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REVIEW OF THE FINANCIAL ADVISERS ACT AND FINANCIAL SERVICES PROVIDERS ACT: ISSUES PAPER

ASB SUBMISSION

1. INTRODUCTION

ASB Bank Limited (ASB) welcomes the opportunity to provide feedback on the review of the Financial Advisers Act 2008 (FA Act) and Financial Services Providers (Registration and Dispute Resolution) Act 2008 (FSP Act)(together, the Acts).

ASB believes that access to quality financial advice is essential for the financial security and wellbeing of New Zealanders and we support the comprehensive review of the regime to ensure that it is fit for purpose and meets its intended objectives. We acknowledge the high level of engagement that has occurred during the initial stages of the review and we look forward to future discussions with officials.

This submission identifies broad thematic principles, along with detailing two key issues (the QFE model and future proofing the regime). We also make some more incremental and technical suggestions in the Appendix.

We acknowledge that ASB's submission will be made publically available by being published on MBIE's website and we are comfortable with this. However, please note that the following are commercially sensitive and should not be published: footnote 5 (pg. 2), footnote 11 (pg. 4), footnote 12 (pg. 4), footnote 24 (pg. 8) and footnote 25 (pg. 8).

If you have any questions relating to this submission, please contact Damian Lawrence, Head of Regulatory Affairs, on 18(d) or 18(d)

2. BACKGROUND TO ASB

ASB is a QFE Group, which comprises ASB, and the following associated entities:

- ASB Group Investments Limited
- ASB Securities Limited
- Aegis Limited
- Commonwealth Bank of Australia (New Zealand Branch)

The QFE Group provides financial advice to clients in relation to:

- consumer lending
- transactions and savings accounts
- Bank term deposits and specified PIE's
- Life and General Insurance
- Managed Funds including ASB KiwiSaver Scheme
- Derivatives and fixed income products.

The QFE Group provides a range of financial adviser services to clients including financial advice, investment planning services, broking services and a Discretionary Investment Management Service. The QFE Group employs approximately 5000 people (excluding contract staff, temporary staff and vendors). Of these, 2900 employees (57%) will or may provide a financial adviser service including:

- Authorised Financial Advisers (AFA's),
- Category 1 QFE advisers[1] and
- Category 2 QFE advisers.[2]

[1] QFE advisers who provide personalised services to retail clients in relation to category 1 products where ASB or a member of the ASB QFE group is the product provider and category 2 products.

[2] QFE advisers who provide class services to retail clients and personalised services to retail clients in relation to category 2 products.

3. KEY PRINCIPLES

3.1. *The Acts have had a positive impact*

In comparison to the landscape pre-2008, and noting that they are still in their relative infancy, the FA Act and FSP Act have had a positive impact on processes and standards for participants across the industry. In this respect they are broadly meeting the objectives of the legislation.

3.2. *Opportunity for incremental change but no case for material reform*

There are areas where improvements could be made to better achieve the objectives of the legislation. We outline a number of incremental issues that, if addressed, will assist in making the regime more workable and also enhance customer outcomes. In our view however, fundamental reform to the regime is not needed, and any change should be justified by demonstrable systemic harm or market failure. To the contrary, the long-term certainty of the Acts is a worthy goal, as this will ultimately enable consumers to understand the regime over time and grow their confidence in the industry.[3]

3.3 *Focus on alignment*

The banking industry has experienced significant regulatory reform over the past 5 years.[4] This changing landscape means a reasonable period of bedding down is required across the wider suite of financial services regulation, in order to fully appreciate the impact of these reforms on the provision of financial advice in New Zealand. We recommend that resources are best spent on aligning the different regulations to ensure consistency and workable interplay across the broader regime, as there are already areas of clear overlap and inconsistencies, which, right from the outset are leading to complexities. For example, there are multiple terms for customers with similar characteristics (wholesale investors, wholesale clients and eligible investors across the FA Act and FMC Act). The suitability provisions under the Responsible Lending Code, FMC Act and FA Act is another example, as is the fair dealing provisions under FMC, FA and Fair Trading Acts and also the fit and proper requirements under the prudential and financial markets regimes.

3.4 *Financial capability is an important part of the solution*

Improving the financial capability of consumers will lead to better consumer outcomes across all three of the FA Act goals - information, access and confidence. Care is needed not to get preoccupied with regulatory reform at the expense of improving financial capability, an important part of the solution. We support the positive work being performed by the

[3] Take KiwiSaver for example; we believe the constant tweaking of rules confuses consumers and disengages them.

[4] In particular, the Financial Markets Conduct Act 2013, Anti-Money Laundering and Countering Financing of Terrorism Act 2009, as well as significant reform to the Credit Contracts and Consumer Finance Act 2003 and the Fair Trading Act 1986 have had a significant impact, as has the flow on effects of international reform.

Government, Commission for Financial Capability and the FMA in relation to improving the financial capability of New Zealanders. In particular, we acknowledge the FMA's work in developing the investor capability strategy and recognising the need to improve access to advice as well as work more closely with business for input and collaboration. ASB's investor confidence survey shows that few respondents rate their level of understanding about savings and investments as high and only a small number have confidence to make the right decision.[5] This highlights that there is much more work to be done, and the need to promote to consumers the value of seeking out professional advice.

[5] 9(2)(ba)(i)

4. KEY ISSUES

4.1. *The QFE system achieves the goal of consumer protection, promotes confidence and improves accessibility of advice*[6]

4.1.1. The QFE system significantly improves the efficiency and effectiveness of the regime. The model was originally designed to '*reduce the compliance costs of institutions with large numbers of advisers whilst ensuring appropriate regulatory coverage of advisers within these institutions*.'[7] Whilst we understand the level of regulatory scrutiny over existing QFEs, in many respects these compliance savings have not been realised as originally intended. Examples of situations which appear contrary to the original objectives of the QFE model include:

- AFAs under a QFE have to separately hold licenses and prepare their own ABS's;
- A QFE should supervise its AFAs, yet in practice the FMA monitors both QFEs and its AFAs;
- QFEs are required to report annually on minor incidents.

4.1.2. It is unfortunate that there is the perception that lower standards apply to QFEs and that there is a lack of transparency, as noted in the issues paper.[8] This perception does not reflect reality and there is no evidence of consumer harm emanating from the QFE model. QFEs are subject to rigorous compliance and consumer protection obligations, strong accountability requirements and more intensive supervision by the regulator, as well as typically being governed by other regimes such as comprehensive prudential regulation. Taken collectively, this provides high levels of consumer protection and adds significant value to the broader regime.

4.1.3. To the contrary, we believe that QFEs contribute to the public confidence objectives of the FA Act. Surveys conducted by ASB show that customers have confidence in ASB as a financial services provider. Customers value the advice received by ASB,[9] have a high-level of satisfaction with ASB as a KiwiSaver provider, and have a good level of confidence in the advice provided.[10] In addition, recorded complaints relating to advice are low.[11]

4.1.4. In addition, QFEs play an important role in introducing new advisers into the industry, which supports the accessibility of advice objective of the Acts.

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[6] Questions 22, 23 and 63 of the Issues paper.

[7] Financial Advisers Bill cabinet paper: Amendments to Policy design

[8] Point 203 (pg. 48) of the Issues Paper

[9] ASB Wealth and Insurance Voice of the Customer July 2015.

[10] 9(2)(ba)(i)

4.1.5. We also note that class advice, a common feature of QFE institutions with a large number of advisers, is a crucial feature of the regime. We outline our views on the importance of class advice in more detail in the Appendix.

4.1.6. Whilst we acknowledge the importance of adviser disclosure in helping providing consumers with the information they need, there is an opportunity to make the framework more meaningful and useful for consumers. For example, the two-tiered disclosure requirements for AFA's [12] process is unwieldy and should be removed. The current disclosure requirements for QFEs results in a double up of information that is already provided to consumers elsewhere. This makes disclosure a liability box-checking exercise for the adviser, and does not provide any additional benefit to consumers – effectively circumventing the goals of the legislation. Anecdotal feedback from customers indicates that they do not see value in receiving (often repeatedly) disclosure. Simplification of the disclosure requirements, particularly by category 2 QFE advisers, could be done in conjunction with increasing consumer financial capability. This would improve public confidence and mean that disclosure of information that is genuinely relevant to that customer (such as conflicts in relation to that particular advice) will actually assist them in making an informed financial decision.

4.2. *Future proofing the regime*[13]

4.2.1. The pace of change in the broader financial services landscape is fast and the risk of disruption high. Increasingly participation is coming from non-traditional sources, especially digital technology. Policy and regulatory settings should be neutral as to the delivery channel and durable to accommodate and encourage new innovations, whilst safeguarding the consumer. In this sense, we advocate for a principles based framework. As noted in the FSI Final Report:

> *"Technology-neutral regulation enables any mode of technology to be used and tends to be competitively neutral. Generally, regulation should be principles-based and functional in design, focusing on outcomes rather than prescribing the method by which it should be achieved."*[14]

4.2.2. There is no doubt that technological advances present exciting opportunities, for example, enabling improved access to and lower costs of advice. We anticipate that they will be increasingly used by consumers, especially younger ones. Trends observed in the advice field include:

[12] Primary and secondary disclosure: s5 and s6 of the Financial Advisers (Disclosure) Regulations 2010.

[13] Questions 53 and 54 of the Issues paper.

[14] Financial Systems Inquiry: pg. 270 (7 December 2014).

- How human beings interact with a machine to achieve optimal consumer outcomes. Topical areas include robo-advice,[15] machine learning (where a machine teaches itself) and cognitive computing. For example, DBS Bank uses a blend of cognitive computing and human interaction to derive actionable insights for its wealth advisory services, and it has been noted that:

> *"This helps reinforce trusted client relationships, empowers customers to make smarter financial decisions and provides consistent and differentiated advice to customers."* [16]

- How providers analyse large amounts of data (much of it about their customer) to better understand customer needs and propose solutions. This is commonly referred to as intelligent data analytics.[17]

- Social media could transform the way advice is given and also how consumers educate themselves on financial matters. The portal Phroogal, which enables social collaboration to share knowledge and get access to financial experts, is a good example.[18]

4.2.3.We understand that such innovations also present additional risks. As noted by PWC,[19] regulators and regulatory settings need to adapt to these changes. The Issues Paper notes that the scope of financial services may no longer be restricted to a set of regulated institutions, but could be opened up instead to a more diffuse set of commercial enterprises. With this, the scope of the regulatory challenge widens and becomes more complex, and the core focus becomes the resilience of the network rather than of a set of institutions within it. Questions such as who is responsible for defective advice of e.g. the consequences of a rouge machine and how regulations and regulators supervise non-traditional players are factors to consider when attempting to future-proofing the regime.

4.2.4.A practical solution to future-proof the advice framework would be to allow appropriately licensed entities, for example a QFE, to be able to give personalised financial advice. Allowing a licenced entity to give advice would:
- allow for flexibility of delivery and access to advice through channels other than traditional face-to-face interaction with an adviser, and
- accommodate technological developments not yet contemplated.

4.2.5.In addition, we recommend that the review seeks to clarify that targeted advice based on known or deduced characteristics that the consumer shares with others in a cohort meets the definition of "class" advice.

[15] Robo Adviser 2.0: A brave new financial services industry: Forbes insights (30 October 2014).
[16] Reshaping wealth management through cognitive computing: wealth.management.com (20 April 2015).
[17] The role of intelligent analytics in retail banking: bankingtech.com (8 July 2015).
[18] Phroogal.com
[19] Future shape of banking: PWC (July 2014)

5. ADDITIONAL COMMENTS

Key Goal	ASB Suggestion	Question
Information	The issues paper states that a significant majority of consumers spoken to by MBIE do not **understand the differences** between the classes of financial advisers[20] and suggests that this is a concern because such uncertainty runs counter to reducing consumer information asymmetries and the public confidence objectives.[21] Even if this is the case, no evidence is provided to demonstrate that this issue in itself is causing undesirable consumer outcomes or that this creates a strong driver for change. Further, it cannot be assumed that making changes to the regime,[22] even with the best of intentions, would make the regime simpler for consumers and/or would automatically lead to reduced information asymmetries or increased public confidence. Rather than reform or attempting to get consumers to better understand the 'details' of the regime (e.g. the distinction between an AFA and an RFA), focus should be on educating consumers on the benefits and availability of financial advice. In addition, given the relative infancy of the regime, further time is required to bed down the regime and understand whether this is really an issue for consumers or just a reflection of consumers adjusting to the significant reforms that have occurred over the past 5 years.	8, 35
	We encourage practical, balanced and well-considered **best practice guidelines**. Further clarity around the boundary issues of 'advice' and on what constitutes a material breach for reporting purposes would be useful.	34
	Minor tweaks to the language of the regime with a focus on **plain English** is a practical way to assist customer understanding – e.g. category 1 and 2 products could more helpfully be called complex products and simple products.	35, 37
Accessibility	Anecdotal evidence suggests that **uncertainty around the advice definition** (including non-advice categories) results in advisers adopting an overly cautious approach, which impacts accessibility to advice. Clarification on the distinction between these concepts would provide certainty to institutions and ensure a level playing field around when a person is providing advice, the type of advice provided, and what the requirements are, compared to when they are selling a product and what	3, 13

[20] As well as their different obligations and abilities to advise on different products and types of advice (point 115, pg. 32 of the Issues paper).

[21] Point 117(pg. 32) of the Issues paper.

[22] For example a product-focused system, as is in Australia.

	the selling requirements are. In particular, the issue of implied advice is problematic,[23] given the current subjective nature of the test. To help improve certainty for providers in what type of advice they are delivering, the current definition should be replaced with an objective "reasonable consumer in the particular circumstances" test.	
	There is opportunity to clarify the parameters around **limited or scaled advice**, a common service requested by consumers. The regulations should make it explicit that it is acceptable to provide advice relating to a limited mandate if the customer is fully informed and agrees that this is the service to be provided. A common example is for a consumer to ask for an adviser to compare two (or more) types of insurance providers for a particular risk product, expressly stating that he or she does not want their broader financial needs considered.	3
	Introducing **product designation powers** for the regulator to allow products to be reassigned to another category – similar to the FMC Act provisions. This would provide flexibility, support innovation and is a practical tool to future proof the regime.	5,
	Class advice is a critical feature of the regime. The perception that such advice is somehow inferior to 'personalised' advice (especially in relation to KiwiSaver) is incorrect. Class advice contributes to the accessibility of advice and enables advice to reach the mass market. For example, it is available to consumers who do not want to go through a full personalised advice process. It also overcomes cost to serve barriers for providers that would otherwise limit access to advice for consumers without the means to pay for that advice. Further, class advice enables a consistent standard of advice to be delivered to consumers and mitigates conduct risk relative to a personalised advice process (which is bespoke). It is entirely appropriate for products to be offered on a class advice basis if the consumer so chooses. In our experience, consumers prefer class advice[24] and have high satisfaction levels under this model.[25] We suggest that any changes to the regime that discourages the provision of class advice would have negative accessibility implications.	5, 45
Public Confidence	The disclosure framework is the proper place to address any **conflict of interest** issues. Public confidence will be enhanced by lifting the transparency and quality of disclosure of conflicts. Regardless of adviser type, where a real or perceived conflict exists, this should be adequately	9, 10, 24, 33, 38, 40, 41, 56

[23] Section 15(1)(ii) of the FA Act.

[24] 9(2)(ba)(i)

[25] 9(2)(ba)(i)

	disclosed to the consumer. Banning or restricting some remuneration structures could result in the unintended consequence of limiting access to advice for some product types. The current legislation is sufficient to address any ethical concerns around conflicts of interest.[26] In addition, the FMA has appropriate enforcement powers under the existing regime to deal with conflict of interest issues. Although we acknowledge that some level of regulatory prioritisation is required, especially given limited resources, transparent and visible enforcement should occur across all financial advisers as this will help to address the (real or perceived) issues relating to conflicts of interest for some adviser types.	
	There is merit in extending the **financial advisers disciplinary committee** framework to all advisers (not just AFAs) as this will improve the level of consistency and transparency of how advisers who do not meet professional standards are dealt with, which ultimately supports the public confidence objective.	21
	There is no evidence that the current formal **education standards** are inadequate or resulting in consumer harm. We believe that raising them would not in itself result in better consumer outcomes. It should be recognised that formal education is only one aspect of competency and that there are other equally important aspects to competency, for example, continued professional training, on the job learning, mentoring and supervision.	57, 58, 59
FSP register	There is opportunity to raise the **public awareness of the FSP register**. This should form part of the financial capability framework. In addition, the information could be more meaningful and useful e.g. providing additional information like qualifications, disciplinary records, product specialisation and membership to relevant professional bodies	76, 77
Disputes resolution schemes	The **$200,000 limit** for Disputes resolution schemes works well in practice and there are reasonable provisions around when consideration will be given to move outside this limit. In 2014/15 the Banking Ombudsman Scheme declined just two disputes across the entire industry on these grounds, so there seems no strong driver for change. In general, access to and the benefits of dispute resolution schemes could be better promoted and understood – this should form part of the financial capability framework.	71, 72, 74, 82

[26] The care, diligence and skills provisions under s22 of the FA Act are adequate to deal with inappropriate ethical behaviour.