



**Submission to:**

Economic Development, Science and Innovation Select Committee

**Subject:**

Financial Services Legislation Amendment Bill

**Date:**

21 February 2018

**Contact Person:**

Andrew Hubbard

We wish to appear before the Committee.

**Background/organisational description**

The purpose of our organisation, Citizens Advice Bureau New Zealand Ngā Pou Whakawhirinaki o Aotearoa, is to:

- Ensure that individuals do not suffer through ignorance of their rights and responsibilities or of the services available; or through an inability to express their needs effectively — Me noho mataara kia kua te tangata e mate i tōna kore mōhio ki ngā āhuatanga e āhei atu ana ia, ki ngā mahi rānei e tika ana kia mahia e ia, ki ngā ratonga rānei e āhei atu ana ia; i te kore rānei e āhei āna ki te whakaputa i ōna hiahia kia mārama mai ai te tangata.
- Exert a responsible influence on the development of social policies and services, both locally and nationally — Kia tino whai wāhi atu ki te auahatanga o ngā kaupapa ā-iwi me ngā ratonga ā-rohe, puta noa hoki i te motu.

We support the principle of partnership reflected in the Treaty of Waitangi. E tautoko ana Ngā Pou Whakawhirinaki o Aotearoa i te mātāpono o te pātuitanga e ai ki Te Tiriti o Waitangi.

We work to empower individuals to resolve their problems and to strengthen communities. The person-to-person service provided by over 2,300 Citizens Advice Bureau (CAB) volunteers is unique in New Zealand. From 82 locations around New Zealand, the CAB provides individuals with a free, impartial and confidential service of information, advice, advocacy and referral. Ka mahi mātou ki te whakakaha i ngā tāngata takitahi ki te whakatika i ā rātou ake raruraru, ki te whakakaha hoki i ngā hapori. He mea ahurei i roto o Aotearoa te ratonga kanohi-ki-te-kanohi e whakaratohia e ngā kaitūao 2,300 o Citizens Advice Bureau (CAB). Mai i ngā takiwā e 82 puta noa i Aotearoa, e whakaratohia ana e te CAB ki ngā tāngata takitahi he ratonga koreutu, tōkeke, matatapu hoki e pā ana ki te mōhiohio, te tohutohu, te tautoko me te tukunga.



In the 2016/17 financial year we had over 525,000 interactions with clients, including around 200,000 in-depth enquiries where we offered information, advice and support across the gamut of issues that affect people in their daily lives.

We use our experience with clients to seek socially just policies and services in Aotearoa New Zealand.

## Introduction

- 1 We welcome measures to strengthen protections for consumers of financial advice and therefore support the general intent of this Bill.
- 2 However, we would like to see the Bill include much stronger measures to prevent conflicts of interest relating to remuneration.
- 3 **We recommend** that the Bill be amended to include a ban on commissions and other conflicted remuneration in the financial advice sector. This is the primary focus of our submission.

## Australian and UK action on conflicted remuneration

- 4 In Australia<sup>1</sup> and in the United Kingdom<sup>2</sup> steps have been taken to ban some or all types of conflicted remuneration in the financial advice sector. In both jurisdictions, this was seen as the surest means to ensure that consumers get financial advice that is tailored to their needs.
- 5 This is how the UK Financial Services Authority described the advantages to consumers when the ban on commissions was introduced in late 2012:<sup>3</sup>

*Financial advice has never been free and, in the past, it was not always clear how advisers were paid. If you received financial advice before our changes, you would probably have paid commission to your adviser – but you might not have even known.*

*Commission was usually paid as a percentage of your investment, typically 1 to 8%. So if you made a £10,000 investment, £100 to £800 could be paid to the adviser. This would come out of the money you invest.*

*The trouble with commission was the potential for advisers to be influenced by what they would receive for recommending a particular product or using a certain provider. For example, if one investment plan paid commission of 5% some advisers might have been tempted to recommend that over one that paid them just 2%.*

*Changes to the way advisers are paid and the information they have to give you about it have now taken effect, under our Retail Distribution Review (RDR). Instead of the adviser being paid commission, they now have to explain to you how much advice will cost and together you will agree how you will pay for it.*

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<sup>1</sup> See Appendix 1 and <http://download.asic.gov.au/media/4566844/rg246-published-7-december-2017.pdf>

<sup>2</sup> See Appendix 2 and <https://www.handbook.fca.org.uk/handbook/COBS/6/1A.html>

<sup>3</sup> [http://www.fsa.gov.uk/consumerinf/product\\_news/saving\\_investments/changes-financial-advice/how-changing/paying-financial-advice](http://www.fsa.gov.uk/consumerinf/product_news/saving_investments/changes-financial-advice/how-changing/paying-financial-advice)

*This could be charged as:*

- *an hourly rate;*
- *a set fee according to the work involved;*
- *a monthly retainer; or*
- *a percentage of the money invested.*

*However you pay for advice, your adviser should set out the charges in a clear and transparent way and make sure you understand how much you are paying. You can even negotiate with the adviser on the amount you pay depending on your advice needs.*

*The changes mean you can be sure the advice you receive will not be influenced by how much the adviser could earn from the investment.*

- 6 Unfortunately, the measures currently proposed in the Financial Services Legislation Amendment Bill do not go far enough to guarantee that the financial advice received by New Zealand consumers “will not be influenced by how much the adviser could earn from the investment.”
- 7 Nothing short of a ban on commissions and other forms of conflicted remuneration will get us to that point. That is why we are asking the Committee to take this step.

### **Ban on conflicted remuneration is needed in New Zealand**

- 8 We urge the Committee to use this Bill to phase out all forms of conflicted remuneration in New Zealand’s financial advice sector. This is the best way to ensure that financial advisers act in the best interests of their clients.
- 9 The Options Paper issued by MBIE in 2015, as part of the review of the financial advice sector, made no secret of the fact that consumers of financial advice in this country are suffering because advisers are not managing conflicts of interest relating to remuneration:  
  
*Remuneration arrangements (such as commissions) and sales targets are incentivising some advisers to provide advice which may not lead to the best outcome for the consumer.*<sup>4</sup>
- 10 This Bill, as it currently stands, seeks to prevent such conflicts of interest by doing no more than asking the adviser to suppress his or her interests in favour of those of the client.
- 11 In an ideal world this might suffice. But that is not the world we live in. Faced with the possibility of a healthy commission or bonus, advisers may not always heed the impulse to do the right thing. Or they may convince themselves that their interests and the client’s align, when this is not the case.
- 12 We are not confident that simply requiring advisers to manage their own conflicts of interest will significantly increase consumer protection.

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<sup>4</sup> Options Paper: Review of the Financial Advisers Act 2008 and the Financial Service Providers (Registration and Dispute Resolution) Act 2008. Ministry of Business, Innovation and Employment, 2015. P.17

- 13 If the Committee wishes to give consumers the best possible chance of getting financial advice that puts their interests first, it should take steps to remove all forms of remuneration and inducements that could unduly influence the advice.
- 14 We acknowledge that moving to a fee-for-advice model may deter some consumers from seeking advice. The fact is, however, as the UK Financial Services Authority makes clear, that financial advice is never free to the consumer.
- 15 We believe it is better to have a system where fees are transparent and advice is neutral, than one where remuneration is conflicted and advice compromised as a result.
- 16 **Recommendation:** that the Bill be amended to include provisions that ban all forms of conflicted remuneration in the financial advice sector.

### **Disclosure is not a silver bullet**

- 17 Disclosure of information is an important element of consumer protection, and we wish to see it used to the best possible effect. However, it is not a silver bullet.
- 18 Disclosure shifts liability to the consumer under the (often false) premise that being in receipt of information equates to being informed.
- 19 Sometimes disclosure has the undesirable effect of leaving the consumer inundated with information but none the wiser as to how to interpret it.
- 20 Where conflicts of interest are concerned, disclosure is the only line of defence in the absence of a ban on conflicted remuneration.
- 21 Unfortunately it is not a strong defence, for consumers will not necessarily know how to use information about the disclosed conflict to evaluate the financial advice they are being given.
- 22 In the worst-case-scenario, the disclosure of a conflict may give the consumer a false sense of security rather than act as a warning.
- 23 The research findings presented in MBIE's Issues Paper on the financial advice sector make disturbing reading:

*...recent studies have called into question the usefulness of information disclosure in helping consumers with the problem of conflicts of interest, concluding that:*

- *Following disclosure, advisers feel comfortable giving more biased advice than they otherwise would.*
- *People receiving advice do not properly adjust for adviser bias and generally fail to sufficiently discount biased advice.*
- *Following adviser disclosure, clients can feel uncomfortable turning down the advice they receive, as it may indicate a lack of trust in their adviser. In fact, upon*

*receiving information disclosure, clients tend to trust their adviser more, on the basis that they perceive an adviser declaring a conflict is a sign they are acting ethically.*<sup>5</sup>

- 24 These findings only confirm that, no matter how robust, information disclosure cannot be relied upon to remove the risks to consumers associated with conflicts of interest.
- 25 As stated above, we believe that the surest course of action is to regulate to remove the conflict.

### **What is deemed to be ‘reasonable’ when ensuring client understands nature and scope of advice?**

- 26 We welcome the inclusion in the Bill of a specific duty to ensure the client understands the nature and scope of advice:

***431I Duty to ensure client understands nature and scope of advice***

*A person must not give regulated financial advice to a retail client unless the person has taken reasonable steps to ensure that the client understands the nature and scope of the advice being given, including any limitations on the nature and scope of the advice.*

- 27 Here again, it will be important to distinguish between simply providing information, and ensuring that the information has been understood and that the client is therefore in a position to act upon it (for example by going elsewhere if the range of products isn't suitable).
- 28 It will also be important for all advisers to have the same understanding of what is meant by ‘reasonable steps’.
- 29 It could be argued, for instance, that information about the range and scope of advice will only be empowering to a client who is very well-informed about how the market works. Would it be the responsibility of the adviser, under the requirement to take ‘reasonable steps’, to get an uninitiated client to that level of understanding? We believe that this provision could be strengthened by adding a number of clarifying examples to the text of the legislation.
- 30 **Recommendation:** that this provision be amended to include a series of examples to clarify the meaning of ‘reasonable steps’.

### **Need for consumer information campaign during transition period**

- 31 From a consumer's perspective, the transition from the old regime to the new one is a lengthy one. The current time-table means that consumers will have to wait until May 2021 before they can be certain that they are getting the full benefit of improvements offered by these legislative changes. This seems like a long time.
- 32 In the intervening period it will be important for consumers to be made aware that, although the law has changed, the new regime does not fully take effect until the transitional period is over.

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<sup>5</sup> Issues Paper: Review of the Financial Advisers Act 2008 and the Financial Service Providers (Registration and Dispute Resolution) Act 2008. Ministry of Business, Innovation and Employment, 2015. P.36



- 33 **Recommendation:** that the transitional arrangements include an information campaign for consumers, including key questions for them to put to advisers during the transition period. The campaign could also aim to provide consumers with a basic understanding of how the financial advice market functions, and of key issues relating to conflicts of interest.

Thank you for this opportunity to comment. Please contact me if you have any questions, or want any clarification about our submission.

Yours sincerely

Andrew Hubbard  
Deputy Chief Executive



## Appendix 1

### Australian Securities and Investments Commission media release

Thursday 7 December 2017

#### 17-421MR ASIC updates guidance on conflicted remuneration

ASIC has updated its guidance on conflicted remuneration to more closely reflect a range of regulatory changes since the guide was issued in 2013.

The updated [Regulatory Guide 246](#) *Conflicted and other banned remuneration* (RG 246), previously titled *Conflicted remuneration*) now includes guidance on the operation of the incoming life insurance remuneration reforms and additional working examples.

The life insurance remuneration reforms, which commence on 1 January 2018, mean remuneration arrangements used in some life insurance distribution channels, including direct sales, will need to change.

Other regulatory changes that have impacted on the guidance in RG 246 include:

- amendments to the grandfathering arrangements for the ban on conflicted remuneration
- the exclusion for basic banking products, and
- the stamping fee and brokerage exclusions.

In addition to updating the guidance to reflect regulatory changes, RG 246 now:

- provides additional guidance on the exclusion for benefits paid by the client
- includes examples of when conference benefits are likely to be conflicted remuneration, and
- reiterates that commissions given by a property developer to an adviser where the adviser recommends the establishment, or use, of an SMSF to purchase property are likely to be conflicted remuneration.

ASIC will monitor industry's implementation of the life insurance remuneration reforms and will consider developing additional guidance if needed to address any specific issues or concerns.

#### Download

- [Regulatory Guide 246](#) *Conflicted and other banned remuneration* (RG 246)

#### Background

The conflicted and other banned remuneration provisions are part of the Future of Financial Advice (FOFA) reforms. The provisions ban many benefits given to those



persons who provide financial product advice to retail clients that could reasonably be expected to influence the advice they give. The ban applies to commissions, volume-based payments, so-called 'soft dollar benefits' and volume-based shelf space fees.

RG 246 provides guidance on the conflicted and other banned remuneration provisions in the Corporations Act, including:

- the ban on conflicted remuneration
- the ban on volume-based shelf-space fees, and
- the ban on asset-based fees on borrowed amounts.

The life insurance remuneration reforms were announced by the Government on 6 November 2015. The *Corporations Amendment (Life Insurance Remuneration Arrangements) Act 2017*, which introduced the reforms, commences on 1 January 2018. Together with the Corporations Amendment (Life Insurance Remuneration Arrangements) Regulations 2017 and the [ASIC Corporations \(Life Insurance Commissions\) Instrument 2017/510](#), the reforms:

- remove the existing exclusion from the ban on conflicted remuneration for benefits paid in relation to life insurance products;
- insert a new exclusion which permits benefits to be paid if certain commission caps and clawback arrangements are met; and
- provide that the ban on conflicted remuneration will also apply to certain benefits in relation to information given on, or dealing in, a life insurance product.



## Appendix 2

Instructions to advisers on how to comply with the ban on commissions are contained in the UK Financial Conduct Authority's Handbook:

<https://www.handbook.fca.org.uk/handbook/COBS/6/1A.html>

### **COBS 6.1A.4 R Requirement to be paid through adviser charges**

*Except as specified in COBS 6.1A.4A R, COBS 6.1A.4AB R, COBS 6.1A.4AC G, COBS 6.1A.4B R and COBS 6.1A.5AR(1)15, a firm must:*

*(1) only be remunerated for the personal recommendation (and any other related services provided by the firm) by adviser charges; and*

*(2) not solicit or accept (and ensure that none of its associates solicits or accepts) any other commissions, remuneration or benefit of any kind in connection with the firm's business of advising or any other related services, regardless of whether it intends to refund the payments or pass the benefits on to the retail client; and*

*(3) not solicit or accept (and ensure that none of its associates solicits or accepts) adviser charges in relation to the retail client's retail investment product or P2P agreement which are paid out or advanced by another party over a materially different time period, or on a materially different basis, from that in or on which the adviser charges are recovered from the retail client.*