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Uninvited direct sales – potential exemptions for certain sales of financial products

1. The New Zealand Law Society (Law Society) has become aware that the Ministry of Business, Innovation and Employment (MBIE) is seeking feedback on whether regulations need to be developed under new section 36S of the Fair Trading Act 1986 (to be inserted by the Fair Trading Amendment Act 2013) and the scope of any such regulations.[1]

2. The Law Society regrets the fact that this response is submitted after the suggested deadline of 16 May, but asks that you note the feedback which has been provided by the Law Society's Commercial and Business Law Committee. The Law Society expends significant resources and deals with a broad spectrum of government agencies on law reform issues, but MBIE's request for feedback was not sent directly to us and was only picked up indirectly in the last 48 hours.

3. In response to the questions raised for consultation, the Law Society responds as set out below.

Question 1: do you agree that applying the UDS provisions to the sale of financial products in [specified] circumstances raises a problem?

4. We agree with MBIE's preliminary view that it may be "reasonably necessary" to provide exemptions from the Uninvited Direct Sales (UDS) provisions for sales of financial products in circumstances which are already subject to an exemption under section 34(2) of the Financial Markets Conduct Act 2013 (FMC Act).

5. However, we are not sure that the present proposal is sufficiently wide to address the issue of potential overlap of different compliance obligations in respect of the same activity. As a result, we suggest that there is some logic to extending the exemption to apply to all financial products that are subject to the compliance regime imposed on financial advisers under the Financial Advisers Act 2008.

[1] *Uninvited direct sales – potential exemptions for certain sales of financial products*, MBIE discussion document.

6. Without such uniform coverage, we are concerned that, by limiting the coverage of the exemption only to those financial products that are covered by the carve-outs provided by section 34(2) of the FMC Act, an uneven compliance burden will be imposed on some market participants – depending on whether the financial products in which they deal are regulated under the FMC Act and not the Financial Advisers Act. Such an outcome would appear to require those market participants to implement different compliance regimes for different classes of financial product. That would be costly to implement and have the potential to create more problems than it solves, particularly in terms of the risk of confusion among the investing public.

7. It is also not clear why the proposed exemption should be limited to authorised financial advisers and QFE advisers, but not all other registered financial advisers. We think it necessary to cover all those categories of advisers under the Financial Advisers Act who are subject to the same (or broadly similar) obligations with respect to care, diligence, skill (and not acting in a manner that is misleading and deceptive conduct).[2]

8. For completeness, we note that having a cooling-off period for dealing in investment products risks creating unwelcome distortions for market participants. The recent partial-privatisation process undertaken by the Crown (particularly the sell-down of part of the Crown's stake in Mighty River Power) illustrates that a cooling-off period would enable prospective investors to pause and see the outcome of several days' trading in "their" shares before deciding whether to use the cooling-off period to their advantage. This creates risks of gaming that are not only distortionary but also out of step with any other comparable investment market of which we are aware in any of the markets that routinely attract investment into the New Zealand market.

9. A cooling-off period may also have the potential to create distortions and the need for extensive further regulation in the market for Kiwisaver products. This is an area in which we suggest great caution is needed – because of the significance of the Kiwisaver market and the need to ensure that the investing public retains confidence in the rules governing Kiwisaver investments.

Question 2: is an exemption under section 36S of the Fair Trading Act required?

10. Such an exemption is both desirable and necessary to address the prospect of inconsistent treatment of uninvited direct sales between the FMC Act on the one hand and the Fair Trading Act on the other.

Question 3: are there any other circumstances in which the sale of financial products should be exempt from the UDS provisions?

11. The point made in response to Q1 above is reiterated: we consider that all financial products that are subject to the Financial Advisers Act should be exempt from the UDS provisions in the Fair Trading Act.

12. We make this point because we believe that the UDS provisions in the Fair Trading Act are inappropriate for their use in relation to *all* – and not just a subset of – financial products. From a policy perspective, we do not see that there is a compelling distinction between the reasons that underpin the exemption for financial products (in terms of the FMC Act) offered by means of authorised financial advisers or QFE advisers and any other class of financial products offered or sold through any financial adviser who is subject to the Financial Advisers Act.

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[2] One suggested comparison, in a consumer law context, is that of the treatment of auctioneers – where the Fair Trading Act criminal provisions apply to both registered and unregistered auctioneers. We submit that the compliance burden (and therefore any sanctions for non-compliance) should be uniform across all registered financial advisers.

13. Put simply, we think it is somewhat artificial to make a distinction between advising on the sale of:

    a. those financial products that are subject to the FMC Act, and
    b. the balance of the market for financial products,

    on the basis that the duties applying to the sale of a subset of the market do / do not make allowance for overlapping or conflicting duties under the Financial Advisers Act. This point already seems to have been conceded in the discussion paper (noting, in particular, the duties of a financial adviser with respect to the exercise of care, diligence and skill).[3]

14. Finally, we believe the preferred outcome is for the obligations with respect to the sale of all such products to be governed by the FMC Act. That would ensure that both the compliance burden and any applicable penalties are uniformly applicable.

Question 4: will consumers be adequately protected against the risks of pressure selling if exemptions from the UDS provisions are provided?

15. As set out above, we consider that the better solution is for there to be consistent protection by uniform coverage under the application of the FMC Act and the duties of a financial adviser with respect to the exercise of care, diligence and skill under the Financial Advisers Act. The risks of a piecemeal approach to investor protection are self-evident in terms of uncertainty about the existence of gaps and the costs of complying with a patchwork of compliance obligations.

Question 5: is it appropriate for any exemption to be subject to a condition re oral notice?

16. You have suggested that it may be appropriate for any exemption to be subject to the condition that the supplier gives the consumer oral notice, before the sale agreement is entered into, that the UDS provisions in the Fair Trading Act do not apply (in the same way that credit contracts are treated under the UDS provisions).

17. We are puzzled about how this might work, and suggest that it would not provide for certainty and consistency in practice. As with any exemption, if the conditions attached to the exemption were shown not to have been met, the seller could not rely on the exemption. Logically, a default would mean the UDS provisions were applicable, and a cooling-off period would be available.

18. Putting to one side our primary reservation that investment products must be (and be seen to be) treated differently to other consumer products, this has the potential to create a compliance nightmare. The most likely outcome is that, rather than try to deal with a patchwork of compliance obligations for different types of investment product, sellers default to giving such health warnings in respect of all classes of products and their sale in all manner of situations. For example, the risk that the sorts of routine discussion many of us encounter around different products in the context of a portfolio review might become an 'uninvited' offer could undermine the usefulness of such reviews – because they would be book-ended with health warnings. That result would be confusing for investors and an unnecessary compliance burden for sellers.

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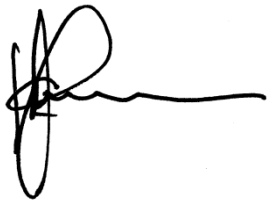
[3] See paragraph 9.

This submission was prepared by the Law Society's Commercial and Business Law Committee. If you have any queries or would like the discuss the submission, the committee convenor Stephen Layburn can be contacted through the committee secretary, Vicky Stanbridge (ph (04 463 2912 / vicky.stanbridge@lawsociety.org.nz).

Yours sincerely



Chris Moore
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