31 March 2017

Financial Markets Policy
Building, Resources and Markets
Ministry of Business, Innovation & Employment
PO Box 1473
Wellington 6140

By email: faareview@mbie.govt.nz

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Submissions on the Financial Services Legislation Amendment Bill

Thank you for the opportunity to make submissions on the *Financial Services Legislation Amendment Bill* (**Bill**). These submissions are made by Cygnus Law Ltd (**Cygnus Law**). Cygnus Law's submissions are set out in MBIE's submission template below.

Cygnus Law supports most of the proposed changes to current financial adviser regime, including the requirement for registered financial advisers to hold minimum qualifications and to comply with conduct standards, and allowing financial advice services to be delivered using a "roboadvice" model. However, Cygnus Law does not support a compulsory licensing regime for all financial advice firms and proposes that licensing should be optional for any financial advice firm in which all advice is delivered by financial advisers (who are separately regulated).

Cygnus Law does not support the proposed changes to the Financial Service Providers (Registration and Dispute Resolution) Act 2008 (**FSP Act**). Cygnus Law fully agrees that changes are needed in order stop abuse of the Financial Service Providers Register (**FSPR**). However, Cygnus Law is concerned that the approach proposed will make it difficult for New Zealand to retain and further develop an export-focused financial services sector and that it will not prevent misconduct by New Zealand registered companies, building societies and other entities that provide financial services off-shore. A number of legitimate jurisdictions successfully operate export-oriented financial services sectors, including the United Kingdom and Singapore. The proposed changes appear to run counter to the Government's goals of increasing the export of services from New Zealand and diversifying our export industries. Cygnus Law proposes an alternative approach, based in part on proposals from MBIE's options paper, including that substantive operations must be based in New Zealand. Enhanced registration standards, and greater monitoring and enforcement by regulators, would be supported by a higher registration fee for the relevant businesses.

Yours faithfully
Cygnus Law Ltd

SIGNATURE REDACTED

Simon Papa
Director

How to have your say

Submissions process

The Ministry of Business, Innovation and Employment (MBIE) seeks written submissions on the issues raised in this document by **5pm on Friday 31 March 2017**.

Your submission may respond to any or all of these questions. We also encourage your input on any other relevant work. Where possible, please include evidence to support your views, for example references to independent research, facts and figures, or relevant examples.

Please include your name, or the name of your organisation, and contact details. You can make your submission:

- By attaching your submission as a Microsoft Word attachment and sending to ***faareview@mbie.govt.nz***.
- By mailing your submission to:

  Financial Markets Policy
  Building, Resources and Markets
  Ministry of Business, Innovation & Employment
  PO Box 1473
  Wellington 6140
  New Zealand

Please direct any questions that you have in relation to the submissions process to: ***faareview@mbie.govt.nz***.

Use of information

The information provided in submissions will be used to inform the development of the Financial Services Legislation Amendment Bill, decisions in relation to the outstanding policy matters, and advice to Ministers.

We may contact submitters directly if we require clarification of any matters in submissions.

Except for material that may be defamatory, MBIE intends to upload PDF copies of submissions received to MBIE's website at www.mbie.govt.nz. MBIE will consider you to have consented to uploading by making a submission, unless you clearly specify otherwise in your submission.

Release of information

Submissions are also subject to the Official Information Act 1982. Please set out clearly in the cover letter or e-mail accompanying your submission if you have any objection to the release of any information in the submission, and in particular, which parts you consider should be withheld, together with the reasons for withholding the information. MBIE will take such objections into account and will consult with submitters when responding to requests under the Official Information Act 1982.

If your submission contains any confidential information, please indicate this on the front of the submission. Any confidential information should be clearly marked within the text. If you wish to provide a submission containing confidential information, please provide a separate version excluding the relevant information for publication on our website.

Private information

The Privacy Act 1993 establishes certain principles with respect to the collection, use and disclosure of information about individuals by various agencies, including MBIE. Any personal information you supply to MBIE in the course of making a submission will only be used for the purpose of assisting in the development of policy advice in relation to this review. Please clearly indicate in the cover letter or e-mail accompanying your submission if you do not wish your name, or any other personal information, to be included in any summary of submissions that MBIE may publish.

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Part 1 of the Bill amends the definitions in the FMC Act

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?
   Enter text here.

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?
   Enter text here.

3. Do you have any other feedback on the drafting of Part 1 of the Bill?
   Enter text here.

Part 2 of the Bill sets out licensing requirements

4. Do you have any feedback on the drafting of Part 2 of the Bill?
   Cygnus Law strongly supports the availability of licensing as an option for financial advice firms and the ability for a firm to be licensed to provide "roboadvice". However, Cygnus Law does not consider that the proposed imposition of licensing on all financial advice firms is justified by

the problems identified with the current regime nor does it consider that the proposed solution will provide significant benefits (except for existing QFE businesses and other businesses that want to be licensed) based on the background information provided. The key issues identified are that RFAs do not currently have to hold any minimum qualifications and are subject to very few obligations in the provision of services, titles (e.g. QFE, RFA) that mean nothing to consumers, and concerns about conflicted conduct. Qualifications and conduct are being addressed in Part 3 of the Bill (and the subsequent code of conduct). There appears to be little justification provided for additionally imposing a licensing regime on all financial advice firms, particularly where all advice is delivered by financial advisers (who will be regulated individually).

Almost all QFEs currently are banks, credit unions, lenders or insurance companies. There are no examples of businesses operated by RFAs, and primarily focused on advice to consumers, that have QFE status- a key (and likely largest) population intended to be licensed under the Bill. FMA has generally discouraged such businesses from becoming QFEs. While the majority of advice on insurance and mortgages (all category 2 products that can be advised on by RFAs) is provided via QFEs (reflecting their scale) the very large majority of insurance and mortgage advice businesses are relatively small- they number at least in the hundreds. MBIE's final report in July 2016 noted the benefits of the QFE model, being reduced licensing costs and economies of scale. This makes sense if a business operates (or wants to operate) at scale. Deploying a licensing model to potentially hundreds of small businesses will add significant costs that they will not be able to be easily absorb. Also, the industry is in parts highly intermediated, with complex structures and commercial relationships that have developed over many years. It's unlikely in some cases that those structures and relationships can simply and easily be reconfigured to fit into a licensing model. That possibly explains, in part, why those businesses have not sought to be licensed as QFEs. The industry in relation to RFAs is different from a number of other industries brought into the FMC licensing regime, where licensing did not in all cases lead to significant changes to industry structures and relationships. It is critical in Cygnus Law's view that the costs and implications of compulsory licensing be considered, to determine whether the benefits of compulsory licensing outweigh those costs and implications. Also, financial advice firms would be by far the largest single population of market participants brought into the licensing regime. Are the resources available to do that, especially taking into account that RFAs (and their firms) to date have only been very lightly regulated? Not only do they face the prospect of significant regulatory change with regard to professional standards and conduct but an additional overlay of licensing.

The licensing solution proposed focuses more on advice as a business than advisers as a profession. As Cygnus Law noted in its submission on the options paper, by way of example, lawyers are regulated as a profession and lawyers can chose to operate through a company (Cygnus Law is an example of this). The company is not regulated. The lawyer(s) who deliver the advice retains a level of personal liability and is subject to standards in law (including in the Lawyers Conduct and Client Care Rules). The Law Society also has a fidelity fund that provides limited compensation to clients in particular circumstances where they suffer loss. Cygnus Law submits that this model works well (while not suggesting that a fidelity fund is necessary for financial advisers) and could be readily applied to financial advisers who work through companies (or who are sole traders). Their personal obligations and liability as advisers (including under the proposed code of conduct) should provide a significant level of comfort. Additional measures could be considered e.g. lawyers (or their firms) are required to hold minimum levels of professional indemnity insurance or otherwise disclose to clients that they don't have cover.

Cygnus Law understands that the intention is that FMA will determine the appropriate level of licensing in particular circumstances so that, in the case of services delivered solely by financial advisers, the licensing burden may be lower. Cygnus Law considers the licensing requirements are central to the proposed regime and that the details of licensing requirements should be set out (in broad terms at least) in the Bill (or at least in regulations) and not left entirely to FMA's discretion. Otherwise it will be difficult for stakeholders at this stage to fully understand the

potential impact of licensing on their current businesses and business models. In that regard Cygnus Law notes that FMA's power to set licensing standards is very broad, being permitted by the requirement that the FMA is "satisfied that… the applicant is capable of effectively performing that service (having regard to the proposed conditions of licence)" in section 396(c) of the FMC Act. So the FMC Act itself provides no guidance as to what a licensing regime may look like. FMA's licensing regimes for other types of financial services provide some guidance. FMA's current licensing regime is configured by reference to larger institutions. While FMA does allow smaller businesses to find simpler ways to comply with minimum standards, and provides some limited guidance on that, in practice small businesses are not well resourced to figure out ways to comply (and often don't have personnel with relevant skills and experience and so have to rely on consultants to a significant degree).

Some existing requirements of the FMC licensing regime are, in Cygnus Law's view, of little real benefit (relative to costs imposed), particularly for small businesses. Cygnus Law considers that for small businesses in a relatively low risk sector like financial advice (assuming that the business does not handle client funds or investments), where the skills, experience and training of the financial advisers will be key to good client outcomes (if all financial advice is delivered by financial advisers), adding an overlay of licensing requirements (like governance reviews, "good culture" policies/processes, business continuity plans, formalised monthly balance sheet, P&L and cash flow forecasting, "appropriate supervisory arrangements") possibly adds little extra value. That's not to suggest that those things aren't important but rather that they are part of good business practice and, relative to the risks involved in delivering financial advice services, can probably be assumed rather than having to be confirmed in writing and through the provision of multiple documents and on-going compliance reporting. The artificiality of the licence is clear in the case of a sole trader personally providing financial advice ("April's story" in the consultation paper). April is both subject to both a code of conduct and licensing but it's unlikely that licensing will lead to better outcomes for clients, but it will result in April having to comply with two different regimes in order to provide a service, the cost of which is likely to be prohibitive (regardless of where licensing lands on minimum standards- the licensing process will likely still take quite a lot of time and effort to navigate).

If licensing is to be imposed on all businesses that deliver financial advice services then Cygnus Law considers that there is real benefit in setting the key licensing requirements in the Bill or in regulations, such requirements to take into account the skills, competence and training of advisers and the relative risks posed by their services. However, the preferable outcome would be for licensing to be optional where all financial advice is delivered by financial advisers, and to set any minimum requirements for such firms in law and to rely on the on-going regulation and monitoring (and subsequent enforcement actions) of financial advisers to support delivery of good customer outcomes.

Part 3 of the Bill sets out additional regulation of financial advice

5. Do you agree that the duty to put the client's interest first should apply both in giving the advice and doing anything in relation to the giving of advice? Does this make it clear that the duty does not only apply in the moment of giving advice?
   Enter text here.

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?
   Enter text here.

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?
Enter text here.

8. Do you have any other feedback on the drafting in Part 3 of the Bill?
Cygnus Law supports the concept that financial advice representatives do not have personal responsibility under the FMC Act for their services (except where caught under the existing accessory liability provisions). Imposing such obligations would be a large change to the current system and would impose significant costs and potentially significantly reduce the number of people willing to perform such roles, without any significant corresponding benefits. Also, the proposal to allow provision of "roboadvice" (subject to a licence) highlights that the systems and processes of the business (and the skills and experience of those implementing them) will be key to good outcomes, which is consistent with primary liability remaining at firm level. Additionally, Cygnus Law can see no benefit in imposing additional personal liability on directors of financial advice firms. The accessory liability provisions in subpart 10 of Part 8 of the FMC Act allow directors and other parties to be found liable in a wide range of circumstances when they are involved in contravention. Imposing additional liability will potentially make it less likely that larger businesses will develop, which is key to improving the costs of delivery of such services.

Part 4 of the Bill sets out brokers' disclosure and conduct obligations

9. What would be the implications of removing the 'offering' concept from the definition of a broker?
Enter text here.

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?
Cygnus Law considers that it is essential that the term "broker" is replaced. The term "broker" is much better known as a person who acts in an agent capacity not as a person who receives money or property from or on behalf of a client. Potentially "broker" could be replaced with "custodian", with the current different obligations applying to "custodians" being specified in law but without a separate designation (given that the difference in some cases between "brokers" and "custodians" currently is often a question of degree).

Cygnus Law suggests that consideration be given to addressing the following "technical" matters:
• The meaning of "client" in s5A(1) of the FAA is unclear with respect to broking services. Different people have provided different interpretations of this section. Broking services are often "outsourced" either within a group or to third parties- so there may be a series of brokers/custodians in a chain. Because of the unclear "client" definition in some cases it is difficult to state with certainty who is a broker for the purposes of registration on the FSPR (as it's clear from s77U of the Financial Advisers Act that only the person with an unmediated relationship with the client will have broker obligations under the FAA). Key interpretation difficulties arise from the from difference between the definitions in section 5A(1)(a) and 5A(1)(b) and the meaning of "person on whose behalf the client money or client property is received, held, paid, or transferred under the service" (this does not appear to be a concept commonly applied elsewhere so it's difficult to confirm its meaning in this context). Cygnus Law suggests that the intended meaning of "client" be confirmed and then clarified in an updated definition.
• The definition of "client" with respect to the definition of "broking service" in s77B of the FAA is circular. A broking service is "the receipt of client money or client property by a person…" and part of the "client money" definition is money "received from, or on account of, a client by a person (A) (and not on A's own account)". However, a "client" under s5A(1)(b) "means the person on whose behalf the client money or client property is received, held, paid, or transferred". So, for example, a broking service arises where a person receives client money,

and client money is money received from a person on whose behalf client money is received.

- Cygnus Law suggests that consideration be given to creating a statutory trust in Part 3A. Currently s77P does not appear to create a trust, rather it requires that the broker hold money on trust for the client and pay it into a bank account. This money is given additional protection through s77T, which protects the money "received or held by a broker on trust" from creditor claims. The risk is that, if a broker does not take steps to create a trust when receiving and/or holding client money (and property), there may be no money held on trust that is protected by s77T. By contrast, the separate rules that apply to derivatives investor money and property in the Financial Markets Conduct Regulations 2014 create a statutory trust. Regulation 245 creates a similar protection to that in s77T. However, regulation 246 goes further and on an insolvency event creates a trust over the investor money and property, with the FMA designated as trustee. The FCA's CASS Rules in the UK go further and create a statutory trust at the outset (see CASS 7.17).
- The effect of s77U means that custodians (other than those who hold money and property directly for clients) are not bound by the broker obligations or the requirements of custodians in Financial Advisers (Custodians of FMCA Financial Products) Regulations 2014- see regulations 4(3) and 4(4). Cygnus Law suggests that amendments are made that impose a direct obligation at law on a custodian to comply with the regulations.
- Cygnus Law considers that the section 77B(1)(b) definition of "broking service" in the FAA is particularly complex and difficult to follow and suggests that it be reviewed and that an example of the key relationship it was intended to reflect is provided.

Part 5 of the Bill makes miscellaneous amendments to the FMC Act

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?
    Enter text here.

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?
    Enter text here.

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?
    Enter text here.

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

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

Part 6 of the Bill amends 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?

Cygnus Law does not consider that the proposed territorial application of the Act fully addresses the issue of misuse and Cygnus Law considers that there are significant unintended consequences. Cygnus Law submitted on the November 2014 options paper with respect to amendments to the FSP Act. The following submissions are in addition to those submissions.

Cygnus Law's concern is that the FSP Act and the relevant regulators have not, to date, properly responded to the question of how New Zealand should regulate the activities of financial service providers who operate from New Zealand but who largely or wholly provide financial services (including issuing financial products) to people outside of New Zealand. The law generally has started from an assumption that New Zealand's financial services industry is domestic only and has failed to fully address the effects of globalisation, the internet and the export of financial services from New Zealand. The law has certainly not supported the operation of NZ as an off-shore financial services centre. The proposals in the Bill will make it even more difficult for New Zealand to develop an export-focused component to its financial services sector. Very legitimate jurisdictions do support the export of financial services, including the UK, Singapore and Switzerland. According to a 8 July 2016 article in the Financial Times (www.ft.com/content/cf0c64e4-2cb2-11e6-bf8d-26294ad519fc), the UK's off-shore financial industry is worth US$1.3tn with Singapore close behind. In Cygnus Law's view the effect of the proposed changes is contrary to the vision and strategies set out in the Government's recent "Trade Agenda 2030" report, which noted that:

- "The adage 'we won't get rich selling only to ourselves' is particularly true for New Zealand." (yet the policy underlining the proposed changes does, if unintentionally, start from an assumption that financial services in NZ should only be sold to ourselves).
- "One of the changes that has taken place is the rising importance of services trade to New Zealand. With changes in technology, an increasing range of services can now be traded across borders. Digital platforms now enable digital products and services to be delivered instantaneously across the internet almost anywhere in the world." & "Digital trade is important to New Zealand to help reduce the enduring challenges of distance and small scale" (Again, the proposed changes don't take the increasing trade in services into account. If NZ is to develop a robust FinTech sector then exports of financial services and products are likely to be a key component- the regulatory settings should support that and not discourage it).
- "… we need to deepen and expand New Zealand's exporting base" (On some measures financial services are 20% of GDP in developed economies. This is a key sector beyond NZ's traditional sectors where we can attempt to grow export revenue.)

The misuse issue relates to attempts to create a minimum "place of businesses" in NZ in order to register of the FSPR. As Cygnus Law submitted in response to MBIE's November 2014 options paper, the 2014 amendments to the FSP Act (together with other initiatives, like the requirement that all NZ companies have at least one NZ resident director or a director of an Australian corporate), together with FMA enforcement, were likely having a significant impact on preventing misuse. While there undoubtedly will be instances of misuse Cygnus Law queries whether there are other potential responses, including enhanced oversight and enforcement, which would provide better outcomes without also deterring legitimate businesses from operating from New Zealand.

Reputational issues have been highlighted as a key (or the key) reason for dealing with these issues. While it isn't acceptable that companies operating from New Zealand breach the law in New Zealand or overseas, Cygnus Law has seen no evidence presented of how breaches off-shore are harming, will harm or have harmed New Zealand's reputation as a well-governed jurisdiction. Traditionally, the key concern with off-shore financial centres has been tax evasion/money laundering. These issues are being reduced via AML/CFT requirements in many countries and the US FATCA requirements and, in due course, common reporting standards in relation to many other countries.

It is suggested below that harm is also likely to result from failures to take enforcement action using the tools currently available. Other countries, including the US, UK and Switzerland have

had financial services businesses (and sectors) that have caused loss to investors off-shore through inappropriate conduct, or that have been accused of facilitating tax evasion/money laundering, but this does not appear to have caused any substantial damage to their reputations. The actions of US and UK were the prime source of the global financial crisis but it doesn't appear that their financial services sectors are any less vibrant or successful. New Zealand has had issues with conduct in export markets before (e.g. Fonterra's recall over concerns of botulism in dairy products in 2013) but that hasn't resulted in calls to prevent operation of the relevant industry. New Zealand has moved to address concerns about the off-shore trusts regime through better regulation rather than by banning such structures, which have economic benefit for New Zealand.

There are legitimate businesses that operate from NZ but that largely (or wholly) have a customer base outside New Zealand. The proposed changes in the Bill will make it harder for those businesses to operate from New Zealand. Those businesses provide economic benefit to NZ's domestic economy as well as being a source of expert earnings. In the absence of a licensing regime for some business types (including providers of payment services and foreign exchange, and lenders), and because parts of the FMC Act do not apply where all customers/investors are outside of New Zealand, the FSPR does serve as a default indication that businesses are subject to some regulatory oversight (as well as serving the important function of giving regulators information on the activities of those businesses). While this a matter the Bill is attempting to address, without some indication that businesses are at least operating legitimately from NZ, it is difficult for legitimate NZ-based businesses to operate outside of New Zealand in the circumstances noted. This reflects that financial services are now so heavily regulated around the world that an apparent lack of regulation is a significant impediment for financial services businesses (and potentially outweighs the benefits of lighter-touch regulation). And, as noted below, such businesses are subject to substantive NZ law regarding their activities outside New Zealand. Also, the process of registration in itself serves as a basic filter of legitimacy, by requiring a criminal record check on key people in the business.

Financial services businesses are attracted to New Zealand because of the ease of doing business, New Zealand's reputation as a well-governed jurisdiction and our location in the Asia-Pacific region. And while some are certainly not legitimate and have taken advantage of opportunities the FSPR opened up to them as a register of convenience, others are here for the right reasons. Also, the large migrant community in New Zealand is actively engaged in operating financial services businesses that serve people outside New Zealand. This is a risk but it also an opportunity. However, the proposed changes will have the effect of removing support, making it more difficult for legitimate financial service export businesses to operate from NZ. By contrast, the New Zealand government and its agencies put a large amount of resource into providing comfort to our trading partners regarding our primary product exports, both by way of regulation and verification.

Cygnus Law supports the requirement for businesses promoting financial services to persons in New Zealand to be registered. However, Cygnus Law does not support this as the overriding criterion for registration. This essentially creates a default assumption that NZ should only be concerned about, and regulate, financial services businesses supplying NZ-based customers (again, we don't take that attitude to other sectors, including primary product exporters). Cygnus Law has legitimate Australian clients who have attempted to set up financial services businesses in New Zealand, which operate through New Zealand registered subsidiary companies but with almost all infrastructure and personnel in Australia. It has been unclear whether some Australian businesses have a "place of business" in New Zealand, yet the expectation of other providers and support services in New Zealand is that they should be registered and be a member of a dispute resolution scheme. The companies have faced pro-longed engagement with regulators over their status. Such companies are a clear example of where registration based on promotion to New Zealand customers will have benefits. And from a policy perspective there seems every reason to ensure that retail clients of those businesses in New Zealand have access to NZ dispute resolution schemes. The process of becoming registered for those companies is also made quite difficult because of the attitude of

the regulators to their planned activities- the default approach appears to be to treat anyone applying from off-shore as someone potentially abusing the process. Yet businesses operating from off-shore will often be carrying out quite benign activities, like commercial and retail lending, and financial advice services (including in relation to bank lending to retail clients).

One possible issue is that the proposed NZ client threshold may not work for new businesses (including new NZ subsidiaries of existing off-shore businesses). It won't be possible to prove at registration that they have (or will have) NZ clients, since registration is a pre-requisite for operating the business. While any new business can claim it will have a NZ client base, this can be addressed by follow-up actions from the regulators at the 3 month time limit under the FSP Act (or possibly a longer timeframe) to confirm they have the requisite number of clients (and meet other relevant criteria) in relation to each financial service they register for.

Cygnus Law noted in its submissions on the Regulatory Systems Amendment Bill Exposure Draft in January 2016 that the Reserve Bank states on its website "that the Bank is not in a position to monitor transactions undertaken by New Zealand registered building societies that operate in overseas markets." The government took active steps to remove such building societies from New Zealand's regulatory ambit, by approving the Deposit Takers (Persons Declared Not to be Deposit Takers) Regulations 2011, later replaced by legislation to the same effect. With regard to the FSPR, while concerns have been expressed about the activities of off-shore providers that have managed to register on the FSPR, the regulatory response has been light. Other than removing some companies from the FSPR there appears to have been relatively little regulator response to their activities and misconduct. The general response to problems presented by NZ registered financial services businesses operating off-shore appears to be to simply cease regulating them while still allowing them to operate unhindered (and with little enforcement activity when there is clear misconduct). However, under the FMC Act (and other law, including the Companies Act), regulators do have powers to regulate in relation to the off-shore activities of registered financial services businesses. Those businesses are subject to the "Fair Dealing" obligations in Part 2 of the FMC Act in relation to their activities off-shore (including via the "restricted communication" provisions in section 463 and section 33 of the FMC Act). There was clear parliamentary expectation that regulators would regulate off-shore conduct - the report of the Commerce Committee on the Financial Markets Conduct Bill stated that (in enacting the "restricted communication" provision): "We consider that the territorial scope of the bill needs to be extended to allow the regulation of the conduct of New Zealand residents and businesses in respect of their offshore activities in limited circumstances." The regulator response is to legitimately raise concerns about the resources required to respond to these issues, given that New Zealanders are not directly impacted. However, Cygnus Law considers that the "hands-off" approach to oversight itself creates risk of reputational damage. The Bill's proposed response of removing businesses from the FSPR does not resolve the risk of reputational damage, particularly as under the Bill those businesses can continue to operate from NZ and are still subject to fair dealing obligations. In that scenario it is very difficult for regulators to regulate, since they will not even have notice that those businesses exist. In Cygnus Law's view New Zealand's reputation is not enhanced by allowing financial services businesses to operate from NZ with no effective oversight. That makes it even more difficult for legitimate businesses with a focus off-shore to operate from New Zealand.

Some companies attempting to register on the FSPR, and who are referred to the FMA by the Registrar for consideration pursuant to FMA's power in 15B of the FSP Act, have been told by the FMA that the review may take up to 3 months (during which time they cannot conduct the proposed business), on top of the time previously required to engage with the Registrar. While genuine instances of abuse are picked up in those cases, this process makes it difficult for legitimate businesses who are referred by the Registrar to FMA on a pre-cautionary basis. This suggests that clearer standards for registration are required and that the registration process needs to be better resourced.

If the Bill is to be retained largely in its current form then Cygnus Law recommends that the application of the fair dealing provisions to off-shore activities should be addressed as it leaves

law in place that will not be monitored or enforced in most instances.

Cygnus Law has noted that the potential for legitimate businesses, who have off-shore clients, to operate from New Zealand, to be seen as an opportunity for New Zealand, as well as a risk. Since the lack of resources to oversee such businesses' registration and activities appears to be the driving force for change (and for not taking regulatory and enforcement action), a simple solution would appear to be to charge such companies a higher registration fee (where they are not otherwise licensed or promoting services to New Zealanders). That fee would need to be sufficient to adequately resource registration and active oversight of their activities (and subsequent regulatory/enforcement actions). Cygnus Law suggests in addition a regime that has the following features:

- A requirement that all financial services business have some substantive operations in New Zealand before they can register, rather than a requirement for a minimum number of NZ customers (other for businesses that are outside NZ but genuinely promoting services to New Zealanders). This was one of the scenarios presented in option 3 of MBIE's November 2015 Options Paper (i.e. "the requirement to register applies only to entities with a stronger connection to New Zealand"- page 53). More substantive operations in NZ would make enforcement actions for off-shore activities more viable. It also prevents the FSPR from being a register of convenience, which is the effect of the current FSP Act and the "place of business" interpretation. What the threshold is can be considered further but could require that some personnel and infrastructure that are core to the business to be based in New Zealand, not just administrative and compliance functions (which is sufficient currently). Where the services are otherwise licensed in New Zealand reference could be made to FMA's licence application guides, which set out the core components of a service.
- Prohibit any business that does meet the substantive operations threshold (which will include the archetypal type of registration the reform is directed at, where there is only a bare minimum "place of business") from operating a financial services business from New Zealand (except where it is otherwise required to register e.g. because services are genuinely being promoted in NZ). This would effectively and finally address the types of misuse that started the process of reform. This is, in Cygnus Law's view, preferable to the approach proposed in the Bill, which is to allow such companies to continue to operate and to be subject to Part 2 fair dealing obligations but to remove them from the FSPR and any effective regulatory oversight.
- Requiring that a notice be provided to off-shore customers, as proposed in the regulation making power in the Bill. However, Cygnus Law does not support the use of the word "warning", which is based on a presumption that any business in New Zealand providing financial services to people outside New Zealand will not operate to appropriate standards or that their customers are not protected via the law in the places they reside. And Cygnus Law does not support wording such as that proposed in the regulation making power – "registration does not mean that the provider is subject to active regulation or oversight". The term "active regulation" has no clear meaning. Cygnus Law suggests that wording is not pre-emptively inserted in the Act and that the precise wording is addressed as part of the regulation making process.
- Potentially adding other requirements to registration, including "fit and proper" (good character) requirements for owners and directors/senior managers. This would allow the regulators to take into account any available information on previous misconduct and regulatory action, in New Zealand and off-shore, and would be to a similar standard to that required for an FMC licence fit and proper assessment. This would deal with the fact that the criminal record check will identify serious issues arising in New Zealand only. Any new owners and directors/senior managers could also be required to be assessed for compliance with "fit and proper" requirements.
- As proposed in Cygnus Law's January 2016 submissions on the Regulatory Systems Amendment Bill Exposure Draft, all New Zealand building societies are required to have at least one director who lives in NZ (consistent with the obligation that now applies to NZ companies).
- As noted in Cygnus Law's submissions in response to the options paper, requiring registration with the IRD. This was one initiative that has been implemented to address concerns about off-shore purchases of houses in New Zealand. It may deter entities that do not genuinely want to operate from New Zealand.

More generally, Cygnus Law queries whether the "light-touch" (i.e. no licensing required) approach to some sectors, including payment services and foreign exchange, provides the benefits claimed (including reducing barriers to entry). Those businesses almost invariably require client money bank accounts to operate. However, it is now often very difficult for those types of businesses to open and maintain client funds bank accounts (highlighted in the High Court case in E-Trans International Finance Ltd v Kiwibank Ltd). Even new licensed businesses are finding it difficult and time consuming to open such bank accounts. Legitimate businesses who want to operate in that sector potentially find themselves in a "catch 22" situation- the barriers to entry are low but the inability to obtain the legitimacy provided by a licence means it can be difficult in practice to operate the business. Cygnus Law is not suggesting that the law be changed but that consideration be given to this issue together with consultation.

If the Bill does come into effect if the manner proposed, it would be appropriate to give affected businesses at least 12 months before the new provisions take effect. While there is a view that some businesses should not have used the FSPR in the way they did, the reality is that the law supported that and legitimate businesses also register. So any transition timeframe should be sufficient to allow the businesses to respond to any impact on their business. It's unlikely that a longer timeframe will make any substantial difference with regard to conduct and perceived reputation risk. FMA is still able to take appropriate monitoring, regulatory and enforcement action in the interim.

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?
    It's hard to see how including AML/CFT supervisor information would help at all. AML/CFT regulation and compliance is of no direct relevance to the client as AML/CFT compliance does not improve service outcomes for a client.

18. Do you consider that other measures are required to promote access to redress against registered providers?
    Enter text here.

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?
    Cygnus Law supports the approach proposed and agrees that further work on the appropriate categories is required. One example is "Issuing and managing means of payment (for example, credit and debit cards, cheques, travellers' cheques, money orders, bankers' drafts, and electronic money)". In some cases that category has been used by businesses that simply sell pre-loaded payment cards issued by a third party, in an artificial attempt to meet at least one financial service category and to give an appearance of being bank-like. It would be helpful to clarify in that such actions do not constitute "issuing" or "managing".

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?
    Cygnus Law supports this approach but considers that the requirements should be clear. Also, if not already provided for in law, Cygnus Law considers that providers should be protected from breach of privacy and other actions if providing such information in accordance with the legal obligation (even though schemes can provide for that in the terms of the service).

21. Do you have any other feedback on the drafting of Part 6 of the Bill?
    Enter text here.

Schedule 1 of the Bill sets out transitional provisions relating to DIMS and the code of conduct

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?
    Enter text here.

23. Do you have any other feedback on the drafting of Schedule 1 of the Bill?
    Enter text here.

Schedule 2 of the Bill creates a new schedule to the FMC Act with detail about the 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?
    Enter text here.

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?
    Enter text here.

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

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

28. Does the drafting of the impact analysis requirement provide enough direction to the code committee without being overly prescriptive?
    Enter text here.

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?
    Enter text here.

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

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?

Enter text here.

32. Do you have any other feedback on the drafting of Schedule 2 of the Bill?
    Enter text here.

About transitional arrangements

33. Are there any other objectives we should be seeking to achieve in the design of transitional arrangements?
    Enter text here.

Proposed transitional arrangements

34. Do you support the idea of a staged transition? Why or why not?
    Cygnus Law strongly supports a staged transition but considers that the transition timeframe should be extended to support this rather than bringing forward the obligation to transition to some financial advisers.

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?
    Enter text here.

36. Do you perceive any issues or risks with the safe harbour proposal?
    Enter text here.

37. 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?
    Enter text here.

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?
    Enter text here.

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?
    Enter text here.

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

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?

Enter text here.

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

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?
    Enter text here.

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?
    Enter text here.

Phased approach to licensing

46. What would be the costs and benefits of a phased approach to licensing?
    Enter text here.

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

48. Do you have any other comments or suggestions regarding the proposed transitional arrangements?
    Enter text here.

Demographics

49. Name:
    Cygnus Law Ltd

50. Contact details:
    REDACTED

51. Are you providing this submission:
    ☐As an individual
    ☐On behalf of an organisation

    (Describe the nature and size of the organisation here)

52. Please select if your submission contains confidential information:

☐I would like my submission (or specified parts of my submission) to be kept confidential, and attach my reasons for this for consideration by MBIE.

Reason: Enter text here.