA provision**

66 The whistleblower protection provision in section 431P of the Bill should more closely align with the current provision in section 45A of the FAA. In particular:

66.1 sub-section (1) of section 431P of the Bill should contain a materiality threshold, such that an adviser is afforded protection only for submitting reports to the FMA that arise from a reasonable belief that a person has *materially breached* a provision of the Act

66.2 sub-section (2) of section 431P of the Bill should contain a provision that prohibits the FMA from disclosing information in a report (whether or not it has been made in good faith) that might identify a client of the reporting adviser, unless that client consents or the FMA believes disclosure is essential.

67 We recommend that MBIE consider providing examples of reports made in bad-faith, such as reports submitted for gaining a competitive advantage or some other ulterior motive or in retaliation for an adverse performance review. This could also be achieved through guidance from the FMA.

## Some duties contain inconsistent drafting

68 Certain duties imposed by part 3 of the Bill are phrased so as to apply only *"when a person **provides** regulated financial advice"* while other duties are phrased so as to *"apply to any person who **gives** regulated financial advice"*.

69 We suggest that all of the duties be drafted consistently, in case a distinction between the two is thought to be intended. We suggest "*when regulated financial advice is given*" so that it is clear that the provisions are meant to apply only when giving regulated financial advice, and not at all times.

## The duty to agree on nature and scope of advice should be calibrated so that it is workable in practice

70 We support the duty to agree on the nature and scope of advice. We are aware that there is concern in the industry (and with MBIE) that customers are too frequently in situations where they don't understand the limitations on advisers, in terms of the scope of products they can advise on, and/or the nature of advice they can give (e.g. if they are only able to advise up to a certain level of complexity, after which a more experience adviser would be required).

71 But this duty needs to be "calibrated" in a way that ensures positive customer outcomes, while being workable for advisers. Our experience is that interactions between advisers and clients tend to be quite fluid, such that it only becomes apparent that advice is or may be required part way through an interaction.

72 It would be artificial and lead to a potentially strained client experience if FARs are required to stop part way through an engagement and agree or extend the scope of the advice they are to provide.

73 In order to ensure the duty is workable, we suggest that:

73.1 the requirement to agree the nature and scope should reflect the nature and complexity of the service and product in question. For example:

(a) if a customer has already approached a provider about a simple product (such as a general insurance product or bank deposit), there should be no requirement to agree the nature and scope of the advice (or, at the very least, the duty should not require the provider to expressly agree that it will not provide advice on another provider's products)

(b) where there is no reasonable likelihood of the customer misunderstanding that they will be given access to only the range of products provided by the particular provider, no agreement as to nature and scope should be required as doing so would be unnecessary

(c) conversely, if the advice and/or product is more sophisticated (such as entry into a DIMS or advice on shares/bonds) greater formality would be appropriate

73.2 there should be flexibility as to the manner in which this duty can be discharged. Providers should be able to comply with section 431G in whichever manner best serves the customer, which will likely not be by the production of printed material in all cases. Satisfaction of the duty through alternative means (electronic or otherwise) will be essential and it would be desirable that the agreement can be verbal or inferred from conduct, and

73.3 the duty must allow for FAPs to be easily able to track compliance (and should permit adviser confirmations where the FAP has no reason to doubt them). Otherwise there is a risk that providers will need to be handing out multiple documents (or undertaking multiple processes) to satisfy those different duties. This would significantly undermine the customer experience and become "too hard".

## PART 4 – BROKERS' DISCLOSURE AND CONDUCT OBLIGATIONS

**9 What would be the implications of removing the 'offering' concept from the definition of a broker?**

**We support removing the offering concept from the definition of a broker**

74 We support the removal of the "offering" requirement from the definition of broking service in the Bill and believe it will clarify when a person is in fact a "broker".

75 Parties who wish to provide a broking service, or any other financial service, are already able to pre-register on the FSPR. Accordingly, it is not necessary to refer to the offering of that service in the FMCA.

**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?**

**The term 'broker' should be changed to 'client money handler'**

76 The use of the term 'broker' is a source of confusion for international and domestic clients. The term is commonly used by industry to refer to roles that have only a limited amount to do with holding client money. For example, insurance broker, mortgage broker, travel broker and share broker.

77 Broker is a term that is generally used to refer to persons who buy and sell assets for others, or who arrange or negotiate agreements on behalf of others. It is an inapt term to describe entities that hold client money ('client money handlers') or those that hold client assets of any kind on trust ('custodians').

78 We recommend changing the term 'broker' to 'client money handler' and 'custodian', or to a term that accurately describes their role, in order to mitigate current market confusion.

**The Broker provisions of the Bill should exclude derivatives issuers as they must already comply with the Derivatives Custody Regulations**

79 We note that there is a great deal of overlap between the provisions in the Financial Markets Conduct Regulations 2014 (*FMCR*) – regulations 238 to 249 – governing the holding of derivative investor money and investor property (the *Derivatives Custody Regulations*) and the provisions of the Bill governing the handling of client money and client property by Brokers.

80 Moreover, we note that the broker service provisions do not apply to derivatives issuers in the course of acting as a derivatives issuer under a licence issued under part 6 of the FMCA. This is on the basis that retail clients are adequately protected by the Derivatives Custody Regulations, which essentially cover, and expand upon the handling of client money and client property provisions in the Bill.

81 Accordingly, in the context of derivatives, the only derivatives issuers that are subject to the provisions of the Bill are those who issue derivatives to wholesale investors. In practice, only section 431V is of any relevance to derivatives issuers. Although technically section 431W applies we consider that it is obviated by the exemption, as discussed above.

82 We, therefore, question whether it is appropriate that the broker provisions in the Bill should apply to derivatives issuers at all. It is not that we think issuers of

derivatives to wholesale investors would have a fundamental problem with having a duty to exercise care, diligence and skill under the Bill. It is that it seems odd that this duty is not similarly imposed on issuers of derivatives to retail clients (there are no corresponding specific provisions in the Derivatives Custody Regulations).

83 If the duties under section 431V are to remain for issuers of derivatives to wholesale investors, subsection (2) of section 77K of the FAA should be included in section 431V. It will be relevant in determining the degree of care, diligence and skill that the derivatives issuer should exercise in providing the broking service that the service is being provided to wholesale investors, not to retail clients. We query why this was not brought across from the corresponding FAA provision.

84 In any event, the Bill presents an opportunity to put the provisions in relation to the handling of client money and client property generally (i.e. those proposed in the Bill and those in the Derivatives Custody Regulations) all in one place, for example in a new schedule to the FMCR. This would also make a legislative response to the G20 requirements for margining uncleared (OTC) derivatives easier to implement.


## PART 5 – MISCELLANEOUS AMENDMENTS TO THE FMCA

**11 Should financial advisers have direct civil liability for breaches of their obligations, if the financial advice provider has met its obligations to support its advisers? Why or why not?**

**No. Civil liability should rest with the licensed entity**

85 We believe that the starting point should be that liability rests with the licensed entity. The giving of financial advice is one of the few professions where an employee of an organisation is potentially personally liable under statute for their conduct while acting in their capacity as an employee of their employer.

86 However, we acknowledge that AFAs have invested heavily in the AFA “brand” and that many of them may welcome the responsibility of personal accountability that goes with that status. Accordingly, we believe that the views of AFAs (most of whom will become FAs) should be highly persuasive on this point.

87 We believe, however, that personal accountability is best reflected through the possibility of disciplinary action. We do not think FAs or FARs should have direct civil liability beyond that.

**12 Should the regime allow financial advice providers to run a defence that they met their obligations to have in place processes, and provide resources to enable their advisers to comply with their duties?**

**Yes. FAPs should have a defence against liability if they have established processes, and provided resources to enable their advisers to comply**

88 FAPs should have a defence against liability arising from the actions of their FAs and FARs in circumstances where they have taken all reasonable steps to ensure that their advisers operate under robust processes, have resources, and are empowered to comply with their obligations under the Act.

89 Affording FARs a defence against liability if they have complied with their duties would incentivise them to continually improve their compliance programmes, and align with the provisions of the FMC Act, such as sections 499 and 503(2)(b). Clients could still seek redress under the FAP’s dispute resolution procedure.

**13 Is the designation power for what constitutes financial advice appropriate? Are there any additional/different procedural requirements you would suggest for the exercise of this power?**

**No. The designation power would create further uncertainty on the boundary between financial advice and 'information only' services**

90 Participants in the financial services industry need to have certainty as to the boundaries between regulated and unregulated conduct. These boundaries are crucial for determining the regulatory impost of providing a service. Without them, financial service providers may hesitate to provide "no-advice" services to clients, potentially restricting customers' ability to access information.

91 The potential mischief addressed by FMA's current designation power does not arise in the context of advisory services. The definition of financial advice is already expansive, requiring only that a person make a recommendation or give an opinion about acquiring or disposing of (or not acquiring or disposing of) a financial advice product.

92 In contrast, the definitions relating to the various kinds of financial products in the FMCA are narrowly cast and highly prescriptive making it conceptually possible to structure a security so as to legally fall within one product definition when in substance it more fits another definition. It was the prospect of such structuring which drove the need for FMA's designation power in the FMCA.

**14 Do you have any feedback on applying the concept of a 'retail service' to financial advice services? Is it workable in practice?**

**The concept of a 'retail service' in the context of financial advice services is not workable in practice**

93 We do not consider that the concept of a 'retail service' is workable in practice in the context of financial adviser services. See our comments in response to **Question 4** in paragraphs 34 to 36 above. It would be more appropriate for:

93.1 section 389(4) in Part 2 of the Bill to be deleted, and

93.2 advisers to identify those retail clients to whom they intend to provide a financial advice service so that there is clarity as to which clients have the "regulated advice" protections in the Bill.

94 This would avoid the risk of retail clients requiring full compliance for financial adviser services that are intended for wholesale clients only.

95 Clause 35 of Schedule 1 of the FMCA provides that a service is a retail service where it is supplied to (a) a retail investor, or (b) to a class of investors, where there is at least 1 retail investor in that class. This may be appropriate for offers of financial

products or DIMS, where the cost, compliance and disclosure differences between providing retail and wholesale clients are not so large, it is possible to screen out retail clients for a 'wholesale only' offer and a safe-harbour is available.

96 But it is inappropriate for financial adviser services, where:

96.1 it is difficult to predict which clients are likely to want to access the financial advice service, particularly where there is a lower threshold for wholesale investors (for example, for wealth or agri-banking advisory services, where some clients may be wholesale and others may be retail);

96.2 there are increased costs and compliance requirements associated with providing financial advisor services to retail clients, which will be largely unnecessary for wholesale clients, such as meeting certain competency standards, agreeing the nature and scope of services, full code compliance, and retail level disclosure, and

96.3 given there is no wholesale safe-harbour, providers may take a risk-averse retail complaint approach for all investors, potentially dis-incentivising or increasing the costs of providing advice to wholesale clients.

97 Also the ability to "opt out" of wholesale client status for regulated financial advice means that – should any one investor declare that they wish to be treated as a retail client – the entire "wholesale" service would become a retail service if continued (inadvertently or otherwise) - with immediate and quite fundamental regulatory consequences for both the service and the service provider.

98 The current wording of clause 35 of Schedule 1 of the FMCA also creates a conceptual question as to when a service is a separate service. Is it when:

98.1 the same output is received by a client i.e. financial advice

98.2 the service is provided on the same essential terms

98.3 the service is provided by the same staff?

99 In our view, this approach would achieve an appropriate consumer protection outcome, as well as reflecting the business reality in this context (and avoid the need for the "artificial distinctions" we describe above).


**15 Do you have any other feedback on the drafting of Part 5 of the Bill?**

**FAs and FARs should not be civilly liable for involvement in a contravention or should have a defence if they comply with the FAPs policies / procedures**

100 We have some concern with FAs and FARs being civilly liable where they are "involved in contravention" under section 533.

101 We acknowledge the policy drivers for with this regulatory setting in the context of financial products (and certain financial services such as DIMS). However:

101.1 these are significant consequences which may make FAs and FARs (as well as the FAPs who employ them) overly cautious in how they engage with clients and possibly hesitant to give advice, thereby compromising the "access to advice" goal of this reform

101.2 FARs in particular are likely to be far more constrained in the type of activity they undertake on behalf of a FAP than the financial markets participants captured by sections 511 and 533 of the FMCA, such as the directors or senior managers of an issuer.

102 The prospect of a FA or FAR being "involved" in a contravention is potentially higher than a director or senior manager. We say this because:

102.1 they deal more directly and personally with individual customers. As a result, it is much more likely (for example) that they could be "knowingly concerned in, or party to," a contravention than, a senior manager or other individual who participates in the preparation of a product disclosure statement

102.2 while the financial advice duties and Code will apply FAs and FARs, FARs (and to a lesser extent FAs) are not persons who are meant to be afforded a material amount of discretion in the advice they provide, and

102.3 invariably FAs and FARs will have little say in the overall compliance approaches of their employers so may not be in a position to do anything except tow the party line, even if they feel that that is not optimal

103 Accordingly, we believe that either:

103.1 FAs and FARs should be excluded from having civil liability for being "involved in a contravention", or

103.2 there should be a specific defence available for FAs and FARs where they have acted in accordance with the processes, controls and limitations of the relevant FAP.

## PART 6 – AMENDMENTS TO THE 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 proposed amendments will help address misuse of the FSPR**

104 We support the amendment of the territorial scope of the FSPA. We also support the new territorial requirements taking effect when the Bill is passed. We believe that the changes will need to be coupled with a more active screening process by the Registrar of Financial Service Providers.

**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?**

**Yes. The FSPR should set out the provider's AML/CFT supervisor and the names of directors and names and roles of senior managers**

105 We support including further information on the FSPR and consider that this will help the public make informed decisions. In particular we support the inclusion of:

105.1 information on the providers AML/CFT supervisor (if any);

105.2 information on the names of directors and names and roles of senior managers of the FSP (but in neither case their date of birth or home address).

106 Including this information on the FSPR would improve public access to information that is collected by the Registrar already, and/or is publicly available elsewhere, but is difficult to access. For example, an entity's AML/CFT supervisor can be found by searching three separately published lists on each Supervisor's website.

107 The second change can easily be accommodated by expanding Schedule 2 of the Financial Service Providers (Registration) Regulations 2010 to include clauses 4(a)(i), and clauses 4(b)(i) from Schedule 1 in Schedule 2, and should not need a transitional provision since the information is already collected.

108 Any decision to require further information will need to be carefully considered in terms of the *functionality and workability* of the register (i.e. it would need to take into account the costs of expansion and whether there would be increased utility or benefit for users).

**18 Do you consider that other measures are required to promote access to redress against registered providers?**

109 We make no comment on this matter.


**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?**

**Category 17 relating to participating in an FMC offer as the issuer or offeror of financial products or acting as an issuer in respect of regulated products or financial products should be removed**

110 FSPA category 17 should be removed from the list of financial services because requiring persons who are in the business of issuing securities to register on the FSPR is unnecessary and causes undue confusion.

111 All of the primary entities who are "in the business of participating in FMC offers as issuers or offerors of financial products" are already captured by existing categories, being:

- registered banks and NBDTs
- managers of managed investment schemes, peer-to-peer lenders and crowd funding service providers, and
- derivatives issuers and DIMS providers,

each of whom are who are already covered by the licensed provider category, or if they are not covered, will be covered by category 26 if they operate under an exclusion or exemption.

112 The other primary group of businesses who are "in the business of participating in FMC offers as issuers or offerors" are listed companies, who regularly issue debt securities under dividend reinvestment plans (*DRPs*) or equity securities through capital raises. Listed companies already operate on licensed markets and should not be required to register on the FSPR solely because they engage in these activities.

113 This leaves one remaining group of businesses, being those who infrequently engage in debt or equity issuances, who often find it difficult to determine whether or not they are 'in the business' of engaging in such activities, and as a consequence find it difficult to determine whether they must be registered on the FSPR.

114 While we appreciate that the category originates from the Financial Action Task Force (*FATF*) definition of financial institution, specifically category 8, persons who are in the business of "participation in securities issues and the provision of financial services related to such issues", we consider that this category overlaps with and is already substantially covered by the licensed categories set out above.

115 Removing the category altogether would simplify the list of categories, remove existing confusion for industry and the public, and have a limited impact on the

integrity of the FSPR (given that most providers are already required to register under other categories in any event).

**Category 24 relating to keeping, investing, administering, or managing money, securities or investment portfolios on behalf of other persons should be removed**

116 The proposed FSPA category 24 should be removed entirely because those entities who are in the business of keeping, investing, administering or managing money, securities or investment portfolios on behalf of other persons will, in almost all cases, be covered by one of the licensed entity or broking categories.

117 As the Consultation Paper notes, there is a substantial degree of overlap between the categories, which can lead to confusion by industry and the public.

118 Almost all entities that would be captured under category 24 would also be captured by one or more of the other categories. That being the case, we consider that it would be preferable if this category were removed entirely, to avoid confusion and improve the FSPR's usefulness for the public and regulators.

**The definition of 'financial institution' in the AML/CFT Act should align with the updated definition of financial services in the amended FSPA**

119 It would be appropriate to align the categories of financial services with the definition of "financial services" in the AML/CFT Act. In practical terms, we believe the sensible outcome here would be to amend the AML/CFT Act's definitions to align with the ultimate position reached in the Bill, as that will reflect the most "up to date" policy position.

120 We also note that the categories on the online FSP register need to replicate those that are in the legislation. This is not the case currently and has caused a great deal of confusion. The register should be re-designed to reflect the outcome of the Bill.

**20 Do you support clarifying that schemes must provide information to the FMA if they believe that a provider may be involved in conduct that constitutes breach of relevant financial markets legislation?**

**No. Dispute Resolution Schemes should focus on the resolution of disputes, not on investigating and reporting potential breaches to the FMA**

121 The informal nature of dispute resolution services encourages providers to engage with customers constructively to resolve issues.


122 If there is a risk that matters disclosed or conceded in a dispute resolution process will be reported to the FMA, particularly if the dispute resolution service uses a “low bar” for reporting, providers may be less willing to engage in these processes for fear of broader regulatory consequences or investigations. This would undermine the “ready access to redress” objective of the dispute resolution schemes.

**21 Do you have any other feedback on the drafting of Part 6 of the Bill?**

123 The title of the Financial Service Providers (Registration and Dispute Resolution) Act 2008 is cumbersome, and should be simplified to "Financial Service Providers Act 2008". Otherwise we have no further feedback on Part 6 of the Bill.


## SCHEDULE 1 – TRANSITIONAL PROVISIONS FOR DIMS AND THE CODE

**22 When should an FMC Act DIMS licence granted to AFAs who provide personalised DIMS expire? For example, should it expire on the date on which the AFA's current authorisation to provide DIMS expires?**

**Yes. A DIMS licence should expire on the date the authorisation to provide DIMS expires**

124 An AFA's personalised DIMS licence should expire on the date on which the AFA's current authorisation to provide DIMS expires.

**23 Do you have any other feedback on the drafting of Schedule 1 of the Bill?**

**The transition period should permit full licence applications to be submitted immediately after the Code of Conduct is approved**

125 The transition process is very long. The proposed process requires providers to wait until at least February 2019 to apply for their full licence. FAPs should be able to begin applying for full licences once the Code of Conduct is approved in August 2018, particularly for those with simpler businesses.

## SCHEDULE 2 – DETAIL ON REGULATION OF FINANCIAL ADVICE

**24 Should the FMC Act definition of 'wholesale' be adopted as the definition of wholesale client for the purposes of financial advice? Why or why not?**

**Yes. There should be one FMCA wholesale definition that applies to every potential investor or client**

126 Currently different tests for the wholesale/retail divide apply under the FAA, FSPA, FMCA and FAA Custody Regulations. A consistent test should apply across all of the legislation.

127 Under the existing wholesale boundary some categories of investor are eligible to be advised about products but not to acquire them, or to acquire products on the basis of being a wholesale client but not to have those products held for them in custody on a wholesale basis. We see this as a perverse and unnecessarily complex outcome which would be continued under the current proposal.

128 We are aware of businesses choosing not to engage with clients as wholesale under one regime, despite the client qualifying for that treatment, and instead electing to treat that client as retail in order to achieve consistency. We are also aware of businesses withdrawing from parts of the market because it has proved impossible to qualify their customers as wholesale due to the different tests.

129 At a practical level, this has resulted in lengthy and unwieldy wholesale/safe harbour certificates which are difficult for the customer to understand and for the provider to implement.

130 Under our proposed solution:

130.1 the wholesale/retail tests should be rationalised so that there is a consistent boundary across all of the relevant legislation, and

130.2 the boundary in the FAA Custody Regulations (or their successor) should be extended to include all categories of wholesale client in clauses 3(2), 3(3) and, to the extent relevant, clause 9 of Schedule 1 to the FMCA.

131 We favour the adoption of the FMCA tests for "wholesale clients". But it is important to gather the views of industry on this matter as we understand some of the "old" FAA categories (for example, the $1m asset or turnover category) are still used in some circumstances.

**25 We understand that some lenders consider that they may be subject to the financial adviser regime because their interactions with customers during execution-only transactions could be seen to include financial advice. Does the proposed clarification in relation to execution-only services help to address this issue?**

**Yes. This will clarify matters for execution-only services**

132 We believe the move away from the old formulation ("making a recommendation or giving an opinion about the procedure for acquiring or disposing of a financial product") is sensible.

**26 Are there any unintended consequences resulting from the minor amendments to the exclusions from regulated financial advice, as detailed above?**

**Yes. The exemption for financial advice given in the context of a wholesale offer of financial products should be extended to advice given by or on behalf of entities under the control of a wholesale offeror**

133 Clause 13(3) of Schedule 2 should be extended to capture advice given by or on behalf of entities under the control of a wholesale offeror where the advice is covered by an exclusion in Schedule 1 of the FMCA.

134 This would align the treatment of entities under clause 9 of Schedule 1 to the FMCA. Another option would be simply to address this matter as part of the definition of "wholesale client".


**27 Do any of the membership criteria or proceedings for the code committee require further clarification? If so, what?**

135 We make no comment on this matter.

**28 Does the drafting of the impact analysis requirement provide enough direction to the code committee without being overly prescriptive?**

136 We make no comment on this matter.

**29 Does the wording of the required minimum standards of competence knowledge and skill which 'apply in respect of different types of advice, financial advice products or other circumstances' adequately capture the circumstances in which additional and different standards may be required?**

**Yes. The wording adequately captures circumstances where additional and different standards may be required**

137 However, consistent with our comment above, the focus of the Code and the competence, knowledge and skill standards it will contain, must be calibrated in a way that:

137.1 **distinguishes between financial advisers and other types of advisers** – i.e. higher standards of competency (and qualifications) should be expected of FAs

137.2 **allows flexibility for demonstrating competence**. The default presumption should not be that external qualifications are required, when many providers have robust, equivalent training programmes run by qualified persons in house, and

137.3 most importantly, **facilitates and enhances access to advice**. While we acknowledge the shift away from rigid category 1 and category 2 classifications, we support the approach of prescribing differing levels of competency depending on the relevant circumstances and the type of product care. The Code should recognise that competency requirements for advice on straightforward products (such as general insurance) should be suitable to that product. Setting the bar too high (or having the bar at the same level for all products) will make it more difficult for consumers to access advice and more costly for providers to provide it.

**30 Should the Financial Advisers Disciplinary Committee consider complaints against financial advice providers as well as complaints against financial advisers? Why or why not?**

**No. The existing dispute resolution regime should be limited to FAs**

138 The existing dispute resolution regime already provides clients with a route to redress outside of a formal legal process where advice is delivered by a natural person. Adding a third tier of disciplinary action will only create additional and unnecessary complexity in these circumstances.

139 We therefore favour retaining the status quo – that the FADC should consider complaints against individual FAs only.

**31 If the jurisdiction of the Financial Advisers Disciplinary Committee is extended to cover financial advice providers, what should be the maximum fine it can impose on financial advice providers?**

140 Not applicable, given our response to **Question 30** above.

**32 Do you have any other feedback on the drafting of Schedule 2 of the Bill?**

**Services provided to a limited partnership by related parties should fall outside the definition of Regulated Financial Advice**

141 As with the FSPA (see regulation 5(1)(b) of the Financial Service Providers (Exemptions) Regulations 2010), services provided to a limited partnership, where the service provider is related to that limited partnership's general partner, should fall outside of the definition of Regulated Financial Advice.

**Principal Officers should be retained**

142 As with the current FAA, the concept of principal officer should be maintained (see section 14(1)(i) and the definition of "principal officer" in section 5), so that advice from a director, or person who occupies an analogous position (for example, a trustee or partner) is not regulated financial advice. The definition of principal officer could be clarified as follows:

> Principal officer means in respect of a company, any director; in respect of a partnership, any partner; in respect of a trust, any trustee; in respect of a limited partnership, any limited partner or general partner; or any person who occupies a position equivalent to them.


**The exclusion from the broking services regime for licensed derivatives issuers should apply to all derivatives issuers**

143 In relation to clause 17(b) of new Schedule 5 in the Bill (which contains exclusions from the broking services regime), the exclusion for derivatives issuers should apply to all derivatives issuers, not just to those licensed to issue derivatives to retail investors under part 6 of the FMCA. We say this because all of the relevant protections in the broking services regime, both for retail and wholesale clients, are provided within the Derivatives Custody Regulations, (which apply to both licensed and unlicensed derivatives issuers).

## TRANSITIONAL ARRANGEMENTS

**33 Are there any other objectives we should be seeking to achieve in the design of transitional arrangements?**

144 We make no comment on this matter.

**34 Do you support the idea of a staged transition? Why or why not?**

**Yes. Full Licences should be granted on a staged basis and the process should begin immediately after the Code of Conduct is completed**

145 We suggest that, rather than waiting until the FMA has determined what it requires to fully license all businesses, full licences should be granted on a staged basis and the licencing process should begin immediately after the Code of Conduct is completed. Full licences could be granted in respect of “simple” advice on an accelerated basis, with more complex applications (which may take more time) following later.

146 The transitional regime should not deter “early movers” or compromise innovation. If applicants with novel services are “ready” for licensing and have demonstrated competence to the FMA, the decision to licence should not be delayed simply because that licensing “phase” has not yet commenced.

**35 Is six months from the approval of the Code of Conduct sufficient time to enable existing industry participants to shift to a transitional licence?**

**Yes. Six months should be sufficient to shift to a transitional licence**

147 Six months should be sufficient, as long as:

147.1 the process for obtaining a transitional licence will be very straightforward (which we understand from the Consultation Paper and the FMA is the intention)

147.2 the detail of the new duties (including any regulations to support them), as well as the disclosure regime, has been implemented with sufficient lead time for providers to adapt their processes, and

147.3 the aspects of the Code which will apply to transitional licence holders are not overly onerous.

148 The item in paragraph 147.2 is critical. Our experience with implementation of the FAA was that insufficient lead time was available for providers to implement aspects of the regime, particularly the disclosure changes.

149 On the current timetable, with implementation from February 2019, this would mean having the details of the duties and disclosure requirements available in early 2018, preferably February. If this is not achievable, we would favour delaying the deadline

for transitional licences and extending the balance of the transitional timetable accordingly.

150 The views of industry will be important on this question. Our past experience of licensing indicates that shifting to even a transitional licence could be a reasonably substantial exercise, if the assurances of simplicity prove unfounded. If so, it may take longer than the six months currently proposed.

151 Organisations would need to:

151.1 make boundary decisions about the advice they will provide and who will be able to provide it

151.2 review their current policies and procedures to reflect the policy settings in the FMCA, and

151.3 train their staff with respect to the above matters.

**36 Do you perceive any issues or risks with the safe harbour proposal?**

152 We make no comment on this matter.

**37 We support the safe harbour as a necessary feature of the transitional regime to allow providers to adapt to the new Code requirements. Do you think there are any elements of the new regime that should or shouldn't take effect with transitional licences? What are these and why?**

**FAPs should be able to provide Robo-Advice during the transition period**

153 We do not support the current transitional arrangements insofar as they relate to robo-advice. They would have the effect of prohibiting existing FAPs from delivering this service until they are fully licensed under the new regime, meaning not until between mid-2020 and February 2021. This is too late for many existing FAPs, who wish to deliver robo-advice services in transition.

154 The FMA could develop criteria to permit existing FAPs to provide personalised robo-advice under a transitional licence provided the FMA is satisfied that the FAP:

154.1 has the necessary skills and competence to develop algorithms and monitor the advice generated by the robo-advice platform on an ongoing basis

154.2 has strong change management systems and is able to retain and deliver testing data on the algorithms and transaction records

154.3 maintains a high standard of digital security and privacy systems, and

154.4 complies with the revised Code of Conduct, disclosure requirements and duties in force at transition.


155 Other jurisdictions are already well ahead of New Zealand in the regulation and delivery of robo-advice.

155.1 **Australia** has permitted robo-advice platforms for several years and ASIC released Guidance last year regulating digital advice (much of which could support the FMA's own robo-advice transitional licensing regime).

155.2 **The United Kingdom** has a well-developed robo-advice market and the FCA has since 1 June 2016 operated a Digital Advice Unit that works with firms developing robo-advice platforms.

155.3 **The United States** has permitted robo-advice platforms since 2005 and has the largest robo-advice market globally. FINRA released a report on Digital Investment Advice in March 2016 that illustrates the growth of these platforms.

155.4 **Europe** permits the provision of robo-advice. The Joint Committee of European Supervisory Authorities released its report on Automation in Financial Advice on 16 December 2016 (finding that robo-advice is already addressed in various ways through a number of EU Directives).

155.5 **Singapore** permits robo-advice platforms through technology neutral financial advice regulation. The Managing Director of the Monetary Authority of Singapore said in a 16 November 2016 speech that MAS will soon set out proposals for the governance, supervision, and management of algorithms for robo-advisers to ensure integrity and robustness in delivering financial advice.

156 New Zealand will fall a long way behind these jurisdictions if FAPs – some of whom may wish to begin development now – are unable to offer robo-advice platforms that provide personalised advice to their customers until 2020 or 2021 when they obtain their full licences.

### Targeted exemptions should be available

157 As a compliment to accelerated licensing for robo advice, we would support a move by the FMA to grant targeted exemptions from the existing FAA requirements allowing robo advice to be provided even ahead of the new regime.

**38 Is two and a half years from approval of the Code of Conduct sufficient time to enable industry participants to become fully licensed and to meet any new competency standards?**

158 It is difficult to answer this question in the abstract without an understanding of the new licensing requirements. Our experience is that licensing processes can require considerable time and resources to be dedicated to them.

159 However, in principle, provided that licensing criteria are set at or near the beginning of the transitional licensing phase, this timeframe should be sufficient, assuming the FMA is able to process licence applications in a timely manner.

## POSSIBLE COMPLEMENTARY OPTIONS

**39 Do you support the option of AFAs being exempt from complying with the competence, knowledge and skill standards for a limited period of time? Why or why not?**

**Yes. AFAs should not be required to comply with the competency standards or should receive an exemption for a significant period**

160 Yes. AFAs should not be required to re-qualify in order to become FAs because they will have already expended significant time, effort and resources on:

160.1 the required qualifications to be experts in their area

160.2 becoming AFAs, and

160.3 the AFA brand.

161 If AFAs are to be required to requalify (which we would not support) they should receive transitional relief to allow them to continue to provide services to their clients with minimal disruption during and beyond the transition period.

**40 Would it be appropriate for the exemption to expire after five years? If not, what timeframe do you suggest and why?**

**If AFAs are subject to an exemption, then 5 years seems appropriate**

162 As set out above, we do not favour AFAs having to requalify to become FAs. If requalification is required, then a five year exemption seems sensible. It would align with the current period for which AFAs are authorised and with the standard period for which exemptions are granted. However, the views of AFAs should be the determining factor here.

**41 Is there a risk that this exemption could create confusion amongst industry and for consumers about what standards of competence, knowledge and skill are required?**

**No. AFAs will likely be required to meet similar standards of competence and skill as FAs, and therefore the risk of confusion is limited**

163 In our view, no. We say this because:

163.1 we would expect the new Code standards to mirror the old (or at least cover similar subject matter) so we do not foresee a material risk of confusion amongst industry and consumers regarding the level of competence, knowledge and skills required of AFAs as compared to FAs, and

163.2 the underlying premise of competence endemic in the new duties and the Code should give consumers confidence that advisers are competent without needing to be concerned about the fine detail.

**42 If you support this option do you think it should be set in legislation or something for the Code Working Group to consider as an option as it prepares the Code of Conduct?**

**The exemption should be set out in regulations – the Code Working Group should focus on preparing the Code of Conduct**

164 Again, as set out above, we do not favour AFAs having to requalify to become FAs.

165 The focus of the Code Working Group should be directed towards drafting the new Code of Conduct. Policy decisions relating to exemptions from certain standards in the Bill should be set out in regulations.

166 The exemption should be set out in regulations, which could exempt AFAs from compliance with the competence, knowledge and skill standards (to be enacted immediately after the date the Bill comes into force). This would provide certainty and allow for a period of consultation.

**43 Do you support the option of a competency assessment process for existing AFAs and RFAs? Why or why not?**

**AFAs should not be subject to a competency assessment. RFAs should be subject to a competency assessment to qualify for the competency requirement exemption**

167 As we set out above, we do not believe AFAs should be required to requalify or should be subject to a competency assessment process, so our comments below do not cover AFAs.

168 We believe that a competency assessment should be required of RFAs if they are to be exempt from the competency requirements that would otherwise be required of a FAR (or whatever other title is used) under the Code.

169 A competency assessment process for FARs should be decided on by the Code Committee and/or the FMA after consultation with industry and once the Code of Conduct has been embedded.

**44 Is it appropriate for the competency assessment process to be limited to existing AFAs and RFAs with 10 or more years' experience? If not, what do you suggest?**

**No. Competency assessments should not be based on years of experience**

170 Any competency assessment process for an RFA should not be dependent on "time served". If the RFA meets the standard, they should not have to undertake further training or obtain further qualifications.

**45 If you support this option do you think it should be set in legislation or something for the Code Working Group to consider as an option as it prepares the Code of Conduct?**

**No. The need for and scope of competency assessments should be left for the Code Working Group to consider**

171 We do not support creating a requirement for competency assessments to be set out in legislation, as we consider that the need for and scope of such a process should be left to the specialist Code Working Group to determine as it prepares the Code of Conduct.

172 In our view, it would be premature to set out requirements for a competency assessment process in legislation without advisers and the industry first knowing what competency and training requirements will apply to them under the Code.

173 The new Code could, for example, set out continuing professional development standards or re-training requirements (as the current one does). These may obviate the need for an external competency assessment process.

## PHASED APPROACH TO LICENSING

**46 What would be the costs and benefits of a phased approach to licensing?**

174 We make no comment on this matter.

**47 Do you have any suggestions for alternative options to incentivise market participants to get their full licences early in the transitional period?**

**Applications for full licences should be able to be made once the Code of Conduct is finalised and transitional licences should permit robo-advice**

175 As noted in our answer to **Question 34** in paragraphs 145 to 146 and **Question 37** in paragraphs 153 to 156 above, FAPs should be given the option of applying for a full licence once the Code of Conduct is finalised, and should be able to apply for a transitional licence condition to permit them to provide personalised robo advice. These steps would expedite the transition process. If providers wish to add any additional services to their licenses later, they should be able to request that FMA vary their licence.


**Existing FMCA licence holders and QFEs should be automatically granted full licences or be required to demonstrate capability only on specific matters**

176 We also believe that existing FMCA licence holders (such as managers of managed investment schemes) and QFEs should be either automatically granted new licences or required to demonstrate capability only in specific matters relevant to the giving of regulated advice.

177 This recognises the significant effort licensees have already expended (very recently) to obtain licences under the FMCA. There should be no need to go through that process in its entirety again.

**48 Do you have any other comments or suggestions regarding the proposed transitional arrangements?**

178 Based on the current proposal, we foresee the following issues with transition:

178.1 providers wishing to offer robo-advice will have to wait till they are fully licensed and FMA may not have developed licensing criteria for this particular service for some time dis-incentivising early adoption. Hence our submission in paragraphs 153 to 157 above, and

178.2 our reading of the transitional regime in the Consultation Paper is that only QFEs will be able to appoint FARs during the transitional period, whereas other providers will be required to appoint FAs. We query whether this is an appropriate distinction.

AUCKLAND
23 Albert Street
PO Box 2206, Auckland 1140
New Zealand
T: +64 9 357 9000
F: +64 9 357 9099

WELLINGTON
10 Customhouse Quay
PO Box 993, Wellington 6140
New Zealand
T: +64 4 499 5999
F: +64 4 472 7111

CHRISTCHURCH
60 Cashel Street
PO Box 2510, Christchurch 8140
New Zealand
T: +64 3 353 4130
F: +64 3 365 4587

www.chapmantripp.com