BUDDLE FINDLAY

Regulation of financial laws – to be like Australia or not to be?

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The Financial Markets Conduct Act 2013 (FMCA) was the most significant statutory reform of New Zealand's financial markets in 30 years and was designed to streamline New Zealand's disparate financial regulatory laws into a single, coherent regime. Has this outcome been achieved, and if not, why? How does New Zealand's approach differ from that in Australia?

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How did we get here?

In 2006 regulators launched an ambitious project to review and reform New Zealand's financial regulatory framework, while the Government identified improving the investment environment as a key part of its economic transformation strategy. Extensive research and consultation with capital-market participants, academics and senior staff from public sector bodies resulted in the establishment of a joint public-private sector steering group to progress capital-market development – the Capital Market Development Taskforce (the Taskforce). The Taskforce released its final report in December 2009, making 60 recommendations as part of a blueprint for the development of capital markets, which the Government used to form an action plan for reform.

Following further stakeholder and industry engagement, this process culminated in an overhaul of the old Securities Act regime (dating from the late 1970s), resulting in the passing of the Financial Service Providers (Registration and Dispute Resolution) Act 2008 (FSPA), then the establishment of the Financial Markets Authority (FMA), and finally the passing of the FMCA.

Since 2014, the most substantive round of changes to the FMCA has come in the form of the Financial Services Legislation Amendment Act 2019 (FSLAA), which came into force on 15 March this year. FSLAA, among other things, amended the FMCA by introducing a new regulatory regime for financial advice and broking/custodial services and repealing the Financial Advisers Act 2008 (FAA) – the old regime governing the provision of financial advice and broking/custodial services.

In addition, there are further changes to the FMCA in the pipeline - the Financial Markets (Conduct of Institutions) Amendment Bill (CoFI) will establish a new regime to regulate the overall conduct of banks, licensed insurers, and licensed non-bank deposit takers (NBDTs) by way of a new market services licence under the FMCA.

Throughout this reform process, the New Zealand government considered Australian regulatory models, as they are useful benchmarks due to the social, economic and institutional similarities to New Zealand, the desire of companies to raise funds in a trans-Tasman capital market, reduction in transaction costs if regulatory differences are minimised, and improved overseas investor confidence if New Zealand's securities laws conformed with international norms.[1] However, the position of the New Zealand government has been to support a deviation from the Australian position where it is appropriate for the smaller New Zealand market.

There is considerable commentary from the 1980s and 1990s on how New Zealand legislators viewed harmonisation with Australian company and securities law. Commercial law reform in New Zealand required the consideration of a 1988 memorandum of understanding between Australia and New Zealand (in connection with the Australia and New Zealand Closer Economic Relations-Trade Agreement) aimed at the harmonisation of business laws.[2] In 1986, the New Zealand government requested that the Law Commission produce a report on the reform of company and securities law.[3] In its report published in 1989, the Law Commission considered such harmonisation to be 'desirable' - however, in this instance, it rejected the Australian model on a number of grounds, including a preference for a distinction between companies and securities legislation (as this permitted 'better focus for legislative objectives'[4]) and the relative complexity of Australian legislation running counter to the aim of making 'company law intelligible to non-lawyers'[5].

More recently, the New Zealand government rejected the Australian approach to regulate all securities trading facilities in the Securities Markets Amendment Act 2002, as it considered that the Australian approach would hinder the development of smaller, more innovative markets and impact the ability of smaller and start-up businesses to raise capital. It also noted that the imposition of additional compliance costs incurred under the Australian regime would be too burdensome to relatively smaller sized

companies in New Zealand.[6]

Where are we at?

New financial advice regime

The new regime introduced by FSLAA arguably improves access to financial advice by simplifying and streamlining the regulatory framework for financial advice. In particular, the new regime removes the previous multiple classifications of those that can provide financial advice (ie authorised financial advisers, registered financial advisers, and qualifying financial entities), the distinction between class and personalised financial advice, and the distinction between category 1 and 2 products, replacing it with one requirement to be licenced as a financial advice provider (FAP), or be engaged by a licensed FAP, to provided 'regulated financial advice'.

The new regime creates additional types of persons that can provide financial advice to retail clients without holding a FAP licence (ie authorised bodies, financial advisers, nominated representatives), as long as they are acting under another's FAP licence. The holder of a FAP licence is essentially responsible for the actions of those acting under its FAP licence, so the FAP should have systems in place (or have confirmed that those acting under its FAP licence have systems in place) to ensure compliance with the obligations in the FMCA and related regulations, Code of Professional Conduct for Financial Advice Services (Code) and the FAP licence conditions.

The FMA decided to specify three classes of FAP licence (classes 1-3) in a document released in November 2020, surprising those in the market who had hoped for a streamlined one-licence-for-all regime. The FAP licence requirements regarding processes and systems increase depending on the number and type of entities and individuals operating under the FAP's licence (with the most restricted class being 1 and the broadest class being 3), and the incremental licencing fees reflect this.

A key benefit of the new regime for fintechs and other types of innovative financial service providers is that it is technology neutral, removing the requirement for financial advice to be given by a natural person and allowing for the sector to innovate the potential provision of digital or 'robo' advice.

New territorial scope for financial service providers

Alongside the changes to the FMCA, FSLAA also amended the FSPA, changing its territorial scope in an attempt to prevent misuse of the FSPR. While originally a financial service provider needed a place of business in New Zealand to be registered (unless it was a licensed provider or required to be registered under the FSPA by another enactment), the new territorial scope captures those that provide 'financial services' to persons in New Zealand (as well as AML reporting entities[7], licensed providers[8] or those required to be registered under the FSPA by another enactment) can satisfy the new eligibility threshold[9] and which do not fall into an exclusion/exemption.

While this new territorial scope has arguably made it more difficult for entities to understand if they need to be registered on the FSPR or not, it gives the FSPR registrar the tools it needs to prevent entities that are not actively providing services to New Zealanders from registering on the FSPR (therefore allocating more time to the supervision of those entities who are, and preventing those who aren't from corruptly taking advantage of registered status).

New conduct legislation

To enhance the existing licencing regime under the FMCA, CoFI will introduce conduct licensing of banks, insurers, and NBDTs by the FMA, requiring those institutions to have systems and processes in place to ensure they treat consumers fairly. CoFI will affect approximately 87 insurers, 27 banks and 20 NBDTs.[10]

CoFI establishes a baseline standard of expected conduct for those institutions and the licensing regime introduced by it represents an expansion of the FMA’s remit, giving it direct oversight of internal ‘entity-level’ conduct and providing it with formal supervisory and enforcement tools. At Select Committee, the ability to be exempt from licensing requirements has been provided to some institutions, however, the scope of such exemptions has not been finalised. Current expectations are that regulations relating to exemptions will be developed, in particular, for participants within certain insurance markets where the licensing requirement may be an onerous and costly administrative burden.

Is such additional regulation necessary and helpful for New Zealand's financial sector? Reviews conducted on New Zealand’s financial institutions have not demonstrated systemic issues as entrenched or extensive as the issues identified in equivalent Australian institutions. There is a risk that CoFI may create regulatory overlap and a disproportionate burden of compliance that doesn't necessarily advance the FMCA's two main purposes – to promote confident and informed participation in financial markets, and to facilitate fair, efficient, and transparent financial markets.

How does it compare to the Australia regime?

In Australia, providers of financial services (which include financial advice and offering certain financial products) must obtain an Australian Financial Services Licence (AFSL), but there is no separate registration regime, as there is in New Zealand under the FSPA.

In addition, there are not different types of licences for different financial activities (ie a FAP licence versus derivatives issuer licence) as there is in New Zealand under the FMCA. Each AFSL describes all the financial activities the holder is licenced to carry out (and all those who are authorised by the holder to act under the AFSL).

In Australia it is common for financial advisers to organise and operate in 'dealer groups' or 'financial advisory networks' – a structure where a corporate entity holds an AFSL, permitting financial advisers in the dealer group to operate as 'authorised representatives' of the licence holder. The corporate entity usually provides the financial advisers back office services and assistance with compliance.

A key concern with the Australian entity licensing model, that was highlighted in the Australian Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Royal Commission), is that dealer groups can restrict the range of financial products their financial advisers can advise on with the use of an 'approved product list' (APL), resulting in potential conflicts.[11] An APL may contain a combination of both in-house financial products (ie financial products manufactured by a related party, such as the bank or other financial institution the adviser is employed by), or external financial products (ie financial products manufactured by an unrelated financial product provider).

There is a risk that financial advisers may inherently be inclined to direct customers to select in-house products, a problem that may further be exacerbated by the prevalence of restricted APLs. A 2018 report[12] by the Australian Securities and Investments Commission (ASIC) found that, of the institutions analysed by ASIC that both manufactured products and provided financial advice, 21% of the institutions' APLs comprised in-house products and 68% of total funds were invested by customers in in-house products as a result of receiving personal financial advice.[13] For the products analysed, ASIC found that for 75% of files the financial adviser was non-compliant with its best interests duty and related obligations.[14] The report noted that the high level of non-compliance "suggests that the [financial advisers] may not be appropriately managing the conflict of interest" associated with in-house products.[15] This is less of a concern in a regime focussed on individual licensing without such potential conflicts.

So does the new regime streamline New Zealand's disparate financial regulatory laws into a single, coherent regime?

While the passing of the FMCA and the changes made by FSLAA have significantly reduced the number of financial laws that must be referred to when providing financial services or otherwise acting in the financial markets, the recent shift towards additional regulation in the form of stand-alone legislation (ie the Financial Market Infrastructures Act 2021) and adding to the already long list of market services licences (currently 4, soon to be 5 under CoFI), suggests we are not quite there yet and may be heading away from a single, coherent regime.

While the Australian regime is not perfect, it is arguably more accessible and understandable for market participants, with all the relevant law sitting in the Corps Act and one licensing regime (for an AFSL) applying across all regulated financial services. By comparison, the New Zealand government could usefully reflect on whether the financial regulatory framework now evolving in New Zealand, with multiple layers of registration, licencing and certification for financial institutions across differing legislation, is becoming overly complex for participants to operate within, places additional compliance costs on institutions (and consumers) and risks stifling innovation and product development.

This article was written by Scott Abel (partner), Lara Wood (special counsel) and Amman Bulchandani (legal adviser).

[1] Lianne Dalziel, Minister of Commerce "Government's vision for Securities Law Reform legislation" (Carlton Hotel, Cnr Mayoral Drive & Vincent Street, Auckland, 28 March 2003).

[2] New Zealand Law Commission, Company Law Reform and Restatement, NZLC R9, Wellington, 1989, at 21.

[3] New Zealand Law Commission, Company Law, NZLC PP5, Wellington, 1987, at ix.

[4] New Zealand Law Commission, Company Law Reform and Restatement, NZLC R9, Wellington, 1989, at 37.

[5] At 38.

[6] Lianne Dalziel, Minister of Commerce "Government's vision for Securities Law Reform legislation" (Carlton Hotel, Cnr Mayoral Drive & Vincent Street, Auckland, 28 March 2003).

[7] Anti-Money Laundering and Countering Financing of Terrorism Act 2009, s5. Reporting entities include a casino, a designated non-financial business or profession, a financial institution, a high-value dealer, TAB NZ and include any person or class of persons declared by regulations or required by another enactment to be a reporting entity.

[8] Financial Service Providers Act 2008, s7A(1)(b). A licenced provider is a person who provides or offers to provide a licensed service (a financial service in respect of which a licensing enactment requires a person to be licensed to provide the service or hold out that they provide the service) or is licensed, registered, authorised, or otherwise approved by a licensing authority (such as the Reserve Bank of New Zealand or Financial Markets Authority) and that is, or is required to be, a licensed provider under a licensing enactment (such as the Financial Markets Conduct Act 2013, the Reserve Bank of New Zealand Act 1989, the Financial Markets Supervisors Act 2011, the Insurance (Prudential Supervision) Act 2010 or the Non-bank

Deposit Takers Act 2013).

[9] Financial Service Providers Act 2008, s7A(2)(c).

[10] Financial Markets Authority *Briefing to the Incoming Minister* (October 2020).

[11] Australian Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, Background Paper 6 (Part A) (2018) at 14.

[12] ASIC *Report 562: Financial advice: Vertically integrated institutions and conflicts of interest* (January 2018).

[13] At para 16.

[14] At para 21.

[15] At para 26.

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