Westpac New Zealand Limited's submission to the Ministry of Business, Innovation & Employment on the Consultation Paper: *New Financial Advice Regime: The draft Financial Services Legislation Amendment Bill and proposed transitional arrangements* – 31 March 2017

Introduction

This submission to the Ministry of Business Innovation & Employment (**MBIE**) is made on behalf of Westpac New Zealand Limited (**WNZL**) in respect of the Consultation Paper: *New Financial Advice Regime – The draft Financial Services Legislation Amendment Bill (**Bill**) and proposed transitional arrangements* (**Consultation Paper**). We appreciate the opportunity to provide feedback on the Consultation Paper and the efforts that MBIE and the Financial Markets Authority (**FMA**) have made to meet with stakeholders during the consultation period. We are keen to engage further with MBIE, the FMA and the Code Working Group to help with the design of the detail of the new regime. We encourage MBIE to publish a marked-up version of the Financial Markets Conduct Act 2013 (**FMCA**) when the Bill is introduced to Parliament to assist stakeholders who are making submissions to the Select Committee.

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As requested, WNZL has provided its responses in the template below.

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?

   Offers made through a financial advice provider should be allowed to be made in the course of, or because of, an unsolicited meeting. This will essentially preserve the status quo. It is understood that the rationale for the current exemption in the FMCA is that Authorised Financial Advisers (**AFAs**) and QFE Advisers are already subject to disclosure and other obligations under the Financial Advisers Act 2008 (**FAA**), which requires them to act with care and take account of client interests. These obligations take sufficient account of the risks of pressure selling.

   The same rationale would continue to apply under the new regime. Financial advice providers (and the financial advisers and financial advice representatives who give advice on their behalf) will be subject to duties to put the client's interest first, to exercise care, diligence and skill, to comply with the Code of Conduct's standards of ethical behaviour, conduct and client care, and to comply with disclosure obligations.

It is not evident that the current exemption in the FMCA has resulted in any consumer harm. Further regulation should only be considered if evidence of harm to consumers comes to light.

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 further restrictions are required. Please see the response to question 1.

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

Part 1 introduces the defined terms "*financial adviser*" and "*financial advice representative*". If a distinction is to be maintained between the two categories, we support the term "*financial advice representative*". Financial advice representatives give financial advice. The term "*financial adviser*" is relatively bland and it is currently used in the market by people who are not "*authorised financial advisers*". There is a risk that people will inadvertently breach section 431D (Prohibitions on holding out in relation to giving financial advice) if a common term becomes a regulatory title that may only be used by individuals registered as such on the Financial Service Providers Register (**FSPR**).

The definition of "*financial advice product*" should exclude consumer credit contracts as consumers are already fully protected under the Responsible Lending provisions and the CCCFA more generally. The net effect would be to create compliance efficiencies (by avoiding duplication between two different regimes in respect of the same customer interaction) without reducing any protection to the consumer. The financial advice regime would then focus on protecting consumers in regards to those products which are more advice dependent – insurance products, KiwiSaver, wealth products (MIS etc).

Part 2 of the Bill sets out licensing requirements

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

Clause 20(2) of the Bill introduces a new type of licence condition which the FMA may impose on financial advice providers. This will allow the FMA to impose a condition:

… [stating] which types of financial advice may, or may not, be provided by a financial advice representative on behalf of the provider.

This means that the FMA may reserve some types of financial advice to financial advisers. However, the FMA's power to impose such a condition is currently very broad and the legislation does not provide guidance as to when or in what circumstances providers might be expected to provide financial advice only through a financial adviser. This will create uncertainty for providers about whether their current business models will be viable under the new licensing regime. There is also the risk that such a broad provision could introduce complexity and consumer confusion into the regime if some providers are subject to the condition when other providers are not.

Clause 20(4) of the Bill provides:

If a licence will cover a financial advice service and regulated financial advice may be given to both retail clients and wholesale clients, a condition referred to in subsection (1) may identify when a retail service is provided (and that identification must be treated as correct).

It is difficult to reconcile this clause with clause 50 which inserts a new definition of "*retail*

service" into Schedule 1 of the FMCA:

A financial advice service is a retail service if that service is supplied –
(a) to a retail client (see clause 2 of Schedule 5); or
(b) to a number of clients and at least 1 of those clients is a retail client.

It would appear that if a financial advice service may be given to both retail clients and wholesale clients, it should be regarded as a retail service in accordance with new clause 35(3) of Schedule 1 of the FMCA and that the power in clause 20(4) is redundant. It is therefore not evident in what circumstances it is envisioned that the FMA might use this power.

If it is intended to empower the FMA to deem a wholesale service to be a retail service, this is not supported as it would cause uncertainty for financial advice providers about their current business models.

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

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

   We do not agree that the duty should extend to doing anything in relation to the giving of advice. The duty should apply only when giving the advice.

   We understand that the rationale for extending the duty to doing anything in relation to the giving of advice is to prevent advisers purposely avoiding the regime, for example providing an information-only service in circumstances where the client might think that they are receiving an advice service.

   However, we do not consider that such activity should be regulated by the financial advice regime – it is already subject to other statutory and common law obligations (for example, the FMCA fair dealing provisions and tortious duties). Extending the regime in such a manner would also cut against the Bill's clear delineation between an information-only and an advisory service. If the financial advice provider is clear that it is only providing information to a customer, there can be no financial advice duty that extends to that service. Otherwise, where the customer has sought a product on an information-only or execution-only basis, the financial provider might consider that they are either compelled to give advice, despite the consumer not wanting it, or the provider might decline to provide the service at all.

   There should at least be a safe harbour for providers who properly disclose that they are providing an information-only or execution-only service to the client.

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 duty should be extended to apply with respect to financial advisers. We understand the rationale for restricting the prohibition to financial advice representatives is that financial advisers are subject to the Financial Advisers Disciplinary Committee and so are personally incentivised to comply with the duty to put the client's interest first and comply with the standards of ethical behaviour in the Code of Conduct.

   However, the prohibition applies to the financial advice provider and it is not evident why financial advice providers should be permitted to give advisers inappropriate payments or incentives (ie payments or other incentives that are intended to encourage or are likely to have the effect of encouraging someone to engage in conduct that contravenes their duties).

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. Wholesale clients should be sufficiently sophisticated that they do not require this protection.

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

New section 431G requires a person giving regulated financial advice to "*agree*" with the recipient on the nature and scope of the advice to be provided and to take reasonable steps to ensure that the recipient understands any limitations on the nature and scope of the advice. Although the language of this obligation is similar to Code Standard 8 of the Code of Professional Conduct for Authorised Financial Advisers, it appears to introduce a new and more onerous obligation on advisers. Under Code Standard 8, the obligation on the AFA with regards to *personalised advice* is to clearly and effectively communicate the nature, scope and limitations of the advice (that have been agreed with the client) to the client. With regards to *class advice*, the client is deemed to have agreed the nature and scope of the service.

The legislation should be amended to provide a safe harbour if the person giving the advice provides appropriate disclosure setting out the nature and scope of the advice.

New section 431H imposes a duty on a person giving regulated financial advice to put the client's interest first. This duty applies if that person "*knows, or ought reasonably to know"* that a conflict exists. It is not evident how this duty would apply with respect to a robo-advice service. This could be problematic where information about the client is held in a financial advice provider's files or systems that are not used by the robo-advice platform.

New section 431O(a) requires a financial advice provider to have clear and effective processes, controls, and limitations relating to the financial advice that may be given by its representatives. This section should be reconsidered as it focusses on process rather than an outcome to be achieved. The section does not make it clear what the purpose of the processes, controls and limitations should be. It is unclear what this duty achieves in terms of consumer welfare that is not already achieved under the duty provisions imposed under new sections 431F to 431M.

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

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

We support the removal of the '*offering*' concept as this clarifies when the brokers' conduct obligations apply.

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?

No comment.

11. Part 5 of the Bill makes miscellaneous amendments to the FMC Act. 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?

Financial advisers should not have direct civil liability for breaches of their obligations. The provider should take responsibility for its advisers and representatives as ultimately it is the licensed entity that provides the advice and designs the business model through which that advice is given. The existing common law of agency will still enable individual liability where

that adviser has operated outside her ostensible authority.

However, if only financial providers have civil liability for breaches of the obligations, it is important that they should be required to hold sufficient capital and professional indemnity insurance so that consumers are protected.

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. If the entity has met its obligations to have in place the appropriate processes and provide resources, this should be a relevant defence.

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?

    Clause 46 provides the FMA with a power to declare that a service that would not otherwise be a financial advice service is a financial advice service. The FMA should also have the power to declare that a service that would otherwise be a financial advice service is not a financial advice service. (Cf section 562(1)(a) and (c) of the FMCA which gives the FMA the power both to bring a security within the regulatory perimeter or to exclude it.)

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

    Applying the concept of a "*retail* service" is not supported and it would not be workable. The outcome should be that retail customers receive the benefit of the duties and that wholesale customers should be free to negotiate terms they want. However, the proposed approach would not achieve this. It would be difficult for providers to demarcate their advice services. It is the identity of the customer that is important and not the nature of the service.

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

    It appears that director liability will attach to financial advice disclosures. Although the disclosure requirements have not yet been prescribed, we anticipate that groups of advisers and representatives working for a financial adviser are likely to have different disclosure documents, depending, for example, on the products they advise on. Disclosures are therefore likely to be more numerous and change more frequently than for offers of financial products. It therefore seems unrealistic to require Board oversight, except through the processes and procedures of the entity for approval.

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?

    We support the proposed territorial application and consider it should take effect as soon as possible after the passing of the Act.

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?

No. The FSPR is not a consumer-friendly source of information. We do not believe that it is checked often by members of the public so adding more information to it is unlikely to produce much benefit.

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

    No.

19. Do you have any comments on the proposed categories of financial services? If you're a financial service provider, is it clear to you which categories you should register in under the proposed list?

    The categories appear to be clear. We have no further comment.

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?

    Under the FMCA, a licensee is required to report to the FMA if the licensee contravenes a market service licensee obligation in a material respect (s412). It would cause confusion if schemes were required to provide information about breaches that were not material breaches, ie if different standards were to apply to the schemes and to licensees.

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

    No comment.

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?

    No comment.

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

    No comment.

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?

    The FMCA definition of '*wholesale*' should be adopted in order to avoid unnecessary compliance costs.

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?

No comment.

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

    No comment.

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

    No comment.

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

    No comment.

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. We would note that it would not be appropriate for the Code to reintroduce the complexity that the current legislative reform seeks to abolish (ie concepts such as category 1 and category 2 products and class and personalised advice).

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. Financial advice providers will be required to obtain a licence under the FMCA. The appropriate enforcement body is therefore the FMA.

    Financial advice providers will be subject to the FMA's powers under subpart 3 (Monitoring and enforcement of licences) of Part 6 of the FMCA. The FMA's powers include the ability to suspend or cancel a licence in certain circumstances.

    Financial advice providers will also be civilly liable for contraventions of the duties on persons giving regulated financial advice (eg the duty to put the client's interests first). This means that the financial advice provider could be subject to pecuniary penalty orders and compensatory orders.

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?

    The jurisdiction of the Financial Advisers Disciplinary Committee should not be extended.

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

No comment.

About transitional arrangements

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

    The transitional arrangements should ensure that new people can enter the market, ie people who were not previously AFAs or QFE Advisers. One concern, if new competence, knowledge and skill standards are introduced during the transitional period, is that there may not be a clear path through which new entrants can qualify, ie suitable training may not be available in the market. Another concern is that new entrants should not be forced to use external training providers during the transitional period where the provider's proposed model under the new regime will be to provide training in-house. Therefore new entrants should be able to comply with the old standards during the transitional period.

    The transitional regime should also ensure that advisers/representatives can change between providers during the transitional period and that they can change roles within providers.

    It is also key that innovation is not stifled during the transitional period. We would support measures that would allow the introduction of robo-advice during the transitional period. Financial advice providers should be able to apply to amend their transitional licence to include a robo-advice service (rather than having to apply for a separate licence). Such an approach would minimise the compliance burden for financial advice providers.

Proposed transitional arrangements

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

    Yes. This will allow current market participants to continue to offer financial advice services while also preparing to comply with the new standards.

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?

    This will depend on the detail of the Code. If new standards in the Code require a provider to change its business model, then six months is unlikely to be sufficient time.

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

    The safe harbour provisions do not go far enough as financial advisers and financial advice representatives entering the market will have to meet the new competence, knowledge and skill standards during the transitional period. New entrants may face practical difficulties attaining the appropriate qualifications during the transitional period (ie the appropriate training may not be available). Providers will also have an increased compliance burden if they have to implement different compliance measures for different sets of advisers and representatives. The safe harbour should be extended to new entrants during the transitional period.

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?

    No comment.

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?

    It is proposed that financial advice providers will be able to start applying for full licences on 28 February 2019, which would give firms two years before the regime comes into full effect to obtain a licence. This would appear to give firms sufficient time. However, the FMA will need to publish its licensing guides and any standard conditions prior to 28 February 2019 if firms are to enjoy the benefit of the full two year period. It is likely that the FMA will want to have regard to the Code of Conduct when determining the appropriate licensing standards. We query whether six months from the Code being finalised will allow sufficient time for the FMA to achieve this.

    Whether two and a half years is sufficient for industry participants to meet any new competency standards will depend on the detail of the standards and, where higher competency standards are introduced under the new Code, the availability of appropriate training and qualifications in the market.

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?

    No. If advisers are to have a distinct status within the regime, former AFAs should have to comply with the new standards from 2021.

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

    See response to question 39 above.

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?

    Yes, especially as financial advice representatives could end up being required to comply with higher standards of competence, knowledge and skill than former AFAs.

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?

    No comment.

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

    This competency assessment process appears to contemplate RFAs maintaining the status of adviser. MBIE's Issues Paper identified that there are concerns that existing competency requirements for RFAs are currently not high enough. The Issues Paper identified that there is an imbalance between higher competency requirements for some advisers (AFAs) and "*low or non-existent competency requirements*" on other advisers (especially RFAs). MBIE stated:

We hear that these competency requirements are not always proportionate to the risk or complexity of the financial advice services being provided. This includes the concern that RFAs do not have to meet a competency standard, despite advising on financial products which can have a significant impact on consumers' financial wellbeing (e.g. insurance). For an RFA to practise he or she must simply register as a financial service provider (this involves an application form, criminal record check, annual fee, and joining a dispute resolution scheme).

The current proposal would appear to perpetuate these problems and runs the risk of creating confusion amongst the public about the competency of advisers.

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?

    See the response above.

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 comment.

Phased approach to licensing

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

    Financial advice providers will be a large and diverse population. Providers will also have discretion over how they design the appropriate processes and controls for their financial advice services. They will therefore need flexibility as to when within the two year period they will apply for a full licence. A phased approach is not supported as it would not provide this flexibility.

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

    The earlier certainty can be provided over the detail of the licensing regime (eg minimum standards for licensing and standard licensing conditions), the earlier market participants will be able to apply.

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

    No comment.

Demographics

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

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Reason: