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Financial Markets Policy
Building, Resources and Markets
Ministry of Business, Innovation & Employment
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SUBMISSION ON EXPOSURE DRAFT FINANCIAL SERVICES LEGISLATION AMENDMENT BILL

1. Financial Services Complaints Limited (**FSCL**) welcomes the opportunity to make a submission on the exposure draft Financial Services Legislation Amendment Bill and Consultation Document issued on 17 February 2017.

2. Our submission is made on the basis of our experience as an approved dispute resolution scheme for over 6,700 financial service providers, including over 1,500 individual financial advisers and 350 QFEs or large companies which have a further approximately 4,000 advisers. In addition, in the calendar year to 31 December 2016, we handled 338 initial complaints from consumers about financial advisers and formally investigated 44 complaints.

3. We have not commented on aspects of the draft Bill or Consultation Document which are not directly relevant to our work as a dispute resolution scheme or to issues we have considered in our complaint investigations.

4. FSCL is happy for this submission to be made public as part of the consultation process.

General submissions

5. FSCL strongly supports the intended simplification of the regime and removal of unnecessary compliance and regulatory boundaries.

6. However, we believe there is more work to be done before the regime is readily accessible to consumers and indeed to parts of the finance sector including the large number of individuals who were formerly termed 'Registered Financial Advisers' and who now will be drawn more closely into the regime.

7. For example:

   a) **Defined terms:** Some of the terms used remain opaque and do not in our view accurately reflect the roles of the people or activities to which they are assigned. A particular example is the term 'financial advice representative' which we believe carries a 'halo' of apparent accountability, liability and competence to an average consumer regardless of the adviser's actual position.

- **(b) Liability and accountability mechanisms:** There is potential for significant confusion between the roles of the various regulatory participants in the new legislation. Particularly: the role of the dispute resolution schemes and their interaction with the roles of the Financial Advisers Disciplinary Committee and the FMA, and
- the relationship between civil liability for breach of duty, disciplinary liability for breach of duty, common law liability for negligence or breach of contract and liability under other legislation

need to be clearly understood and articulated.

b) **Sales vs advice:** one of the key concepts emphasised in the earlier options papers was the need to strengthen the ability of consumers to understand whether they were receiving advice, or were being 'sold to'. That concept does not seem to feature in the draft Bill. Its exclusion would be a significant loss to the effectiveness of the new regime.

It may be that it is proposed that the disclosure proposed to be prescribed by regulations under section 431L will cover information about whether the person who purports to be their adviser is actually providing advice or 'selling' a product. If so, we recommend that this be at least signposted in the Act so this important factor that was a key theme of earlier consultation, is not lost.

8. Finally, we think the format and layout of the proposed amendments – with sections and schedules of the Bill introducing new sections to be scattered throughout the FMCA – is confusing for non-lawyers to navigate and construe. It presupposes a high level of familiarity with the FMCA and the ability to navigate complex legislative structures.

This is not a skill within the set of the average financial adviser or member of the public and will inhibit understanding of, and compliance with, the new law. At the least, it will cause advisers to incur significant legal costs to understand and implement the change and is likely to result in an over-legalistic, rather than a practical and industry-led, implementation of the new concepts.

We encourage you to find other ways of articulating the changes, for example:

a) to include all the financial advice and dispute resolution provisions in a stand-alone schedule that incorporates the concepts (such as the penalty provisions) it needs to carry across from the rest of the FMCA, so that the financial advice laws are stand-alone and can be readily accessed by financial advisers; or

b) at least, to produce a marked-up version of the FMCA showing the new sections in-situ and with navigation aids and explanatory notes.

FSCL's answers to your questions

9. **Question 5: duty to put client's interests first:** we strongly 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 advice. We consider the duty to be fundamental to the role of a professional adviser and it should apply to all actions an adviser takes in giving, and in relation to, the advice both at the time the advice is given and throughout the adviser's relationship with the client in relation to the product.

   We think the wording of section 431H could be further strengthened in that it may be taken to suggest that 'in relation to the advice' is limited only to actions directly connected with the act of giving the advice (eg doing research, preparing a memorandum of advice) and may not apply to downstream actions an adviser takes to implement the advice on behalf of the client such as arranging subscription for the recommended products or to later replace the product with another.

   We suggest amending the first sentence of section 431H (2) to read 'In giving the advice or doing anything in relation to the giving or implementation of the advice...'

10. **Question 6: inappropriate incentives:** we support the proposed duty that a provider must not give a representative any kind of in appropriate payment or incentive - 'you get what you reward'.

    We consider the proposed wording of section 431O is appropriate and should cause financial service providers to think carefully about the outcomes their remuneration and reward structures encourage.

    However, while acknowledging that financial advisers are personally liable for their practice and breaches of duty, we think the concept in section 431(1)(b) should be extended to apply to the relationship between financial advice providers who distribute products through financial advisers as well as those who distribute through financial advice representatives.

11. **Questions 11 and 12: liability for financial advisers, defence for financial advice providers:** as referred to in paragraph 7 the relationship between civil liability for breach of duty, disciplinary liability for breach of duty, common law liability for negligence or breach of contract, and liability under other legislation, such as the consumer credit regime, needs to be clearly understood and articulated.

    The extension of 'civil liability' to the financial advice arena is a significant change that requires more discussion and consideration in this context.

Sanctions and remedies available under and in support of the current regime are:

a) **Criminal liability:** fines of up to $100,000 for an individual and $300,000 for an entity.
b) **'Public' civil liability:** public consequences by way of pecuniary penalties and compensation orders play a minor role and apply only for breach of the wholesale certification requirements or conduct obligations related to DIMS.
c) **Administrative actions:** cancellation of licence or temporary banning orders may be made by the FMA.
d) **Disciplinary proceedings:** referral by the FMA to the FADC for breaches of the Code by AFAs. Sanctions include censure, fine up to $10,000, ordering training.
e) **Dispute resolution:** mandated by the FSP Act, but otherwise governed by the dispute resolution scheme's rules. FSCL's Terms of Reference allow us to consider and provide redress of up to $200,000 for direct financial loss.
f) **'Private' civil liability:** brought on an individual or class basis for those complainants who can afford to do so.

The public sanctions of criminal, civil and disciplinary proceedings are clearly important, but we know from experience, that the vast majority of complainants' primary motivation in making a complaint of any kind is to obtain financial compensation.

As currently drafted, the Bill extends the concept of civil liability so it becomes a principal liability mechanism to be used against financial advice providers, which is where most liability (and assets to satisfy them) will sit.

Care must be taken to ensure that in opening up the possibility of civil liability proceedings (and the capacity for the court to make a compensation order) the principle of double jeopardy does not prevent individual complainants – either in fact or in law - from taking a complaint to the adviser's dispute resolution scheme and so obtain prompt, practical and affordable redress.

For example, while we acknowledge that the FMA's role is regulatory (rather than consumer protection as such) we would like to see the FMA be required to proactively inform customers of financial advisers or financial advice providers against whom they have taken regulatory or referred for disciplinary action, of the availability of the dispute resolution scheme.

In any event, as currently drafted, there is capacity for confusion about the nature of the 'civil liability' referred to in 431E(4) and the references to it could be read as referring to common law civil liability (ie liability under the laws of contract and negligence) and be seen to operate effectively as a limitation on liability for the negligence of a financial adviser (either personally or falling on his or her financial advice provider).

We acknowledge that for the persistent reader, the point is clarified in section 431E(7) but we suggest that the words '(see subpart 3 of Part 8)' and a brief description of what these liabilities are, is inserted next to each reference to civil liability in the newly inserted sections, in common with other usage throughout the FMCA.

You ask specifically whether:

a) **Financial advisers should have direct civil liability for breaches of their obligations.** We think they should, but with an appropriate defence for advisers whose breaches are the result of organisational settings and choices made by their financial advice provider.

b) **Whether the regime should allow financial advice providers to run a defence that they met their obligations to have in place processes, resources etc to enable their advisers to comply with their duties.** We think they should not. We accept that a financial advice provider cannot anticipate and avoid all inappropriate behaviour such as theft or deliberate wrongdoing among its representatives. It can, and should, however be held to strong obligations to supervise and otherwise 'own' the behaviour of its representatives.

   As well as providing a mechanism by which a financial advice provider could 'dis-own' the actions of its representatives from a regulatory and disciplinary point of view, such a defence could put at risk the ability of a consumer to seek compensation through the dispute resolution scheme or the courts by setting an inappropriately high hurdle to liability in negligence or contract.

12. **Question 14: 'retail service':** we think applying a concept of 'retail service' to financial advice services is appropriate and we agree that once a service is provided to one retail client, the whole service should become retail even if the other clients of the service are wholesale. Capacity for confusion (both at client, adviser and wider market levels) and reputational contagion otherwise arises.

    As noted in our answer to Question 24, however, we consider the definition of 'wholesale client' needs to be revisited.

13. **Question 16: territorial application:** we think the proposed territorial application of the FSP Act will help address misuse of the FSPR, though we note that the number of overseas financial service providers applying for membership of FSCL has dropped significantly since the early days of the regime. We currently have approximately 100 overseas based transactional service providers out of a total scheme membership of 6,700.

We do think there is potential for unintended consequence in the drafting of proposed new section 6A(2)(d) of the FSP Act (see clause 57 of the Bill) in its reference to a proposed 'threshold' below which a person cannot register under the FSP Act.

The regulations prescribing the threshold will require very careful drafting to ensure that the threshold does not create capacity for unscrupulous financial service providers to operate in New Zealand at an apparently low level but with potentially high individual impact without providing their NZ clients access to a dispute resolution scheme.

14. **Question 18: other measures to promote access to redress:** we support your suggestion that the legislation should provide that dispute resolution schemes may refuse or terminate membership if a provider is not engaging with the scheme. FSCL's Participation Agreement (paragraph 4.2) already provides for participation to be terminated if a participant breaches its obligations – a power which we have used on several occasions.

    We would also like to see the disclosure regulations require a registered provider to notify their clients about the availability of their dispute resolution scheme at the time a complaint is received, not only when point of sale disclosure is provided as under the current regime.

15. **Question 20: provision of information by dispute resolution schemes:** we support your suggested clarification of the requirement on dispute resolution schemes to provide information to the FMA.

    As currently drafted the obligation in 67 of the FSP Act is to report only 'a series' of material complaints. There have been, and we expect will continue to be, circumstances in which a single, but highly material, complaint about a licensed provider or class of licensed provider should properly be communicated to the FMA so it can carry out its statutory functions.

    We note the 'high' materiality threshold for notifying single complaints would need to be clearly defined by reference to the impact of the behavior complained of (for example, large number of customers affected or unusually significant loss) to avoid the need for the schemes to notify the FMA of a large number of complaints in circumstances where the most appropriate outcome is individual compensation.

    We would not want to see an obligation to report every single complaint, no matter how minor, for fear that would prejudice our ability to negotiate early settlements of complaints.

16. **Question 24: 'wholesale' definition:** we do not support the re-definition of 'wholesale' status for financial advice purposes and consider the test should be consistent across

the FMCA (including the new financial adviser provisions). This will promote investor, adviser and wider market understanding and reduce the capacity for deliberate or accidental mis-classification of investors.

As a starting point, we consider the proposed $1m asset/turnover test for entities to be too low – the level should at least match the equivalent FMCA levels of $5m.

However, we think there is also a case for further alignment with the exclusions in Schedules 1 and 3 of the FMCA under which (broadly) the following are excluded:

a) **Wholesale investors:** being investment businesses (entities regulated by the FMA or the RBNZ) or people who meet investment activity criteria (those who have carried out acquisitions of complex financial products of at least $1m or who have recent experience working and participating in the decisions of an investment business), are 'large' (assets/turnover of at least $5m) and government agencies.
b) **Close business associates:** including directors and senior managers, people who hold material proportions of the issuer's voting shares or are otherwise in a close professional or business relationship with the offeror that allows them to assess the merits of the offer or obtain information that will enable them to do so.
c) **Relatives:** of the offeror or its directors.

17. **Question 25: execution only services:** we would support an explicit exception from the definition of regulated financial advice for lenders providing services that are subject to the responsible lending code.

18. **Question 26: exclusions from financial advice:** we share the concerns of the Code Committee (its submission of 15 March 2017) on this question and particularly their submission that

d) the excluded occupations be subject to specific basic conduct obligations; and
e) the relief be subject to the restriction that the advice is a necessary incident of the professional activity in question.

19. **Questions 30-32: jurisdiction of FADC:** we support the extension of the FADC's jurisdiction to cover disciplinary proceedings against financial advice providers. To omit them would leave a significant gap in the private dispute/disciplinary/public consequences nexus outlined in paragraph 11. Our comments in that paragraph are also relevant.

20. **Question 38: timescale to competency:** we consider a transitional timeframe of two and a half years for competency cutover is too long and will lead to undesirable confusion and potentially loss of confidence by customers.

The new competency standards will be targeted and 'right sized' to the degree of complexity and sophistication of the particular adviser's business. On the assumption that:

f) the advisers who will have the furthest to travel in terms of competency growth (the RFAs) will give the least complex advice and therefore be subject to the lightest competency requirements;

g) the advisers who give the most complex advice (the AFAs) are already qualified at least to Level 5;

a shorter transitional period does not seem unattainable.

We encourage you to look for the shortest transitional period possible.

21. **Questions 43 and 44: competency assessment for existing AFAs and RFAs:** we do not oppose the concept of an 'assessment process' for very experienced AFAs and RFAs per se. 10 years seems an appropriate experience level. We note, however, that the assessment would need to be very robust and externally moderated to take the place of a structured qualification framework.

Conclusion

22. We are happy to work with the Ministry over the months ahead to discuss issues raised by our submission and to answer any questions you may have.

Yours sincerely

REDACTED

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