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7 June 2019

Financial Markets Policy
Building, Resources and Markets
Ministry of Business, Innovation & Employment
Wellington

By email: FinancialConduct@mbie.govt.nz

Conduct of Financial Institutions: Options Paper, April 2019

The New Zealand Law Society welcomes the opportunity to comment on the *Conduct of Financial Institutions, April 2019, options paper* (paper).

The paper has been considered by commercial practitioners on the Law Society's Commercial & Business Law Committee and the committee has responded to consultation questions that are within its remit and expertise. Some general comments are also provided.

General comments

Lack of focus on the consumer has long been an anomaly in New Zealand financial services regulation.[1] The Law Society supports a principles-based approach to regulating organisations that provide financial services to consumers in New Zealand. The preferred package of options appears sound, subject to the comments below.

The proposals set out in this options paper are being pursued to a tight timetable, with the ambitious aim of legislation being introduced to Parliament before the end of 2019.

The Law Society understands that regulators, banks and insurers are currently engaged in an ongoing review of Conduct and Culture. A measured approach needs to be taken to developing this regime, to allow sufficient consideration and input from regulators and market participants.

The Financial Advisers Act 2008 is an example of a regime that was developed in haste. The bill that became that legislation was significantly amended shortly before commencement.[2] As a result, the regime had unintended consequences, such as hindering the development of robo-advice because of a legislative requirement that personalised advice be delivered by a human. The Law Society supports the manner in which MBIE has subsequently engaged with regulators and stakeholders in reviewing the

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1 As identified by commentators: IMF Financial Assessment Program (FSAP), New Zealand Financial System Stability Assessment report 2017 (available at https://www.rbnz.govt.nz/-/media/ReserveBank/Files/regulation-and-supervision/FSAP/new-zealand-FSAP-2016-FSSA.pdf?la=en&revision=1aa83aee-9df6-4244-80f4-8de570a0b5b0); and Colinvaux's Law of Insurance in New Zealand, 2nd ed.

2 Supplementary Order Paper no. 253, 23.9.2008, Financial Advisers Bill 192-2.

Financial Advisers Act, and recommends a similar measured approach is taken to developing this legislation, to avoid unintended consequences.

Part 3.2: Options for overarching duties

Q1: Which overarching duties should and should not be included in the regime? Are there other duties that should be considered? Do you agree with the pros and cons of each duty? Do you have any estimates of the size of the costs and benefits of these options? Are there other impacts that are not identified?

- **Option 1: a duty to consider and prioritise the customer's interest, to the extent reasonably practicable**
- **Option 5: a duty to manage conflicts of interest fairly and transparently**

The options set out for the proposed overarching duties do not include an obligation to treat customers fairly. Instead Option 1 imposes a *modified* duty to prioritise customers' interests – the duty to prioritise customers' interests is only "to the extent reasonably practicable", and the potential for conflicting interests is inherent in the requirement to "prioritise" the customer's interests (i.e. there may be other interests at play).

A duty to treat customers *fairly* is imposed by the IAIS (International Association of Insurance Supervisors) Insurance Core Principles (ICP)[3] that set out international best standards for insurance regulation. ICP 19 provides that "supervisors require insurers and intermediaries, in their conduct of insurance business to treat customers fairly, both before a contract is entered into and through to the point at which all obligations under a contract have been satisfied."

It is not clear why it is proposed that the duty to treat customers fairly (ICP19) should be replaced by a modified duty to prioritise customers' interests. Reasons should be provided to justify the proposed rejection of international best practice.

The Law Society notes that there could be unintended consequences of imposing the Option 1 duty on product providers. A similar duty will apply to product distributors (under the Financial Markets Conduct Act 2013 as modified by the Financial Services Legislation Amendment Act 2019 (FMCA)). The FMCA regulation of financial advice is not currently in force and it would be desirable for it to be tested in practice before extending it to parties who do not provide financial advice.

It is important to take into account the complexities and pitfalls of a multi-layered conflicts of interest duty. Option 5 reflects the IAIS duty and the requirements set out in the Financial Services Legislation Amendment Act 2019, but it will be replicated in different legislation, applying to different parties. For example, it will apply to the insurance company (under these proposed legislative reforms) and to the adviser who sells the insurance policy (under the Financial Advisers Act).

[3] Available on the International Association of Insurance Supervisors (IAIS) website: https://www.iaisweb.org/page/supervisory-material/insurance-core-principles/.

Part 3.6: Options for tools to ensure compliance

Option 2: Entity licensing

Q12: What is your feedback on the option to require banks and insurers to obtain a conduct licence? Do you agree with the pros and cons? Are there other impacts that are not identified? Are there other options that should be considered? Do you have any estimates of the size of the costs and benefits of the options?

The Law Society agrees that entity licensing as outlined in the paper would be appropriate. Imposing high level principles on entities providing financial products/services in the absence of a licensing regime would likely result in uneven application and enforcement of the proposed regime and this would have a detrimental impact on consumers.

As outlined in the paper, the proposed regime will require guidance from and enforcement by an appropriately resourced regulator. Licensing will ensure that the regulator has good information about the regulated population and the regulated population has a sound understanding of the regulator's conduct expectations.

The Law Society suggests that consideration be given to centralising the various licensing regimes currently in force, to a single model and regulator. There are various licences that financial services providers may currently hold. Those that the FMA oversee include licences for managed investment scheme managers, derivative issuers and financial advice providers. With the commencement of the new FMCA regime for financial advice, all these licences will fall within the Financial Markets Conduct Act 2013. It is timely for consideration to be given to whether there can be a degree of co-ordination between the licences to ensure efficiency of markets and regulatory outcomes. For example, a financial service provider could hold one consolidated licence issued by the FMA to enable it to manufacture and provide financial advice on its products. That would be more efficient than holding a number of separate licenses.

We hope you find these brief comments helpful. If you have any questions or wish to discuss the comments, the convenor of the Law Society's Commercial & Business Law Committee, Rebecca Sellers, can be contacted via the Law Society's Law Reform Manager, Vicky Stanbridge Privacy of natural persons .

Yours faithfully

Andrew Logan
Vice President