FINANCIAL SERVICES LEGISLATION AMENDMENT BILL EXPOSURE DRAFT AND NEW FINANCIAL ADVICE REGIME CONSULTATION PAPER

7 April 2017

SUBMISSION BY SOVEREIGN[1]

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Sovereign welcomes the opportunity to provide feedback on the Ministry of Business, Innovation and Employment's *Consultation Paper – New Financial Advice Regime* (the **Consultation Paper**) and Financial Services Legislation Amendment Bill Exposure Draft (the **Exposure Draft**).

This submission makes both general comments on the proposed regime and answers specific questions from the Consultation Paper. General comments have been marked as such, while specific questions have been referenced.

Sovereign has also contributed to the submission on this matter being made by the Financial Services Council (**FSC**) and we support the points made in that submission.

Sovereign does not seek confidentiality for any aspect of this submission (though, for commercial or privacy reasons, it may request confidentiality of any further supporting information that the Ministry might seek).

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  REDACTED

[1] "Sovereign" is defined as Sovereign Assurance Company Limited, Sovereign Services Limited, and associated entities.

PART 1 – About Sovereign

1.1. Sovereign is New Zealand's largest life insurance company protecting over 741,000[2] New Zealanders and their families through the provision of life and health insurance using a range of distribution channels. Sovereign insures total sums insured of over $120 billion[3] and last financial year paid out more than $374 million[3] in claims.

1.2. Sovereign has an A+ (superior) financial strength rating from A.M. Best. Our life insurance market share is 28.0%[4] and our health insurance market share is 6.9%[4].

1.3. Sovereign is a Qualifying Financial Entity (**QFE**). Sovereign has approximately[5] 700 employees and as at September 2014, approximately 200 employee roles were permitted to provide class and/or personalised financial advice as QFE employee advisers.

1.4. Sovereign is a subsidiary of Commonwealth Bank of Australia and a related company of ASB Bank Limited (**ASB**).

[2] This includes policy owners, life assured, borrowers and workplace business
[3] Sovereign internal reporting as at 30 June 2016
[4] FSC Market Share Report December 2016
[5] An approximate is given as staff turnover results in vacant roles which can fluctuate on any given day

PART 2 – Policy intent

2.1 Sovereign supports the primary objectives of the new financial advice regime (the **New Regime**), to achieve a more informed and confident participation of consumers in financial markets. We want customers to be able to make sound financial decisions that protect themselves and their families from adverse future events.

2.2 For consumers to make important financial decisions it is critical that they receive appropriate advice and information at the right time in a way that is appropriate to their personal situation. For this reason it is essential that the market offers a range of advice options to ensure all New Zealanders can access expertise when required.

2.3 Accessibility needs to be matched by trust in the integrity of services being provided by the market.

2.4 Customers must have confidence in the financial services sector and this can only be achieved through clarity regarding the roles and responsibilities of advice providers. This clarity must be supported by customers accepting their decisions when they have been treated fairly but also having the opportunity to seek recompense when they are not treated appropriately.

2.5 The New Regime is part of the solution to improving the quality of financial advice in New Zealand. When linked with licensing regulations, the Code of Conduct and activity of market participants, it should improve the financial services landscape in our country. As such, having the end customer at the core of any decisions has been a guiding principle for Sovereign when developing this submission.

2.6 We note that the proposed changes are likely to cause disruption to the industry. However, we are confident that through regular government consultation and engagement with the market, the final legislation will result in an industry that meets customer objectives by improving capabilities, standards, and support mechanisms.

2.7 Underpinning this customer experience with a licensing framework that reflects, and is proportionate to the different business models of product providers and advisers, is essential. There must be no bias, preference or restrictions placed on any single advice channel or structure.

2.8 The Sovereign submission reflects internal discussion and collaboration with valued external stakeholders including our adviser network, ASB, and the FSC.

2.9 Broadly speaking we endorse the New Regime and look forward to working with government and industry to ensure the future interests of New Zealanders are protected.

PART 3 – Key issues as identified by Sovereign

3.1 Despite our comments in Part 2 that the New Regime largely achieves the policy's objectives, there remain a number of issues that we believe require further consideration in order to provide clarity for industry and the consumer and prevent unintended consequences. These are noted below:

3.2 Duty to put clients' interests first *(relevant to Consultation Paper question 5)*

3.2.1 Sovereign strongly supports the duty to give priority to clients' interests and think it correctly reflects the increased focus on appropriate customer outcomes, and the conduct work undertaken by the Financial Markets Authority (**FMA**).

3.2.2 The heading of section 431H should be amended to 'Duty in relation to conflicts of interest' to better reflect the conflict management nature of the section and avoid an implication of a broader best interests duty".

3.3 Inappropriate incentives *(relevant to Consultation Paper question 6)*

3.3.1 The duty in section 431O (Financial Advice Providers (**FAPs**) to not offer inappropriate incentives) should apply to all FAPs, irrespective of whether they engage Financial Advisers (**FAs**) or Financial Advice Representatives (**FARs**). There is no valid basis to exclude FAPs that engage FAs from this duty , irrespective of any parallel personal duty that the FA might have, particularly noting that the personal duty is limited to disciplinary action only.

3.4 Agreeing the nature and scope of advice *(relevant to Consultation Paper question 8)*

3.4.1 In relation to section 431G, we are concerned that the word 'agree' could be interpreted broadly to require an active bilateral agreement between adviser and client in every instance. This could be problematic in a situation where an adviser is providing advice to multiple consumers. For example, a FAP providing advice intended for more than one person through an online process.

3.4.2 Section 431G should be amended to provide for both one-to-one and one-to-many situations. Where a FAP is providing advice intended only for one person (tailored advice), active bilateral agreement as to the nature and scope of the advice is appropriate. Where advice is intended for more than one person (general advice), the FAP should disclose any limitations on the nature and scope of the advice. The standards for disclosure could be managed through regulations.

3.4.3 Section 431G could be amended as follows:

> **431G Duty to agree on nature and scope of advice**
>
> (1) A person (**A**) must not give regulated financial advice intended for—
>
> (a) only one person (**B**), unless A has agreed with B on the nature and scope of the advice to be provided; or
>
> (b) more than one person, unless A has disclosed to those persons any limitations on the nature and scope of the advice in a clear, concise and effective manner.
>
> (2) This section applies only to a retail service.

3.5 Liabilities for duties *(relevant to Consultation Paper question 8, 12)*

3.5.1 It is important to appropriately incentivise FAPs to ensure that their processes and controls are adequate. FAPs that have taken all reasonable steps to ensure that their FAs and FARs

comply with sections 431F to 431M should not be exposed to possible civil penalties, and their liability should be limited to compensatory orders only. This approach incentivises FAPs to take all reasonable steps to ensure their FAs and FARs comply with their duties, because only by doing so can they avoid possible civil penalties. However, it is still appropriate that the FAP compensates clients for their losses even if the FAP has taken all reasonable steps to ensure compliance.

3.6 Unsolicited meetings *(relevant to Consultation Paper questions 1,2)*

3.6.1 FAPs should continue to be able to make offers during an unsolicited meeting if the meeting takes place in the ordinary course of their business. Therefore, we support clause 10 of Part 1 of the Exposure Draft which retains the current exceptions in section 34 of the Financial Markets Conduct Act 2013. If section 34 is breached, the recipients of the financial product can withdraw, and the offeror (and directors of the offeror) are liable for any failure to repay money owed following a withdrawal.

3.6.2 We do not support any narrowing of the exception. That would lead to confusion as to which rules apply in what circumstances.

3.6.3 Furthermore, we consider that the duty to put a client's interest first and the disclosure requirements of the New Regime combine to provide adequate protection against pressure selling (we note that there are comparable uninvited direct sales provisions in Part 4A of the Fair Trading Act).

3.6.4 In our view, adequate consumer protection is provided by the tightly controlled circumstances around the current exception and the overarching adviser duties.

3.7 Transitional arrangements *(relevant to Consultation Paper questions 35, 37, 38, 39, 43, 46)*

3.7.1 It is important that the Exposure Draft clearly sets out which aspects of the existing regime will continue to be in effect after the New Regime commences until FAPs become fully licensed. This includes detail around whether advisers can take on new staff during this period, what qualifications new staff will need, whether FAPs can advise on new products, and whether the terminology of the existing Financial Advisers Act (**FAA**) will continue during transition. For example, it should be clear how an adviser should explain the concepts of class and personalised advice during the transitional period (where these concepts would otherwise no longer exist under the New Regime).

Question 35

3.7.2 It is difficult to say whether six months is possible to facilitate a successful transition for some industry participants given the unknown shape of the new disclosure requirements and contents of the revised Code, (notwithstanding the competence, knowledge and skill standards will only apply on full licence).

Question 37

3.7.3 During the transition period, FAPs should be able to obtain a limited license that allows them to provide robo-advice, as long as they can meet the robo-advice requirements contemplated by the New Regime. This limited licence should be available as soon as the New Regime takes effect. A limited license of this type would mean large FAPs would not be disadvantaged in their ability to provide robo-advice relative to a new-entrant in the market during the transition period. We understand the FMA is looking at providing relief under the current regime, but rather than stretching the FAA beyond the scope of what Parliament might have intended, it would be better to proactively licence robo-advice under the New Regime in a manner that would ultimately be rolled into a full FAP licence.

Question 38

3.7.4 The proposed effective date of February 2019 for transitional licences sets a very tight schedule for both the legislative process and compliance by FAPs with the provisions that will

come into effect at that time. For this reason, it is important that the industry has the finalised Code, disclosure regulations, and licensing information from the FMA as soon as possible. Any delay in the development of those supporting instruments should be reflected in a delay in the implementation date for transitional licences.

Question 39

3.7.5 Sovereign's expectation is that Authorised Financial Adviser (**AFAs**) would likely only need minimal changes to competency, knowledge and skill requirements. If this is the case we believe that the standard two year transition period is suitable. However, if AFAs are required to complete major changes to competency, knowledge and skill requirements, we believe that consideration should be given to prior investment and efforts by AFAs to achieve qualification obligations.

Question 43

3.7.6 We support the flexibility in the approach of the current AFA Code of Conduct, which allows basic minimum standards to be met by recognising alternate qualifications as equivalent for the purpose of demonstrating competency. We would also support other assessment approaches if they effectively measure the competence, knowledge and skill to the same minimum standard as those required in the new Code of Conduct, noting that experience in the market alone would not be an effective measure.

Question 46

3.7.7 We believe participants should be free to choose when they wish to apply for a licence within the transitional period to ensure a level playing field. A shortened transitional period could result in costs for market participants that need not be incurred.