Boutique Investment Group submission on "Fit for purpose financial services conduct legislation" and "Effective financial dispute resolution"

19 June 2024

1. This is a submission by the **Boutique Investment Group (B.I.G.),** a forum that most non-bank MIS managers participate in. No part of this submission is confidential.

Fit for purpose financial services conduct legislation

2. We support the concept of improving the law to ensure that New Zealand regulations address identified harm in the least burdensome manner. We particularly support looking for ways to avoid duplication of reporting.

3. As our members are not parties to the COFI regime we are not providing detailed comments on most of the consultation paper. We focus our submission on the issues that go beyond COFI, namely:

    a. The proposal that market services licences under COFI and the FMC Act should be consolidated;
    b. The proposal that all FMC Act licensed businesses should be required to seek approval of the FMA before a change of control can take place; and
    c. Additional powers for FMA.

A single market services licence

4. We are impacted by this proposal because:

    a. Many of our members hold more than one market services licence; and
    b. When any of us apply for our next licence, we will be making our application into a potentially more complex uber application process designed to accommodate all financial markets activities, rather than the single new form of business that we are hoping to take up.

5. Our view of the proposal is that:

    a. there is merit in doing some work to develop a list of generic matters that could genuinely apply to all licence types, and to have common application questions and standard conditions for these; However,
    b. going further and creating a single licence and licence process for all licence types is not likely to give rise to many efficiencies. In fact, it may create more problems than it solves.

Matters applicable to all licence types.

6. Examples of things that every financial sector business (and probably any reasonable sized non-financial sector businesses) should have in place are:
    a. A complaints handling process;
    b. Some level of cyber resilience;
    c. Processes for keeping records and managing information; and
    d. Some form of business continuity plan.

7. To date, universal matters such as these have formally been required of some license types, but not others (without there being any indication of risk-based reasons for the differences in treatment) and/or the drafting of standard conditions relating to these has been inconsistent.

8. As an example to illustrate the point:

    a. A business continuity plan has been a requirement for financial advisers since March 2021, however it has not been a requirement for MIS managers (it will be from July this year); then
    b. Having decided that MIS managers should also be subject to an obligation to have a business continuity plan, the notification obligations are stricter for MIS managers than for advisers without there being an apparent deliberate reason for the difference in treatment.

9. The standard condition that has applied to advisers since 2021 is set out below:

Condition: You must have and maintain a business continuity plan that is appropriate for the scale and scope of your financial advice service.

If you use any technology systems, which if disrupted would materially affect the continued provision of your financial advice service (or any other market services licensee obligation), you must at all times ensure that information security for those systems – being the preservation of confidentiality, integrity and availability of information and/or information systems – is maintained.

You must notify us within 10 working days of you discovering any event that materially impacts the information security of your critical technology systems and provide details of the event, the impact on your financial advice service and clients, as well as your remediation activity.

10. The Standard condition for MIS managers is set out below:

Standard Condition: *(This standard condition will be effective from 1 July 2024)*

You must have and maintain a business continuity plan that is appropriate for the scale and scope of your licensed market service.

If you use any technology systems, which if disrupted would materially affect the continued provision of your market service (or any other market services licensee obligation), you must at all times ensure the operational resilience of those systems – being the preservation of confidentiality, integrity and availability of information and/or technology systems – is maintained.

You must notify us as soon as possible and, in any case, no later than 72 hours, after discovering any event that materially impacts the operational resilience of your critical technology systems, and provide details of the event and impact on your licensed market service and recipients of the service.

11. These inconsistent outcomes do not create significant problems but are incongruous.

12. It should be noted that from the FMA's perspective the work involved in creating two different standard conditions on the same topic and going through two distinct processes would be greater than running a single process that covers both licence types. On the face of it you might expect similar provisions for FAPs and MIS managers on this topic as there is a lot of cross over between these particular business types.

13. Based on the above, we believe that there could be some efficiency to the FMA maintaining a list of matters that are genuinely universal and having consistent drafting across them:
    a. The benefit for the FMA would be the ability to make changes on genuinely generic issues across the board in one hit; and
    b. The benefit for industry is that once you have one licence, you would have met a chunk of standard conditions for any other licence that you apply for.

14. However, it needs to be recognised that while there is benefit in identifying issues that are genuinely applicable to all licence types, different financial sector activities:

a. Have different levels of risk;
b. Require different skills and processes (both on the part of the participant to carry out the activity and on the part of the assessor); and
c. Serve a different role in society and thus you would be looking for different outcomes from them.

15. Therefore even on the most generic of topics like having a business continuity plan, there may be reasons why you would seek different standards from different participants and draft the conditions differently as a consequence. For example, the ramifications of a bank discontinuing service for a period would be significantly different from a one-person financial adviser business discontinuing service for a period that would definitely justify some difference in treatment.

16. Therefore, we caution against forcing false homogeny onto the financial sector and finding too many generic issues, and applying them the same way. In fact the matters referred to above may be close to the limits of what is universal.

17. The social harm caused by treating homeloans the same way as payday lending under the CCCFA has proven the level of harm that can be done by trying to force things that are not alike into the same regulatory box. The problem is that while a strong light has now been shone on the CCCFA there are a great many other instances of the same problem of forcing things that are not alike into the same mould that have not received the same level of attention and the lesson that the CCCFA does not appear to have been learned by policy makers.

18. One final point about matters that should be the subject of generic conditions: Our view is that generic matters to be applied across the board should be limited to tangible and practical things like whether a business has a complaints handling process. Subjective matters that mean different things to different people like "treating customers fairly" should not be eligible for being brought within the scope of a generic condition. These kinds of condition are undesirable in general (outside of the this context) because they lack certainty. What then compounds the uncertainty to an unacceptable level is trying to apply a subjective concept to lots of quite different kinds of financial service provider where the nature of the services and expectations of customers will be quite different.

Benefits versus burdens of a single licence do not stack up

19. If a business today holds a MIS manager licence and a Financial Advice Provider Licence (which is not an uncommon situation among members of BIG), saying that those two licences are now one licence with two endorsements is largely a matter of semantics. It doesn't in a practical sense help with anything for that entity.

20. If the same business now wants to branch out into DIMS, say, (in addition to providing financial advice and managing funds) which some members of BIG do, then it will be more straight forward for that entity to just apply for a DIMS licence than to enter an application process that has been designed to cover every single type of possible licence and to work through out how the DIMS application fits within that. This reflects the reality that most businesses tend to expand their businesses incrementally and therefore an add extra licences as you go approach is not a problem, it is a net benefit.

21. Further, many businesses that today hold multiple licences do not tend to choose to have them all held by the same corporate entity. There are a range of good reasons for this. Examples are:

    a. Large corporate entities will want certain types of business activities to be carried out somewhat autonomously and according to a different culture to the main business. For example, the fund management or insurance subsidiaries of banks will often operate under a different brand, in a different location, and under a different corporate entity to the bank, simply because it is a different kind of business to the core business.

    b. There may be a desire to maintain corporate separation of activities in order to create merger and acquisition opportunities down the track. For example, if a bank has at the back of its mind that it might want to sell a non-core part of its business down the track e.g. KiwiBank selling KiwiWealth, ASB selling Sovereign and BNZ selling BNZIL. All these sales would be facilitated if there are discrete licences, rather than one licence that somehow has to be broken up.

    c. Different financial activities may be higher risk than others and therefore there is a need to segregate activities in order to quarantine the lower risk part e.g. the derivatives issuing and trading activities of a bank would ideally not sit within the part of the bank that accepts retail deposits.

22. Overall, our view is that being able to hold different licences in different corporate entities ends up being advantageous as far as corporate structure is concerned. A quick look at the FMA's register of licensed entities will confirm this truth.

23. Finally, it should be noted that giving effect to a single licence regulatory framework would require a fair amount of regulatory tweaking. There would need to be new drafting to the FMC Act to provide for a single licence framework and thought would need to go into consequential matters such as the drafting of levies regulations, and how to migrate existing licences into new single licences.

24. In short there would be considerable administrative work to do something that would likely end up being on balance slightly more annoying from a corporate structure perspective, rather than helpful. There are better things to put MBIE and FMA resources towards.

Requirement for FMA permission before there can be a change of control of owner for FMC licenced entities

25. This proposal has no merit:

    a. The current situation of parties informally engaging with the FMA prior to acquisition is working;
    b. There is no evidence of a problem that needs solving to justify adding a new regulatory hurdle to commercial processes. Current market consolidation in fact tends to support the market outcomes the FMA seems to favour; and
    c. The proposal is based on entirely false logic that because a change of control requirement is necessary for prudentially regulated entities, the same must be true for FMC Act licenced entities i.e. the CCCFA approach of treating all entities the same, even though they are quite different is once more at play.

26. The MIS sector is seeing consolidation. Typically established entities are acquiring other established entities with the consequence that the sector is tending towards fewer entities in the market, more scale, better resourced entities remaining and more low-cost generic vanilla products that are easier to regulate.

27. Where an acquisition is contemplated, a potential purchaser will typically informally engage with the FMA at a suitable point in the process, which in practice tends to provide the FMA with the opportunity to raise concerns. Our understanding is that most law firms advising on a potential acquisition will include a discussion with the regulator as part of their standard process. The prevalence of informal engagement is noted in paragraph 92 of the discussion paper.

28. Because the kind of engagement that we are currently seeing is not a formal approval process, the regulator engagement does not hold up the commercial process or inject unnecessary complexity into the ability to run a project in the way that the OIO process does for example. Therefore our view is the current state of affairs is working well.

29. Not only is the proposal an impractical solution where there is no problem to solve, but the false logic of saying that that FMC entities should be subject to a permission

requirement just because prudentially institutions have a permission requirement needs to be called out.

30. There is a very clear reason why certain institutions have been subject to prudential oversight, whereas others have not. This drives the difference in treatment as far as control is concerned.

31. Prudentially regulated institutions are considered to be of a nature and/or scale to have an impact on the broader New Zealand economy if they fail or go into financial distress, whereas other types of financial entity are not. Unsurprisingly therefore, prudentially regulated entities are subject to a higher level of scrutiny on matters relating to their financial strength and stability, than entities not deemed to require oversight by the RBNZ. This includes the quality and nature of their owners.

32. It is quite surprising that the discussion paper does not recognise that there is a financial stability difference between prudentially regulated and non-prudentially regulated businesses at play.

Extension of FMA powers to conduct onsite inspections

33. One of the main reasons why New Zealand is prosperous and stable country is that there are effective checks and balances on the powers of the state. This gives people the freedom to innovate, allocate resources effectively and live their lives in peace in accordance with their own conscience and priorities. Both from a financial and quality of life perspective giving the state more powers can take life backwards.

34. One of the core restrictions on state power that has contributed to us being free people is that the state is generally not permitted to enter a person's premises without a warrant. In fact, first instances of private citizens being able to deny entry by the king's men marked the turning point toward moving away from a state where the king was all powerful and a step toward becoming a modern free society. Therefore as a matter of principle, any requests by arms of the state to override this core protection should be pushed back upon unless there is an absolutely compelling case.

35. Is there a compelling case? No. In this instance, the FMA is quite capable of obtaining warrants where it needs them and the only reasons for eroding the checks and balances are:

    a. A theoretical speculation that there may in the future be occasions where it may be tricky to get a warrant. No actual example is being pointed to;

b. No equal consideration is given to how giving the power could result in disproportionate outcomes, or have an eroding effect on other freedoms in other aspects of New Zealand life due to the precedent it sets; and
c. An argument that other countries have an ability to enter without a warrant has been raised. Our view is that we should not be aspiring to emulate states with less respect for checks and balances than we have.

36. In short, MBIE is proposing to override a core principle that protects freedom for no demonstrable good reason.

Extension of FMA powers to require production of expert reports

37. We are opposed to this proposal.

38. As noted in the discussion paper, the FMA has all the powers it needs to request any information that an entity holds. If the FMA then wants an expert to analyse that information, there is nothing to stop it from engaging an expert to carry out that work.

39. Our concern is that if the FMA has the ability to require entities to pay for experts to carry out the FMA's work for it, then the result will be disproportionate burdens on industry and distraction from our core business.

Effective financial dispute resolution

40. Our view is that MBIE is looking at the wrong issue and is asking the wrong questions as far as dispute resolution is concerned.

41. The real question to ask is which financial services businesses have incentives to facilitate good dissatisfaction resolution services (of which formal disputes resolution is only one strand) to their customers and which do not and why. Once that has been established, more work can then be done to target the specific problem areas.

42. Logically the following factors would make a financial services business much more inclined to provide good dissatisfaction resolution to its customers:

a. The customer has the ability to switch to another provider easily **and** losing the customer would mean loss of an ongoing stream of revenue that would matter to the provider;
b. The financial provider is sensitive to negative recommendations;
c. The potential value of resisting the customer is not significantly greater than the cost/ effort/ time involved in resisting the customer; and

d. The incentives, culture and value of staff involved in responding to complaints is aligned with wanting to help the customer.

43. Based on the factors described above, MIS managers in general, and KiwiSaver providers in particular, would have strong reasons to go to significant lengths to keep our customers happy because:

    a. We may spend significant amounts of money to win customers upfront, we hope to retain customers throughout their entire working life and their value increases over time as their balances increase;
    b. Customers can (and do) switch providers very easily if they are dissatisfied. This is particularly true for customers of boutique providers that customers had to actively seek out to join in the first instance; and
    c. We are all sensitive about our reputations as there are over 25 KiwiSaver providers in the market and our sector is under constant scrutiny and comment from media and regulator.

44. Conversely, it easy to imagine that certain kinds of other financial product have the opposite kinds of incentive built in. For example, where customers are essentially locked into using a particular provider in a practical sense for their product or credit facility, or where the amount the customer is seeking from the provider as recompense to a wrong is a very large amount, you would expect to see more tension in the system. Identifying these kind of areas where there is less reason to settle a problem in a mutually satisfactory way would be the kind of thing that a good policy review would shed light on and seek solutions for.

45. The current set of questions and proposals are unlikely to achieve much because they would not address who has reason to find a solution for their customers and who does not. They will however, likely drive up costs to both the taxpayer and financial sector to the extent that they simply result in more oversight and KPIs that do not address the things that might be problematic in the framework.

Final remark

46. For a consultation paper that has been put forward under the auspices of removing "undue compliance costs for financial markets participants" , there is very little in the way of anything that will benefit MIS managers:
    a. The proposal for a single licence will bring us as many annoyances as efficiencies; and
    b. Every other proposal impacting us is directly negative for us, without really creating public welfare:

i. Requirement to seek permission for changes of control would result in sand in the gears of the M&A process to fix a problem that doesn't seem to exist;
ii. Giving the FMA powers to enter without a warrant would barely if ever needed from an enforcement stand-point, but would serve as a precedent to further erode civil liberty in some other context and so is net negative from a public welfare perspective;
iii. The ability to require participants to do the FMA's own work by forcing them to engage experts to perform analysis (which the FMA could commission itself if it were minded to) will likely result in disproportionate burdens based on our previous observations; and
iv. Proposed changes to dispute resolution seem to involve a lot of administrative activity, hence costs, without getting at the problem parts of dispute resolution. The best way to understand where there are problems would first be to study the incentives that exist within the framework.

Yours sincerely

Privacy of natural persons

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