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Financial Markets Policy
Building, Resources and Markets
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ICNZ submission on exposure draft of the Financial Markets Conduct (Regulated Financial Advice Disclosure) Amendment Regulations 2019

Thank you for the opportunity to submit on the exposure draft of the *Financial Markets Conduct (Regulated Financial Advice Disclosure) Amendment Regulations 2019* ('exposure draft' or 'disclosure regulations'), which was released for comment by the Ministry of Business, Innovation and Employment (MBIE) on 10 October 2019.

ICNZ represents general insurers that insure about 95 percent of the New Zealand general insurance market, including about a trillion dollars' worth of New Zealand property and liabilities. ICNZ members provide insurance products ranging from those usually purchased by individuals (such as home and contents insurance, travel insurance, motor vehicle insurance) to those purchased by small businesses and larger organisations (such as product and public liability insurance, professional indemnity insurance, commercial property, and directors and officers insurance).

Please contact Andrew Saunders (andrew@icnz.org.nz or 04 914 2224) if you have any questions on our submission or require further information.

This submission is in two parts:

- Overarching comments
- Responses to questions in the consultation document released with the exposure draft

Overarching comments

ICNZ has consistently supported the introduction of the enhanced disclosure regime for financial advice and welcomes the introduction of commission/incentive related disclosure. It is critical the disclosure regime is effective in achieving a level of disclosure to customers of information that allows them to make reasoned judgments about the extent to which remuneration arrangements might alter the behaviour of the person/system providing regulated financial advice. It is also important that the disclosure regime can be efficiently implemented by providers across a range of different distribution

model and in ways that provide a good customer experience and do not discourage the provision of financial advice. As such we generally support quality of disclosure over volume, noting the current Qualifying Financial Entity (QFE) disclosure arrangements are generally efficient.

We remain of the view that the disclosure regulations will need to be supported by guidance that more specifically addresses the 'when' and 'how' of disclosure in different situations, and in some cases potentially the detail of the 'what'. This guidance should be developed by government in consultation with industry and other stakeholders. While flexibility is important, and we support the high level approach taken in the exposure draft, we also note that where regulatory expectations are less clear there is a greater risk of some providers taking a conservative approach leading to excessively long and complex disclosures while others may try to exploit the uncertainty to provide relatively little disclosure.

To fully consider the workability and implications of the proposed disclosure obligations it is necessary to practically apply them to various business processes. The ability to do this has been limited by the relatively brief consultation period provided, particularly given the overlap with other regulatory processes (e.g. October 2019 deadline from FMA/RBNZ for general insurers to report to their boards on conduct issues). We would welcome the opportunity for any further engagement subsequent to the consultation period if practical and have provided comments on the need for a transition period/delayed commencement in response to question 10 below in the second part of this submission.

ICNZ supports the use of examples in the disclosure regulations and considers that more could be included to illustrate how they apply in different situations. Multiple examples would be useful as these would help to illustrate how the regulations might be applied in different financial advice contexts, including those where all the various phases occur in a single relatively brief (e.g. ~10 minute) customer interaction. Examples that go right through for how you would provide more detail at the various phases, or when the phases are combined, would be useful in the regulations and/or in subsequent guidance.

Our specific comments are provided in the second part of this submission.

Responses to questions in the consultation document released with the exposure draft

In this part of the submission we provide responses to the questions posed in the document that accompanied the release of the exposure draft. Some text, including sections of the exposure draft, has been underlined for emphasis or to show proposed revisions to drafting.

1	Will the proposed record-keeping requirement be workable in practice?
	MBIE have indicated that they take the record keeping obligation to mean that in the case of 'authorised bodies', it is the licence holder that has the record keeping obligation, not the authorised body. This seems inconsistent with the FMA proposed standard licence condition (outlined below) which states that the authorised body is responsible for record keeping: 'Explanatory note: In this condition 'you' means the person who holds the licence and each of the licence holder's authorised bodies. 'Adequate written records' include, without limitation, information about any regulated financial advice given to retail clients and copies

of any written information or documents required by or for the purposes of the FMC Act, the FMC Regulations and the new code in connection with the service.[1]'

The disclosure regulations and standard conditions should be consistent. Given the authorised body is a financial advice provider ('FAP'), it would make sense for the authorised body to have the obligation. Another potential solution to this issue would be to provide that the licence holder must ensure a record is kept, as opposed to keeping the records.

2	Do you have any comments on the drafting of the Regulations that will require information to be made publicly available?

Financial advice products from different providers (Clause 4(1)(e) of Schedule 21A)

Clause 4(1)(e) of Schedule 21A provides that if a FAP 'gives advice in relation to financial advice products from particular product providers' it should publicly disclose a statement to that effect and give the names of the product providers. Clause 5(1)(e) has a similar requirement.

ICNZ understands the policy intent of this requirement is to address the situation where a consumer may believe that they are receiving 'independent' advice (i.e. where an adviser finds the product that best meets the consumer's needs from amongst many providers) when in practice the adviser is limited to considering products from only one or two providers. We support this requirement and for those FAPs that do advise on a limited number of product providers, which are the focus of this provision, it will be straightforward to comply with by listing a single or small number of providers.

It is however less clear how the obligations apply in the following situations:

- FAPs that advise on many, but perhaps not all product providers. Read literally clause 4(1)(e) suggests that unless an FAP advises on any product provider (i.e. it is not selective at all) then the FAP should list every provider it might advise on, even if these represent the vast majority of available product providers (i.e. the FAP is in reality providing 'independent advice'). It is not apparent whether this is the policy intent of this requirement and what is intended in such situations.
- FAPs that don't have in place any restrictions/limitations in terms of which product providers they do/might advise on. We interpret the drafting as not requiring these FAPs to disclose anything under clause 4(1)(e) due to the inclusion of the word 'particular'.

We are mindful that as well as a degree of uncertainty, if the above interpretations of the current drafting are correct then FAPs with very similar levels of independence could provide very different disclosures. Amongst other things this could be confusing for customers. There is also a risk of unintended consequences, for example an entity that works with three providers and discloses them appears more independent than an entity that works with all providers and discloses none.

We recommend the drafting of Clause 4(1)(e) is revisited in order to give effect to the policy intent and avoid the uncertainties outlined above.

[1] FMA consultation: Proposed standard conditions for financial advice provider transitional licences, June 2019, Page 7.

3	Do you have any comments on the draft Regulations that will require the disclosure of information when the nature and scope of the advice is known?

Clause 5(1)(a)(i)

For completeness it could be appropriate to require that where a person gives advice to a client of an FAP, they should be required to provide a statement that the person is acting under the FAP's licence (if relevant). In this respect, clause 5(1)(a)(i) of Schedule 21A should read 'a statement to the effect that P holds a licence issued by the FMA to provide a financial advice service and (if applicable) that A is acting under that licence'.

Reliability history (clause 5(1)(h))

We consider that including the reference to 'nominated representative' in clause 5(1)(h) should be reconsidered. We note that given disclosures will be applied in a systemised way by larger FAPs, any need to disclose a reliability event for an individual will likely make that person unemployable by a FAP, which could have severe personal consequence for some individuals.

Identifying information (clause 5(2)(a) – (c))

These requirements are logical in regard to financial advisers. However, when applied to nominated representatives (for example call centre staff) there may be some practical issues. In some cases a customer could speak to multiple nominated representatives and the contact details, for example a freephone number, would likely return to the call centre rather than any specific nominated representative. It is ultimately the FAP that is providing advice through the nominated representative and it must ensure the processes and controls must ensure that the advice given by a nominated representative is commensurate with their competence, knowledge, and skill. Given the above, and the practical implications outlined in the next paragraph, we do not consider that a nominated representative should be required by the regulations to disclose their name and contact details (recognising these will likely be corporate contact details in any case).

For a call centre scenario, requiring nominated representative details would mean having to personalise each written disclosure statement. This is the opposite to the current QFE requirement where a standard non-personalised disclosure statement can be used by all nominated representatives. The system costs of personalising each nominated representative disclosure statement would outweigh any apparent customer benefit. A customer can in any case ask the nominated representative for their name, assuming it has not already been provided, if they want to know it, it does not need to be in the written disclosure statement.

Clause 5(2)(f)

Clause 5(2)(f) applies if any commission or other incentive will or may be given 'in relation to the advice the client is seeking'. There are a range of different commissions, fees etc. paid by insurers to brokers and other intermediaries and it will be necessary to clarify through the disclosure regulations or subsequent guidance etc., whether for example:

- services fees (or other fees) payable by insurers to brokers (or broker organisations) would fall within this clause, especially where such fees are calculated by reference to premium volume; and

- disclosure is required of commissions or incentives at each layer. For example, would disclosure set out the commission received by the FAP, and of that, the commission received by the individual broker?

Clause 5(2)(f)(iii) of Schedule 21A requires disclosure of the amount or value of the commission or incentive or how that would be determined. Our comments on this are as follows:

- This appears to be broad enough to permit disclosure in a general sense at this stage, for example "We will receive a commission from the insurer of up to 30% of the premium." Given that financial advisers may receive different levels of commission from different product providers, we acknowledge that it may not be practicable to disclose the exact amount or value of commission upfront (i.e. at the 'initial information' phase). However, where this is not done, we expect the amount or value of commission would be disclosed under clause 6 at the 'time advice is given' or as soon as practicable afterwards, such as on the client's bill.
- It would be helpful to have an example of how this could be disclosed (perhaps as a follow on to the example below clause 4(2) of schedule 21A).

4	Do you have any comments on the draft Regulations that will require the disclosure of information when the financial advice is given?

Removing the need to repeat information on fees and commissions (sub-clauses 6(1)(d)-(e))

We consider the regulations are not sufficiently explicit about whether it is necessary to repeat disclosure of information on, or associated with, fees and commissions as between 'initial information' and 'additional information' in situations where the information that would be disclosed would not change. The regulations need to be explicit that information given in initial information under clause 5 does not need to be repeated in additional information under clause 6. While this is covered in general terms by regulation 229E(5) more specific provisions are required to make this aspect explicit.

The words 'to the extent not already given under clause 5(2)(d)' should remain in sub-clause 6(1)(d) and equivalent wording should be added into sub-clauses 6(1)(e) and 6(1)(f) in relation to clauses 5(2)(e) and 5(2)(f) respectively.

Complaints procedure and dispute resolution process (sub clauses 6(1)(g)-(i))

We consider that the requirements to detail a FAP's complaints and dispute resolution procedures in sub-clauses 6(1)(g)-(i) are unnecessary (as there is no complaint at this stage), disproportionate (why detail something that has yet to occur and usually won't) and risks distracting and putting off customers.

We understand the policy rationale for including this is that customers may not be generally aware that FAPs will have internal complaints processes and external dispute resolution processes. While this issue could be addressed in other non-regulatory ways we recognise that mentioning it during a customer interaction may increase awareness levels amongst customers. If this is the case, to achieve the policy intent, FAP's should be simply required to disclose that customers can make a complaint and if necessary access a dispute resolution scheme, rather than being required at this specific time to outline how these processes work.

We are also mindful that FAPs are required to make detailed information on complaints procedures and dispute resolution processes publicly available for those customers who are

interested in accessing this detail at the time at which they are considering making a complaint, and that regulation 229F requires a financial advice provider who receives a complaint to give the complainant an overview of their complaints handling process. These are both appropriate and ensure that customers receive this information when it is most relevant, and can also access it at any time if necessary. More detailed information is available on request or when a complaint in made in any case.

Given the above we recommend the policy intent is achieved by replacing sub-clauses 6(1)(g)-(i)) with a simplified version along the following lines:

> *'Complaints procedure and dispute resolution process*
>
> *(g) an explanation of* how *to make a complaint and that the customer can access a free dispute resolution process'*

A requirement to state that more information on complaints procedures and dispute resolution processes is available (e.g. on websites) could also be included if this was considered to be necessary.

Drafting comments

We submit that Schedule 21A clause 6(1)(f)(iv) can be deleted because it is in substance a repeat of clause 6(1)(f)(i). We also note the inconsistent use of 'and' following the semicolons in clause 6(1)(f)(i) – (v).

5	Do you have any comments on the draft Regulations that will require the disclosure of a provider's complaints handling and dispute resolution processes when a complaint is received?

Regulation 229F(1)(a) requires a financial advice provider who receives a complaint to give the complainant an overview of their complaints handling process only if they have such a process. We would have thought that all FAPs should have a complaints handling process (and therefore the carve out for FAPs with no such process should not be required).

6	Do you have any comments on the draft Regulations that set the manner in which information must be disclosed?

We support the flexibility for information to be disclosed in different methods. The requirements outlined in regulation 229G appear appropriate.

7	Are there instances in your business when regulation 229D might apply to someone who is not the one to give advice to the client? Please give examples and provide any comments on how the draft Regulations apply in such scenarios.

The following are some examples our members have identified:

(a) In a larger FAP there may be a mortgage adviser who makes the initial disclosure and then passes the client on to a different adviser in the business that is qualified to give the insurance advice.

(b) An intermediary generates a lead for a different financial adviser, for example a nominated representative in the call centre gives the initial disclosure and then passes the client on to a financial adviser to give the financial advice.

(c) Initial fact find and disclosure may be done online (e.g., robo-advice) but the final advice is given by a human adviser.

8	Do you have any further comments on new regulation 229A to 229H of the draft Regulations?

We are generally supportive of these provisions beyond the specific comments made elsewhere in this submission.

9	Do you have any further comments on new Schedule 21A in the draft Regulations?

Clause 2(2) definition of conflict of interest

We consider sub-clause 2(2)(b) should be deleted and the concepts of 'conflict of interest' and 'commissions and incentives' not merged. Our reasons for this are as follows:

- As a matter of substance and principle the current drafting approach assumes that all commission payments create a conflict of interest. We recognise that commission and incentives have the potential to create a conflict of interest, along with other arrangements or situations, however, to simply define 'commissions and incentives' to be a 'conflict of interest' is an oversimplification and not appropriate. We also consider this goes beyond policy decisions that have been made, suggests commissions should be avoided and fails to recognise that commissions are simply a form of income for providing advice.
- Deeming 'commission and incentives' to be 'conflicts of interest' in clause 2(2)(b) creates unnecessary complexity and circularities in the drafting:
    - The disclosures of 'conflicts of interest' in Schedule 21A (e.g. clauses 4(1)(i), 5(2)(e) and 6(1)(e)) all exclude disclosures of a commission or other incentive, which are addressed separately. This begs the question of why the concepts have been merged. The regulations could retain the same substantive requirements found in 4(1)(j), 5(2)(f) and 6(1)(f) with regard to commissions and incentives without defining them as a 'conflict of interest' in clause 2.
    - The headings above sub-clauses 4(1)(i), 5(2)(e) and 6(1)(e) all currently provide 'Conflicts of interest, including commissions or other incentives'. This is currently unnecessary but also confusing as the first sentence below then states 'if any conflict of interest (<u>other than a commission or other incentive</u>)'. We recognise this is because the next clause then covers commissions and incentives, but it is clumsy and makes it hard to read.

We consider a better approach would be to delete clause 2(2)(b)and then redraft the relevant sub-clauses 4(1)(i) & (j), 5(2)(e) & (f) and 6(1)(e) & (f) along the following lines using clause 4(1)(i) & (j) as an example (changes underlined):

Conflicts of interest <u>and</u> commissions or other incentives

(i) if any conflict of interest currently exists or is likely to arise in the future in relation to advice given to P's clients,—

(i) a description of the nature of each conflict of interest; and

(ii) a brief explanation of the steps that have been or will be taken to manage each conflict of interest:

(j) if any commission or other incentive will or may be given in relation to advice given to P's clients,—

(i) an explanation of when, or in what circumstances, they will or may be given; and

(ii) a brief explanation of the steps that have been or will be taken to manage any conflict of interest associated with the commission or other incentive.

The materiality/reasonableness threshold in clause 2(2)(b)

Further to the comments above in relation to clause 5(2)(f), we consider the application of the test in clause 2(2)(b) that provides 'a reasonable client would expect to, or to be likely to, influence the advice given by A' is open to a degree of interpretation. Given this we expect there will be varying disclosures, at least initially, between different FAPs based on their interpretation, approach and level of caution. Including further policy detail in regard to this in the regulations (e.g. examples) could help to mitigate this. Absent further policy explanation and clarity in the regulations, it is likely to require regulatory guidance, oversight and enforcement over time to establish how this is appropriately applied.

We also note that the use of 'materially influence' in the Cabinet paper[2] has been replaced by simply 'influence' in the exposure draft. Paragraph 30 of the Cabinet paper states

> 'I propose that anyone who gives regulated financial advice to retail clients disclose the incentives they may receive as a result of their relationship with the consumer. This disclosure will be limited to commissions and incentives that a client might perceive as having potential to materially influence the financial advice they receive. This will ensure that the information disclosed to consumers is not overly complex.'

Providing 'materially influence' in this part of the regulations would also make it consistent with the approach in the new section 431K (Duty to give priority to client's interests) to be included in the *Financial Markets Conduct Act 2013*. This would also address any concerns about the need to disclose minor matters (i.e. of a de minimis nature) that might be provided to a person who provides advice, which could be practically unworkable and potentially confusing for customers.

Separation of disclosure requirements into regulations 229A – 229H and Schedule 21A

We recognise there are reasons why the disclosure requirements may have been separated and laid out across regulations 229A – 229H and Schedule 21A, for instance to mirror the existing style of the principal regulations or to allow easier amendment of the detailed information requirements. Nonetheless, we consider there are disadvantages and risks in doing it this way, as opposed to having all the content in an expanded subpart containing regulations 229A – 229H (for example merging regulation 229D and clause 5 of Schedule 21A together), for example:

- likely longer and more complex overall drafting;
- a need to look at different parts of the regulations, which will be hundreds of pages apart once they are incorporated into the principal regulations; and
- risk that people read Schedule 21A in isolation, as this is where most of the requirements are found, and miss key elements not located there, for instance regulation 229F.

Drafting comment

We note the term 'nature and scope of advice' is used both in relation to information that must be publicly available (Schedule 21A clause 4) and initial information (Schedule 21A clause 5). The information given under each of these clauses will differ so we consider they should have different terminology to avoid confusion. For publicly available information, we

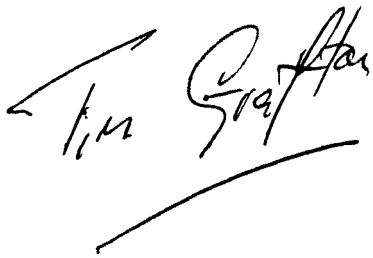
[2] Cabinet paper, Regulation of Financial Advice: Disclosure and Multiple Providers, February 2019, page 5.

	suggest the term 'nature and scope of advice services' – this will help make it clear that it is the scope of services the FAP can provide as opposed to the more specific nature and scope of advice disclosure in the initial information (which will likely be given by a financial adviser or nominated representative).
10	What (if any) transitional provisions should be included in the regulations?
	ICNZ does not consider that the regulations can be brought into effect on 29 June 2020. While we support the regulations coming into effect and recognise aligning this with the rest of the revised financial advice regime on that date would be desirable, requiring full compliance from this date would be unreasonable and impractical given when the disclosure regulations are likely to be finalised. Implementation work has already started but cannot be definitively progressed until the regulations are finalised. Insurers are also subject to other regulatory pressures at this time. The period of time between when the regulations are finalised (expected to be in the early part of 2020 but specific timing uncertain at this stage) and 29 June 2020 will not enable entities to undertake the necessary analysis of the finalised regulations and to implement the consequences of this through changes to their various systems (including testing) and documentation, and to undertake the required staff training etc. Given the late stage at which the regulations will be finalised it is not reasonable to impose on entities the additional costs and risks of non-compliance that are associated with a rushed implementation. Every regulatory implementation is different, however, we have found that a minimum of six months between the law being made (e.g. regulations gazetted) and coming into effect is usually required, even for relatively straightforward changes and where the explicit policy intent was already known prior. Given the important detail of the regulations is yet to be confirmed and is likely to be amended in response to submissions, and the implications for different entities vary, it is likely more than six months will be required. We also note appropriate allowance needs to be made for the practicality specific timing and issues such as the summer period. Some of our members have identified that aspects of the disclosure requirements (e.g. updating website content for the publicly available elements) could be put in place more rapidly than some others (e.g. collateral, documentation and any personalised aspects). While this potentially opens up the option of bringing different aspects of the regulations into effect at different times, we suggest caution in this respect as this would introduce further complexity and potential costs (e.g. multiple implementation projects). ICNZ would welcome further engagement on the appropriate timing of commencement once the regulations are approaching finalisation.

Conclusion

Thank you again for the opportunity to submit on the exposure draft. If you have any questions, please contact our Regulatory Affairs Manager on (04) 914 2224 or by emailing andrew@icnz.org.nz.

Yours sincerely,



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