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31 March 2017

Financial Markets Policy
Building, Resources and Markets
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Financial Services Legislation Amendment Bill – draft Bill and proposed transitional arrangements

The Law Society welcomes the opportunity to submit on the exposure draft Financial Services Legislation Amendment Bill (Bill) and follows the format of the submission template provided.

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?**

Yes. In principle, if licensing of financial advice providers is sufficiently robust this should control mis-selling. (Please see comments below on drafting (question 3)).

This section should protect customers from pressure selling. In the absence of regulations extending the definition of "financial product" to particular financial advice product(s), the unsolicited meeting prohibition only applies to sales of a financial product (debt security, equity security, managed investment product or derivative).

The current proposals do not contain a link between the licence conditions of the financial advice provider and the product being offered. The unsolicited meeting exception should only apply where the product provider is licensed to distribute that product.

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?**

Yes. The exception should only apply where the product provider is licensed to distribute that product.

It is a matter of policy whether that protection extends to all financial advice products or only financial products. We note that the global experience is that much mis-selling relates to financial services, rather than financial products (e.g. payment protection insurance).

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

Clause 5
"dispose of" should be amended to include "other financial advice product". Clause (ba) should clarify that a renewal or variation does not amount to a disposal.

"financial advice representative" This terminology is not a significant improvement on "registered financial adviser". Although financial advice representatives technically provide "advice", the terminology may create an expectation of a different or more comprehensive interaction. Consumers may not be able to distinguish between a "financial adviser" and a "financial advice representative". It would be clearer to call these employees or agents "representatives".

The legislation should clarify what is meant by "engaged". It is not clear whether a person will be "engaged" if they receive an incentive when a product is sold, or whether it is necessary for there to be a contract of engagement.

Clause 10 - Unsolicited meetings
The meaning of an offer made "through" a financial advice provider needs to be clarified. For instance, would this include any salesperson remunerated by a commission payment from a financial advice provider?

When a resulting sale occurs "because" of an unsolicited meeting should also be clarified. Financial advisers often meet clients at unsolicited meetings. It may be appropriate for the FMA to issue guidance on when a relationship and any resulting sale are no longer "because" of an unsolicited meeting.

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 14
It may be simpler to exclude the ancillary services and other occupations (provided in proposed clauses 7—14 of Schedule2 of the Bill) from the definition of "financial advice" rather than introducing the complexity of another concept of "regulated financial advice". Although this is consistent with the section 41 and Schedule 1 approach to disclosure for regulated products and regulated offers, it adds a layer of complexity that may not be justified.

Clause 15
Clause 15 amends section 389 to provide exemptions to when a provider of market services needs to be licensed. The proposed new section 389(4) states that "if a financial advice service is a retail service, the licensee's market services licensee obligations apply in respect of the service as whole (whether the service is provided to a wholesale client or a retail client)".

These requirements do not fit well with current business models: most financial service providers are in business to sell financial products, not provide financial advice. Accordingly, understanding the scope and application of the regime becomes difficult. For example, it is not clear how the licence requirements will apply to any particular product or a division of a business.

Clause 17
See comments below on clause 24.

Clause 20
Clause 20(2) amends section 403 by inserting a new subsection (3)(d) which will allow the FMA to impose conditions on the "types of financial advice" that can be provided.

The text conceptualises a "service" but it is not clear whether the intention is to allow the regulator to control the type of products that can be sold by a provider's representative. If so, it would be more appropriate to amend section 403(3)(a) to refer to "classes of financial service" as well as "classes of financial product".

It is also not clear how limits will be imposed on the types of products that can be sold by a financial adviser "engaged" by or making an offer "through" a financial advice provider. (See unsolicited offer provisions section 34 for "through" and section 431C for "engaged").

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?**

As this provision is limited to circumstances where there is a conflict of interest, the scope of the duty is narrower than in the current code of conduct for Authorised Financial Advisers. This is not consistent with the July 2016 policy decisions.

Although the duty itself has been narrowed, its potential application is extremely wide. The duty applies more widely than just when the advice is provided, but it is not clear how far the scope of the duty extends. The duty will apply when giving advice and "doing anything in relation to the giving of advice". There is a risk that "anything in relation to the giving of the advice" is too wide and will capture activities that should not be regulated. The activities in scope need to be clearly set out in the Bill.

Arguably, this may mean that some advisers could be compelled to give financial advice (or ensure that it is provided) to a client who has not otherwise sought or paid for it. This does not appear to be the case under broadly equivalent provisions in Australia – where the relevant duty is "prioritise the interests of the client".

We also note that the interaction between this section and the payment of commissions is not clear. Will the duty effectively prevent financial advisers being incentivised? (The former Commerce Minister publicly stated that he did not intend to ban commissions.)

See also further comments below on section 431H.

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?**

We note that this duty only applies to financial advice representatives. There remains a potential conflict between a financial advisor's ability to receive payments or incentives and their duty to put the client's interest first under section 431H.

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 extension of this provision to wholesale clients has the potential for unintended consequences, complexity and costs. For example, the cost of the additional protections will be imposed on all wholesale transactions when wholesale clients already have the ability to negotiate for those protections. This is not the most appropriate way to regulate good conduct in the wholesale financial markets.

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

Clause 24 – new section 431A
The earlier issues paper identified "promoting public confidence in the professionalism of financial advisers" as a goal.[1] It is not clear that the professionalism of advisers has been addressed in the Bill. The concepts of professionalism and integrity of financial advisers should be included as an additional limb of the proposed new section 431A(1)(b).

Clause 24 – new sections 431C and 431N
What it means to "engage 1 or more individuals to give regulated financial advice on A's behalf …" should be clarified. (For instance, does it require a written engagement agreement to provide financial advice, or is an individual engaged if the product provider will provide an incentive when a product is sold?). Section 536 suggests that a party is "engaged" when it "is acting within the scope of his, her or its actual or apparent authority".[2]

Clause 24 – new section 431L
The proposed wording is "make available to". The equivalent broker provisions (section 431S) refer to "disclosure" and for consistency this terminology should be used.

The second use of "a prescribed person" in new section 431L(1) may need to be reconsidered. It is not entirely clear whether this is intended to be the same "prescribed person" who requests the information, or any one (or more) individual in the category of "prescribed person".

Clause 24 – new section 431P
We note that the FAA provisions protecting client information have been deleted (section 45A(3) FAA). Additional protection for clients may be required.

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[1] Issues Paper: Review of the Financial Advisers Act 2008 and the Financial Service Providers (Registration and Dispute Resolution) Act 2008, released 20 May 2015. See also diagram on page 7 of the Consultation Paper.

[2] Section 536 FMC Act provides that "*Conduct engaged in on behalf of a body corporate by any of the following must be treated, for the purposes of the Act, as having been engaged in also by the body corporate:*
(a) a director, employee, or agent of the body corporate, acting within the scope of his, her, or its actual or apparent authority:
(b)any other person at the direction or with the consent or agreement (whether express or implied) of a director, employee, or agent of the body corporate, given within the scope of the actual or apparent authority of the director, employee, or agent."

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 the key proposed change, of removing the offering concept from the definition of a broker – namely by confining the definition to a person who carries on a business of providing a broking service to a client (rather than providing or offering to provide a broking service) – on the basis that the 'offering' concept does not appear to add anything and its removal provides better alignment with the equivalent definition for financial advice.

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.

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?

Yes. The regime should make it easier for the customer who relies upon the individual advice of a financial adviser to seek redress from that adviser when there is a problem.

Further consideration could also be given to increasing the fines that can be imposed upon a financial adviser; enabling the disciplinary committee to order that the financial adviser makes redress to a customer (although there may be practical issues with enforcement) or enabling the court to make a declaration of contravention against a financial adviser (as provided in section 486 of the FMC Act).

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.

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?

Yes. Consideration could be given to appointing an administrative panel to hear appeals from decisions made by the FMA. Currently the only option for a market participant who does not agree with the decision made by the FMA is to seek judicial review.

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

Regulating a "service" when the market sells "products" may lead to inefficiencies, as indicated in the response to question 4, above.

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

Clause 43 amends section 546 of the FMC Act to provide for Regulations for the purposes of Part 6 (market services). The additional purposes should include the concepts of professionalism and integrity of financial advisers, as recommended in response to clause 24 (new section 431A), above.

Part 6 of the Bill amends the FSP Act

15. 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?

The territorial scope provisions require further refinement. It is unclear how the proposed provisions relating to the territorial scope of the new FAA and FSPR regimes interact – particularly in the case of electronic advice provided by offshore entities that are already regulated by another (approved) jurisdiction – particularly Australia. To recognise the existence of a trans-Tasman market (and prevent unintended consequences) the FMA's exemption-making power should include the ability to specify a list of approved overseas jurisdictions so that qualifying providers are not subject to a two-tier level of licensing and conduct obligations in their home jurisdiction and New Zealand.

We agree that the new territorial application should take effect within a reasonably short time frame (i.e. a few months).

16. 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, although we consider that the warnings or other information contemplated by clause 71 of the Bill will more likely have a bigger impact on addressing misuse. The majority (perhaps the significant majority) of investors/clients will likely proceed on the basis of what they see on the business' websites rather than going further and looking at the FSPR.

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

We do not have enough information on the extent of the problem to be able to comment on this. The dispute resolution schemes will be best-placed to give a view on the extent of non-compliance/engagement.

18. 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?

In our experience, it is not always clear which categories a business should register in. The FSPR registration application guide should provide examples of the types of businesses that do or do not need to be registered, particularly for what appear to be the more "difficult" categories for businesses, specifically:

- operating a money or value transfer service;
- issuing and managing means of payment; and
- keeping, investing, administering, or managing money, securities or investment portfolios on behalf of other person.

Uncertainties can arise with these categories where a business provides one "link" in a chain of different products or services which ultimately make up a product or service as a customer sees/receives it.

In addition, providers of non-financial goods or services that offer customers collateral credit contracts are deemed to be "creditors under a credit contract" (by virtue of the definition of "credit contract" set out in the Credit Contracts and Consumer Finance Act 2003), and are therefore a "financial service" under section 5 of the FSP Act. This is an anomaly and we recommend that the Act be amended to exclude such providers.

19. 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?

We would caution against this. It would fundamentally change the nature of the schemes' role, and would likely require significant additional resources and associated compliance costs, most of which would likely be funded by the "good" FSPs.

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

Yes. Maintaining the two concepts within the same legislation is unnecessarily complex and risks being confusing. Furthermore, the examples of mis-selling within the New Zealand market have primarily been to wholesale clients. On that basis, restricting the definition of "wholesale" would have advantages for the good functioning of the market.

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?

The inclusion of express provisions dealing with "execution-only" transactions are to be welcomed. Greater clarity as to what constitutes "execution-only" transactions is needed in the Bill and in supplementary guidance so that it is clear when the duty to put the client's interest first is engaged.

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.

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

Yes.

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.

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

The Financial Advisers Disciplinary Committee should not consider complaints against financial advice providers. This committee exists to support and maintain the professionalism of financial advisers. Its remedies are relatively limited. It is more appropriate that financial advice providers are regulated directly by the FMA under the civil liability provisions of the FMC Act.

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?

See response to question 30 above.

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?

No comment.

Proposed transitional arrangements

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

We consider that the idea of staged transition is sensible in principle, but see response to question 37 below.

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?

It is unclear whether six months will be sufficient as the transitional licensing process and requirements, and work required to transition is not yet clear.[3]

[3] Page 44 states that *'As with transitional licensing, process and requirements of licensing will be determined by the FMA and/or regulations in due course.'*

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

The safe harbour depends very strongly on current market participants policing their financial advice representatives and financial advisers in accordance with the new regime.

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?

Further consideration should be given to the role of the regulator in the transition period, to allow more flexibility to the business models of current market participants and to ensure the protection of consumers. In addition, further consideration should be given to enabling current market participants to provide a class service through individual employees or agents, and enabling current market participants to change their business model, during the transition period.

There is a lack of consistency in the consultation paper about who can operate under a transitional licence: page 47 states that *'only previous QFE's may operate with representatives under a transitional licence'.* This is inconsistent with page 48 which states that *''Love Life can continue to provide the life insurance service it was permitted to provide under the previous regime (including class advice through an online platform)*.'

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?

Yes, however it is our experience of the transition to the FMC Act that many market participants left transitioning until the end of the transition period. Everything possible should be done to encourage market participants to transition early in the transition period (see also response to question 47).

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. AFAs currently represent the highest quality of financial advice available in the New Zealand market. These advisers may be the only source of independent financial advice for New Zealanders and so everything possible should be done to maintain consumer confidence in these advisers. It would seem more appropriate to ensure that the code of conduct is set at a similar level to the current code of conduct for authorised financial advisers. Standards of competency can then be developed and raised within the context of the code framework.

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

No comment.

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.

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?**

As set out in answer to question 39, we consider that this would be more appropriately resolved within the framework of the code of conduct.

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

We support the option of a competency assessment process for existing AFAs. These financial advisers are already meeting the competency requirements of the current code of conduct. We are concerned about the implications of allowing RFAs to operate without relevant qualifications. This will do nothing to enhance the professionalism of financial advice and leave consumers in a significantly worse position than consumers in equivalent jurisdictions. If the proposal is adopted it should be used in only exceptional circumstances.

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?**

A figure of 10 years appears arbitrary. This provision appears designed to enable good financial advisers to continue in the market. If that is the case, the number of years' experience should be considered as part of the assessment process, and not used to limit those who can apply under this process.

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?**

If this is to remain as an option it should be dealt with by the Code Working Group and not dealt with in legislation.

Phased approach to licensing

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

The benefits of a phased approach to licensing is that it would allow the market and regulator to better manage the licensing process. The disadvantage in this approach is that licensing is generally most work for those who apply first. Other market participants are able to benefit from the experience of the first-movers.

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

Everything possible should be done to encourage market participants to transition early in the transition period – not by the end of it. Consideration should be given to providing for a scale of fees for licencing applications, with lower fees at the start of the transition period.

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

No comment.

Conclusion

This submission was prepared by the Law Society's Commercial and Business Law Committee. If further information or discussion would assist, the committee convenor, Rebecca Sellers, can be contacted through the committee secretary, Karen Yates (04 463 2962, karen.yates@lawsociety.org.nz).

Yours sincerely

Kathryn Beck
President