

To: The Financial Markets
Authority (FMA) Te Mana
Tātai Hokohoko

On: Proposed fair outcomes for consumers and markets

1/03/2024

Introduction

This submission is from Chapman Tripp.

About Chapman Tripp

1. Chapman Tripp is a leading law firm with offices in Auckland, Wellington and Christchurch. Our firm acts for a range of market participants on most of legislation in Schedule 1 of the Financial Markets Authority Act 2011 (*FMAA*), across our financial services regulation and funds management, equity capital markets, debt capital markets, finance, corporate governance, litigation specialist practice groups.
2. Thank you for the opportunity to submit on Te Mana Tātai Hokohoko or the Financial Market Authority's (*FMA*) consultation on the Proposed fair outcomes for consumers and markets dated November 2023 (the *Consultation Paper*).
3. Our submission does not purport to represent the views of our clients.

Introduction

4. We support FMA's transparency of its priorities and objectives when undertaking its role. We also support the FMA's desire to achieve measurable improvements for New Zealanders, by embedding a regulatory approach that puts outcomes for consumers and markets at the heart of its work.
5. However, in our view, as it is currently drafted, the Guide to outcomes focused regulation (the *Draft Guide*) would impose significant additional compliance burdens on the financial services industry without clear legislative authority, because the regulatory expectations proposed in the draft Guide are not always supported by corresponding requirements of primary or secondary legislation.
6. Some of the Draft Guide rationale for taking regulatory intervention could increase the risk of successful judicial review against FMA's decision making, whereas closer alignment with statutory criteria may avoid that outcome, and prevent undermining confidence in FMA as an effective enforcement body.
7. Having an 'outcomes-based' focus would not, in itself, necessarily lead to additional compliance burdens or potential judicial review. A purpose-based approach, for example, can often enhance the effectiveness of the law, and support the development of fair, efficient and transparent financial markets. Enforcing current laws solely when fair outcomes are not achieved would be consistent with a 'purpose-based' approach which is commonly adopted when interpreting statutory obligations and commonly touted as giving effect to the will of Parliament.
8. The 'public interest test' contained in the Solicitor-General Prosecution Guidelines likewise promotes fair outcomes through ensuring there is a demonstrative public interest when prosecuting breaches of the law.
9. However, additional compliance burdens, confusion and uncertainty comes when there is a misalignment of the targeted outcomes and the statutory obligations on

which they need to be based. Without an underpinning statutory base, some of the Draft Guide lacks the authority of Parliament, and risks being unenforceable, or amendable to judicial review, for being contrary to the Constitutional principle of the separation of powers (as embodied in *Fitzgerald v Muldoon* [1976] 2 NZLR 615). Only Parliament can determine the law, and where Parliament devolves power to the executive arms of Government under a delegated authority, there are limits on the exercise of that power, which are enforced by the Courts.

10. Accordingly, we suggest that the Draft Guide should clearly state that the 'fair outcomes' approach will be applied to filter FMA's enforcement decisions, and not as additional matters for financial market participants to ensure are achieved on top of the compliant behaviours required by law.
11. We note that when the Ministry for Economic Development, Innovation and Employment (*MBIE*) embarked on consultation in June 2010 on the securities law review (which ultimately resulted in the Financial Markets Conduct Act 2013 (*FMCA*)), MBIE specifically sought comment on whether New Zealand should adopt a 'treating customers fairly' overlay along the lines of the United Kingdom and Singapore approach. That overlay was not supported by consultation, and ultimately did not feature in the FMCA as enacted. We would be concerned if, contrary to that direction, FMA should try to introduce such an imprecise notion through its guidance, given the rejection of it as part of the 2010 – 2013 statutory reform process.
12. We instead prefer an approach that seeks to provide certainty on what the law is and which promotes innovation and flexibility in the financial markets.
13. Positively, there are currently statements in the Draft Guide that the desired outcomes are not rules (and do not change existing obligations) and some outcomes would naturally follow from meeting current legal obligations (as demonstrated by some of the examples). However, in contrast, other outcomes have no clear statutory basis and there are statements which indicate that the FMA is going to actively hold financial institutions accountable for fair outcome failures through 'robust conversations' and taking 'enforcement actions, where appropriate', when the FMA sees 'unfair practices'. This apparent inconsistency leads to debate and uncertainty as to the FMA's intent.
14. We suggest that FMA;
 - a. **clarifies the scope of each outcome** to ensure that it does not impose additional obligations on providers where there is no statutory basis,
 - b. **provides examples of what firms can do to meet FMA's expectations** (in respect of each outcome). If implemented, we also consider that the Draft Guide should identify when compliance with existing legislative requirement is sufficient to ensure delivery fair outcomes;
 - c. **clarifies which providers are legally required to provide fair outcomes and on which legal requirement the outcome is based.** In many cases, a fair outcome is supported by a legislative basis in at least a sector of the market (for example, KiwiSaver schemes have reasonable fees requirements, but these requirements do not apply universally). Likewise

different requirements apply only to financial advisers, insurers and other providers, but the Draft Guide does not distinguish between providers, causing confusions when it purports to extrapolate targeted laws across all financial service sectors; and

- d. **consider finalising the Draft Guide after the CoFI regime is properly implemented.** The legislative landscape for financial service providers is currently undergoing significant changes (in particular, the implementation of the CoFI Act regime). In our view, FMA should consider publishing the Draft Guide after those changes are more thoroughly embedded, and aligning the fair outcomes approach with CoFI's fair conduct obligations. This would ease the regulatory burden on those financial institutions and allow the FMA to justify the proposed outcomes approach on the current laws.

15. The feedback form with our full response to FMA's consultation questions is set out in the Schedule attached below.

	<p>From a legal perspective, we also note that this section also suggests that the outcomes will become the “starting point” for decision making. This approach potentially introduces conflicts with the existing regulatory settings (further discussed in Q13, 14 and 15 below).</p>
<p>2. What are your views on the proposed fair outcomes for consumers and markets? To what extent do you think the proposed fair outcomes will bring benefits for consumers, providers and markets?</p>	<p>Our views on the specific outcomes are discussed in more detail below.</p> <p>In general, we consider that (in its current form) the proposed fair outcomes will be detrimental to compliant providers because it proposes new and ambiguous compliance burdens. The proposed fair outcomes will unlikely deliver material benefits (beyond what is already delivered by legislation).</p> <p>The outcomes themselves have been drafted using subjective language (and standards). While we acknowledge that the Draft Guide states creating new compliance obligations is not intended, FMA has indicated that providers are expected to “demonstrate ownership and delivery of the fair outcomes”. This means that firms will need to be prepared to demonstrate to FMA how it is achieving those outcomes (at an individual level), which may require more than demonstrating the providers compliance with current law. We discuss this in further detail in Q11.</p> <p>The outcomes have also been drafted in a manner that partially refers to existing legal obligations and regulatory terminology. This creates a partial overlap which introduces a degree of ambiguity (and complexity) in how those obligations should be interpreted. We discuss this in further detail in Q12.</p>
<p>3. What are your views on Outcome 1: Consumers have access to appropriate products and services that meet their needs?</p>	<p>Outcome 1 introduces two new concepts of “access” and “appropriateness” of products and services. While these two words may have a basis in FMA’s general objectives and functions (as well as some specific purposes, for example, “availability” of financial advice under section 431B of the FMCA) these concepts will likely introduce uncertainty for providers as their meaning in individual providers contexts is illusive. In particular;</p> <ul style="list-style-type: none"> individual firms have limited influence over products and services available to consumers in the wider market (i.e., outside of the firm’s own offerings). It is unclear what FMA’s expectations for individual firms are (in respect of Outcome 1), especially in relation to their expectations of

	<p>FMA’s monitoring and enforcement of Outcome 1, and</p> <ul style="list-style-type: none"> • “access” and “appropriateness” may not always be achievable. For example, with legacy products, providers may be forced to decide between “access” and “appropriateness”. <p>Outcome 1 also does not acknowledge commercial limitations on providers (and their inability to achieve market outcomes).</p>
<p>4. What are your views on Outcome 2: Consumers receive useful information that aids good decisions?</p>	<p>Outcome 2 overlaps with existing disclosure requirements. There is a risk that this outcome would impose additional disclosure obligations (or prohibitions) where there is no specific legal requirement for certain firms.</p> <p>For example, under the CoFI Act, financial institutions will be required (specifically) to assist consumers to make informed decisions (under section 446C of the FMCA). Outcome 2, in effect, introduces another “similar” requirement which partially overlaps with the section 446C requirement (and which could apply to non-financial institutions too).</p> <p>In such cases, it will be useful for FMA to provide examples of when compliance with a regulatory requirement would meet FMA’s expectations for the outcome. We discuss this further below in Q17.</p>
<p>5. What are your views on Outcome 3: Consumers receive fair value for money?</p>	<p>Outcome 3 formalises FMA’s 2021 “guidance for manage fund fees and value for money” and 2022 “Value for Money Industry Report” and expands this principle to the wider financial services sector.</p> <p>From a legal perspective, this is a significant imposition of a regulatory obligation that previously applied only to KiwiSaver schemes under the KiwiSaver Act 2006.</p> <p>In terms of the monitoring of Outcome 3, FMA should consider the risk of a significant regulatory burden and capacity (both for providers and the FMA) discussed in the 2022 “Value for Money Industry Report”.</p>
<p>6. What are your views on Outcome 4: Consumers can trust providers to act in their interests?</p>	<p>Outcome 4 overlaps with existing duties relating to customer interests, and potentially expands the requirement to new firms (where there is presently no specific legal basis).</p> <p>For example, financial advice providers have duty to give priority to client’s interest under section 431K of the FMCA. Outcome 4 adds an additional layer to this existing duty creating a “partial” overlap (resulting</p>

	<p>in ambiguity and potentially requiring financial advice providers to “update” their compliance plans).</p> <p>Outcome 4 also introduces the concept of a “trusted provider” which refers to the provider’s actions to safeguard its consumers’ assets and data, and be operationally resilient. Again, firms will have existing obligations in terms of cyber resilience (for example, under the Standard Conditions for financial advice providers). Since Outcome 4 mixes this concept with the concept of “acting in the consumer’s interests”, this potentially expands the definition of “interests” in respect of existing obligations (such as section 431K of the FMCA identified above).</p> <p>As mentioned for Outcome 2, it would be beneficial for firms to understand when compliance with a legislative requirement would satisfy FMA’s expectations for the outcome (discussed further below in Question 17).</p>
<p>7. What are your views on Outcome 5: Consumers receive quality ongoing care?</p>	<p>Outcome 5 does not adequately reflect the commercial factors underlying the dichotomy between providers and consumers, as well as the existing Consumer Guarantees Act 1993 regime (which is not administered by the FMA).</p> <p>Ongoing care, including the quality of such care, is generally derived from the contractual terms between the provider and consumer. Drivers include pricing of the service / product, but also includes more fundamental factors such as the nature of the product / services.</p> <p>The term “quality” is also not defined and adds an additional layer of conduct expectations (for example, in relation to “complaints”).</p>
<p>8. What are your views on Outcome 6: Markets are trusted based on their integrity and transparency?</p>	<p>It is not entirely clear what the expectations are of individual providers under Outcome 6.</p> <p>Based on our understanding, “integrity and transparency” can refer to (among other matters) an individual firms’ governance arrangement (i.e., via the reference to the RBNZ and FMA Governance Thematic Report published in 2023). If so, how FMA interprets the term “trusted” could become very significant and lacks precision. Trust is not easily earned and depends heavily on the subjective reaction of the consumer.</p> <p>There is also some potential overlap with the “trusted provider” concept (intentional or otherwise) in Outcome 4 when considering how this outcome might apply to an individual providers.</p>

<p>9. What are your views on Outcome 7: Markets enable sustainable innovation and growth?</p>	<p>Again, it is unclear how this will be monitored and what the expectations are of individual providers.</p> <p>As discussed in Q3, individual providers will have limited ability influence whether the market itself is enabling sustainable innovation and growth.</p>
<p>10. Is anything missing that should be included in the fair outcomes? Please explain</p>	<p>As discussed above, what is missing in each of the outcomes is clear acknowledgement of the basis in existing legislative regime for the seven outcomes.</p> <p>While some outcomes may refer to (or use similar language) to existing legal requirements, there are no examples of when compliance with existing legal obligations would meet FMA's expectations under each outcome.</p> <p>Instead, this creates a "partial" overlap with existing requirements which make interpretation of those requirements more complex and introduces incrementally additional compliance requirements.</p> <p>If FMA considers that an outcome can never be reached by compliance with the existing legal obligation alone, this may also indicate that the outcome is imposing a new rule or requirement.</p>
<p>11. If you are a provider of financial products or services, how will you demonstrate ownership and delivery of the fair outcomes? What will be the implications for your governance, leadership, management and operations, and how they work together?</p>	<p>Chapman Tripp is not a provider of financial products or service, however we wish to respond to this question.</p> <p>As noted above, each of the outcomes rely on subjective terms and concepts. This means that, in effect, individual providers would need to "argue" how it is demonstrating ownership and delivery of the fair outcomes. This also means that demonstrating ownership and delivery of the outcomes would require significant investment in compliance processes (and that information about non-achievement those outcomes is recorded by the provider and remedial steps be taken). This is a significant issue for smaller firms, as well as larger financial institutions currently undertaking large regulatory change programmes (in response to the CoFI Act).</p> <p>Unfortunately, "fairness" is an imprecise notion, with scope for considerably subjectivity and different application even amongst a class of investors in the same product, depending on their different characteristics. By contrast, legislated minimum standards set some baseline conduct expectations that the FMA can legitimately seek to uphold.</p> <p>Use of subjective terms and concepts will also need to be applied to existing compliance requirements,</p>

	<p>which adds an additional layer of complexity (discussed below at Q12).</p> <p>If implemented, we consider that the Draft Guide should provide clarification on when compliance with existing legislative requirement should be sufficient to demonstrate ownership and delivery of the fair outcomes.</p>
<p>12. If you are a provider of financial products or services, how will outcomes-focused regulation help support your regulatory compliance? Are there areas you will find challenging or where you have concerns?</p>	<p>Chapman Tripp is not a provider of financial products or service, however we wish to respond to this question.</p> <p>The outcomes have been drafted in a manner which partially refers to existing legal obligations and shares similar terminology. This partial overlap introduces ambiguity (and potential misalignment) in how those obligations should be interpreted. For some firms, the outcome may even impose additional obligations where there is no specific legal requirement.</p> <p>For example, re-using the concept of “fair” may create potential overlap (and expand) existing concepts of fairness (for example, under the “fair conduct principle” in the CoFI Act and the Code Standards for financial advice providers) to all regulated firms.</p> <p>In practice, this means that some firms which comply with the requirements (prescribed in legislation) might find itself falling short of FMA’s expectations in terms of delivering the required fair outcomes.</p>
<p>13. Do you have any comments in relation to how a move towards a more outcomes-focused approach to regulation should influence our supervision and monitoring approach?</p>	<p>While an outcomes-based approach might be a useful factor for the FMA when reviewing the overall effectiveness of its supervision and monitoring approach, it should not be the starting point of decision-making as described on page 13 of the Draft Guide.</p> <p>The starting point for FMA’s regulatory approach should be the legislative regime itself. This includes the FMA’s use of any legal powers (for monitoring, supervision and enforcement).</p>
<p>14. Do you have any comments in relation to how a move towards a more outcomes-focused approach to regulation should influence how we seek to address and hold individuals and entities accountable for misconduct?</p>	<p>Our response to Q13 above (in relation to monitoring and supervision) also applies to Q14 (in relation to FMA’s enforcement activities).</p> <p>The thresholds for when misconduct (requiring enforcement action) occurs is prescribed in the legislative regime. Whether or not a breach has occurred should first be determined by the legislative regime itself (interpreted in accordance with established statutory interpretation principles), before</p>

	any purposive or “fair outcomes” based enforcement filter is applied.
15. If you are a provider of financial products or services, what are your views on the link between outcomes-focused regulation and innovation? Will it provide you with increased flexibility to achieve your business needs?	<p>Chapman Tripp is not a provider of financial products or service, however we wish to respond to this question.</p> <p>In our view, the Draft Guide (in effect) adds an additional layer of conduct expectations which further complicates the existing financial markets conduct regulations. The increased compliance burden will likely reduce the incentive for innovation.</p>
16. If you are a consumer or consumer group, do you understand the fair outcomes and are they relevant to your interactions with the financial sector?	Chapman Tripp is not a consumer group.
17. What are your views on the examples provided in the guidance? Are they helpful, and are there any other examples we should include?	<p>The examples provided in relation to each outcome generally focus on “what not to do” (i.e., the negative), despite the outcomes themselves being framed almost entirely on “what to do” (i.e., the positive). This approach creates uncertainty.</p> <p>We suggest that examples of “what to do” (in respect of each outcome) are prepared and given primacy. This will better support the delivery of the outcomes (rather than avoid “non-delivery”).</p> <p>In particular, examples of when compliance of existing regulatory requirements would help individual providers demonstrate ownership and delivery of fair outcomes.</p>
18. Do you need any further guidance or support from the FMA in relation to outcomes-focused regulation or the fair outcomes?	<p>As stated above in our cover letter, the FMA should;</p> <ul style="list-style-type: none"> clarify the scope of each outcome to ensure that it does impose additional obligations on firms where there is no legal basis, provide examples of what firms can do to meet FMA’s expectations (in respect of each outcome). If implemented, we consider that the Draft Guide should provide clarification on when compliance with existing legislative requirement is sufficient to demonstrate ownership and delivery of the fair outcomes, and consider finalising the Draft Guide after the CoFI regime is properly implemented. This would ease the regulatory burden on those financial institutions (and the firms it interacts with) and allow the FMA to base its objectives with a broader current legal basis.

Feedback summary – *if you wish to highlight anything in particular*

Please note: Feedback received is subject to the Official Information Act 1982. We may make submissions available on our website, compile a summary of submissions, or draw attention to individual submissions in internal or external reports. If you want us to withhold any commercially sensitive or proprietary information in your submission, please clearly state this and note the specific section. We will consider your request in line with our obligations under the Official Information Act.

Thank you for your feedback – we appreciate your time and input.



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