To: Finance and Expenditure Committee

Requested Supplemental Submissions

On: Financial Markets (Conduct of Institutions) Amendment Bill

June 2020

INTRODUCTION

These supplemental submissions are from Chapman Tripp Partner Tim Williams. We are a full service firm with offices in Auckland, Wellington and Christchurch.

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Introduction

1 The Select Committee has asked Chapman Tripp to elaborate on certain of its specific oral submissions made by Partner, Tim Williams, on the Financial Markets (Conduct of Institutions) Amendment Bill (***the Bill***).

2 Our supplementary submissions do not purport to represent the views of our clients.

Summary

3 As the only full service law firm making submissions in person, Chapman Tripp focused in its oral submissions on its unique points which were of a practical and drafting nature. In particular, Tim Williams' submitted orally that:

3.1 **Balance:** Section 446B (which defines the "fair conduct principle") needs to balance the interests of consumers with the reasonable interests of financial institutions (and intermediaries) so equitable, commercial and practical outcomes are reached; remembering that financial institutions and intermediaries could easily be smaller companies or individuals with limited resources;

3.2 **Individualisation of interests:** Section 446I(3) indicates that financial institutions (and intermediaries) would be required to treat customers fairly on an individual basis. Section 446I(3) penalises financial institutions (or intermediaries) if a failure "relates to only one consumer". This would clearly be impractical in the context of the generic activities to which the principle is applied in section 446C; particularly designing and offering products or services. These functions are mass market activities where it is not practical for the product manufacturer (as opposed to an adviser) to consider each potential customer's individual interests, as opposed to the interests of all potential consumers generally; and

3.3 **Uniqueness of Insurance:** Section 446B needs to recognise that insurance policies may not always be demonstrably fair to individual customers. Construction of insurance policies, which often needs to align with reinsurance sourced from overseas, requires categorising risks and determining the risk propensity of policyholders on a generalised class basis. Risks are shared between customers in a similar class, with "unders and overs" in their propensity to suffer the insured event. A requirement for individual fairness creates fertile ground for insurers to be challenged for reasonably categorising risks when undertaking the usual business of insurance. Separately, any form of discrimination could be considered unfair. Under the Human Rights Act, insurance policies have legitimate exemptions from the discrimination prohibitions, when the policy determinants are supported by actuarial advice. The Bill needs to be tailored so insurance policies are not considered unfair, in the same way as they are not considered discriminatory under the Human Rights Act, when certain requirements are met.

4 **We provide solutions to these issues below:**

How to provide for a balance between the interests of customers and financial institutions (and intermediaries)

5 As currently worded, section 446B appears to be referring only to the interests of consumers. This could require financial institutions (or intermediaries) to go to unreasonable lengths to benefit consumers, which may become uneconomic. It was submitted that the Bill should follow the approach applying in Australia in relation to the obligation on AFS licensees to act

"efficiently, honestly and fairly" in section 912A(1)(a) of the *Corporations Act 2001* (Cth). In the Federal Court's decision in *ASIC v AGM Markets Pty Ltd (in liq) (No 3)* [2020] FCA 208, Beach J concluded the word "fairness" requires an equal assessment of the interests of both parties, rather than exclusive attention to the interests of consumers. He stated "Fairness is to be judged having regard to the interests of both parties." Chapman Tripp submitted that the wording of section 446B prohibits a balanced interpretation of section 446B by the Courts, as it refers only to the interests of customers. Balance could be achieved if section 446B was redrafted as follows:

5.1 "The fair conduct principle is that a financial institution (and an intermediary) must treat consumers fairly, ~~including~~ by ~~paying~~ having due regard to their respective reasonable interests."

How to address the individualisation of interests

6 Removal of section 446I(3) would address the restraints on the Courts taking a common sense approach and concluding that the fair conduct principle requires regard be given only to consumers' interests generally when undertaking generic activities, such as designing policies.

How to deal with the peculiarity of insurance

7 The Bill contains powers for regulations to disapply requirements of Part 6A. These powers could be used to address the peculiarities of insurance products. However, it would be preferable for specific drafting to be contained in the Bill reflecting the concepts underlying the Human Rights Act relief for insurance policies and the more limited meaning of fairness in the context of insurance policy design, in the same way as is recognised in the Human Rights Act.

How to address the subjectivity of 'fairly'

8 In addition, Chapman Tripp submitted along with other submitters, that "fairly", like other subjective and imprecise language, is unsuitable for use in legislation without clarification as to precisely what is meant. In Australia, the doctrine of "fairness" is being developed by the Australian Courts in response to the obligation on AFS licensees to act "efficiently, honestly and fairly" in section 912A(1)(a) of the *Corporations Act 2001* (Cth). At least two leading cases, ASIC v. Westpac Securities Administration [2019] FCAFC 187 and ASIC v AGM Markets Pty Ltd (in liq) (No 3) [2020] FCA 208 have been devoted to clarifying the intent of the expression. It was submitted that the time and cost spent of providing clarity, and the uncertainty until clarity is provided, could be avoided if the Bill either specifies, or provides that Regulations prescribe, what specifically is required. MBIE has articulated clearly in its presentations what it intends "fairly" should be taken to mean. It would be highly desirable and efficient for the Bill or Regulations to record precisely what is meant. As the Bill is framework legislation, it would make sense that clarity is provided in the Regulations by, for example, adding **"in the prescribed manner"** after "fairly" in proposed section 446B.