SIFA INC

SUBMISSION ON

FINANCIAL MARKETS (CONDUCT OF INSTITUTIONS) AMENDMENT BILL

TO FINANCE & EXPENDITURE COMMITTEE

PARLIAMENT BUILDINGS

30 APRIL 2020

Contact: Murray Weatherston AFA

Address: PO Box 28781 Remuera 1541

Phone: (09) 303 1447

Email: murray@finfocus.co.nz

INTRODUCTION

We submit that Bill, however well intentioned, should be sent back to officials for rework. We continue to be amazed that financial institutions have not pushed back very strongly against this legislation. Basically, financial institutions stand accused of doing bad things generally to their consumers, and having consistently failed to design products that benefit their consumers. This is arrant nonsense, and should not have passed even a first level reviewer. We appreciate that "conduct" has become a fashionable catch-cry for regulators, but that does not make it right.

First, we think legislation should have a clear target that has been substantiated. This Bill is based on supposition (unsupported by any strong evidence) that

- financial institutions have not been fair to their customers,
- that current remuneration structures have not led to good consumer outcomes;
- that current incentive structures have led to financial institutions and financial advisers implicitly mis-selling their customers.

While there are a few anecdotal stories floating around, there is no body of evidence that what has been supposed is actually true generally.

Second, there is a lot of change already occurring in the financial markets as a result of the passing of FSLAA to amend FMCA by adding a new Part 6 to cover the provision of financial advice. This is due to kick-off on or after March 2021. This Bill adds yet another layer of change on this existing transformation by adding a Part 6A to FMCA to cover the conduct of financial institutions and their intermediaries.

Third this Bill requires financial institutions who are already regulated by effective licensing under other Acts to obtain a second licence to cover their conduct. This will be a costly change with the businesses required to set up new departments to set out policies procedures and controls to govern their conduct, and internal and external audit processes to ensure that they are complied with. This cost will clearly be loaded onto their consumers either as specific fees or by making their products more expensive than they would have been in the absence of such additional burden.

It would be very interesting to see an old-fashioned cost-benefit analysis that would show the benefit to the consumers vs the additional costs they are going to be levied. But traditional cost benefit analysis seems to have been replaced by a new tick-cross methodology used ex post to justify the policy choices officials and Governments have made

Fourth we believe the key provisions of the Bill are worded only vaguely. There is extensive power under the Bill for Ministers and unelected bureaucrats to increase the regulatory burden on financial institutions by way of Regulations and licensing conditions introduced outside the effective view of the public.

This is especially relevant in two specific areas

(a) The essential thought behind the Bill expressed in proposed s446B, which requires financial institutions and their intermediaries to "treat customers fairly, including by paying due regard to their interests."

This phrase is vague and uncertain. The Cabinet paper says that in that form that concept may be “unenforceable”, and there will need to be some flesh added to the bare bones of the Bill by further Regulations.

(b) The rules that will apply to incentives are completely unspecified in the Bill. It seems that it would be possible under Regulations to at one extreme abolish all commissions or at the other to put a cap on the allowable commission rate without any discussion with the industry. Before you say this couldn’t happen in NZ, let us ask you to take a look over the Tasman to the Trowbridge reforms of commission in the Australian life insurance industry.

Of course, Government is making the soothing noises that this legislation is not designed to put a cap on or abolish commissions. That may be true but the Bill contains a very simple mechanism to be used if tomorrow the Government just happened to change its mind. Who would bet against that possibility?

We do not think that such extensive powers to regulate should be removed from the normal parliamentary process.

Sixth, we think that the requirement for Financial Advice Providers and financial advisers to comply with the good conduct programmes of every provider whose product they advise on will have the perfectly foreseeable result that many advisers will choose to limit the number of providers whose products they will use, and in the extreme will return to being effectively a tied agent to one company – not necessarily in the old way but rather forced into voluntarily adopting that position because of the regulatory impost of this Bill.

Any one of these six matters in itself would seem to give rise to a pause and reconsideration. In aggregate, they demand that the Bill be sent back to its authors, and they be asked to amend it to fix all these flaws.

We pick up some of these issues in more detail below.

What does “treat customers fairly” really mean.

The essential being of the Bill is the obligation under s446B that the institutions must treat customers fairly, including by paying due regard to their interests.

There is no material evidence provided that currently institutions don’t treat their customers fairly.

Whatever happened to the notion that before the Government regulates, it has a responsibility to show what the problem is, and identify what the harm that is being suffered by the consumer?

We have seen comments that authorities believe there are some forms of insurance that consumers are encouraged to waste their money on – e.g. funeral insurance, credit insurance. Try telling that to the widow whose 75-year-old husband has just died, and 18 months ago, they had been “persuaded“ to buy funeral insurance. The essential nature of insurance is for a community to pool the risk for when a peril that could affect all persons actually happens to one of those people.

We would have thought if Government had a view that particular types of insurance policies should be outlawed, they would simply ban those forms of insurance, rather than to load costs onto providers of every form of insurance to solve that particular issue. That would be efficient regulation.

In any event we would have thought that the amount of premiums paid on these forms that they have mentioned as being a bad deal for the purchaser, would be only a very small proportion of the total premiums paid by consumers on all forms of personal insurances.

To make the point more bluntly, if the problem is 5% of the aggregate, why pick on the other 95% at the same time. Unless of course you believe all insurance is either bad and/or overpriced. Or to use another common phrase "because we can!"

The Code of Conduct for Provision of Financial Advice Services has as Standard 1 TREAT CLIENTS FAIRLY which states "A person who gives financial advice must always treat customers fairly".

The Commentary then goes on to say "What is fair depends on the particular circumstances, including the nature and scope of the financial advice. It goes on to say that treating clients fairly should include – note these words suggest that there could be other things –

- Treating with respect
- Listening, considering clients views and responding to their concerns and preferences
- Communicating in a timely clear and effective way
- Not taking advantage of a client's lack of financial knowledge or other vulnerabilities
- Not applying due pressure

Now this standard has yet to become law. So its efficacy has never been tested.

Will this be a sufficient definition of what is effectively meant by the CoFI legislation? The answer is almost certainly no, as the conduct provisions apply much more widely than financial advice. S446C applies the principle to product design, offering to sell any such product, the implementation of a sale to/purchase by the consumer and any post-sale interaction including a complaint.

Financial advisers are going to be required to comply with the definitions of "fair" in the Code and "fair" in the fair conduct programmes of every financial institution whose products they advise on. What happens if the definitions conflict?

It doesn't seem to be a reasonable answer to shrug that off and simply say something like "we'll deal with that when it arises".

Our big point under this heading is that the principle set out in 446B is extremely bare-bones – it's a statement of "apple pie and motherhood" which we define as a statement that everybody nods their head in agreement with, but when you drill down, individuals think it means a whole range of different things.

We understand one of the principles of good legislative design is set out in the Plain Language Provisions in the PCO Drafting manual. Part of par 3.1. says

"plain language promotes legislation that is—

- *fit for purpose (by ensuring that legislation is written with a clear purpose and that the content fulfils that purpose)*
- *accessible (by ensuring that legislation is easy to find, use, and understand)."*

We think this section fails both those requirements. It is neither fit for purpose nor easy to understand.

Incentives

Under s446N, 466O and 446P, incentives are defined quite exhaustively.

We understand that Government and regulators are totally opposed to any form of volume-based incentives in financial services. We note that they do not seem to have any concerns about similar incentives in new car sales, construction materials sales, or pharmaceutical sales.

Financial institutions have recognised these official preferences and have already given up, without the need for regulations, volume-based sales incentives.

But the Bill includes flat rate commission structures as incentives – see s446P (3) (f) which includes as an incentive a matter calculated "on a linear basis (that is on a per service or per product basis)". On that definition a real estate commission scale would be an incentive.

Our problem with the incentive section of the Bill is that there are very wide powers included to bring down regulations absent the scrutiny of Parliament or the public, to limit the amount of any commission by imposing a cap or indeed by banning any commission outright. We know there are politicians and officials who privately harbour the latter to occur.

With a simple stroke of the pen, business arrangements which have served the test of time could be completely overturned.

If we were allowed to make only a single change to this legislation, it would be to remove s446P (3) (f).

The application to financial advice providers

We understand the clear intention of this legislation was to exempt the provision of financial advice from these conduct rules. This is on the basis that the provision of financial advice is separately regulated under FMCA (the amendments introduced via FSLAA.)

But this Bill does not do this.

Instead, the Bill adds yet a further layer of compliance burden on intermediaries who are involved in the provision of financial advice. Financial advisers would have an additional duty to take reasonable steps to comply with the fair conduct programme of any financial institutions whose products they advise on in every client interaction.

This duty may well (or maybe we should say will almost certainly) result in consumers being limited in their choice of products. In order to minimise their obligation under this provision, some financial advice providers and financial advisers will limit the number of product providers with whom they will deal. This would be a perfectly foreseeable consequence, and in no way if it happened could it be shrugged off as an unintended consequence.

We are also concerned with the impact of the duty of financial institutions to monitor the compliance of its intermediaries with respect to the financial institution fair conduct programme as set out in 446K. We see that under 446L, the financial institution has a carveout when the intermediary is a financial advice provider. We assume this extends to any financial advisers who are providing regulated advice on behalf of the financial advice provider.

We are concerned that the financial institutions, out of an abundance of caution recommended by their lawyers, may ignore that carveout and insist that they audit compliance of financial advice providers who advise on their products. We have seen that in other areas where providers have gone way beyond the minimum requirements in areas such as AML-CFT.

If an institution decided to ignore the carveout, then financial advice providers would have a third layer of compliance – they already have internal compliance and they are subject to FMA monitoring. They would then be audited by the product provider as a third layer.

Previous submissions on other legislation have shown that we think financial advisers are already overburdened by the morass of legislation about to come into effect in March 2021. We feel that it is highly likely that a number of current advisers will simply throw in the towel, as is also happening in Australia, and say “it is just too hard”. That is another perfectly foreseeable outcome, which of course runs counter to one of the stated aims of the regulations being to increase the access of consumers to advice.

But does anyone actually care?

Select Committee Hearing

We look forward to presenting and hopefully debating our submission in a formal appearance at the Select Committee.