FMA
FINANCIAL MARKETS AUTHORITY
TE MANA TATAI HOKOHOKO - NEW ZEALAND

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Trust and confidence in financial services – Are we there yet?

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Given the phased implementation of the FMC Act, it's easy to forget that the FMA was actually set up over two years before that Act was even passed. It was our fifth birthday on May 1. Actually we did get one present. A formal complaint from Winston Peters.

Anyway….. the FMA's early years were dominated by wading in the rubble of the finance company collapses. That work is largely but still not completely done.

We were also dealing in the early period with the Financial Advisors Act and preparing for the FMC Act. That statute, and therefore our full remit, wasn't legislated until 2013 and didn't start to come into effect until 2014. And it's not over. The licensing work for MIS and a number of transitional periods will take us all the way to the end of this year.

So, at this point, where are we as an organisation? What's the status of conduct regulation of financial services in New Zealand? And where is it headed?

In terms of defining and articulating how we intend to go about our conduct regulation mandate, we are still a work in progress.

In terms of building our capability – whether that is funding, human resource, IT/systems, management and performance evaluation information – I'd say we have matured rapidly. But we're still evolving to meet the full range of our remit as it now looks.

And in terms of industry understanding of what we are trying to achieve, and the tools we intend using to do it, I'd say we are only just off the ground. That's not unreasonable given that we are barely two years into our new regime.

So, overall, we remain in build phase. But we are in the final stages.

As a proud Englishman, who grew up in a village bearing the great man's name, I'm always willing to paraphrase Sir Winston Churchill. So let me say that this is the end of the beginning.

Part of our job is to ask the businesses and professionals we regulate to take a good look at what they do and why and how they do it. It's only fair we do, too.

So here's my five-year report card on the FMA:

What's gone well

1. The enforcement outcomes of the Finance Company cases
2. Our transparency around consultation and policy work and, through the Strategic Risk Outlook, of what risks we are focussed on and why
3. The work done on exemptions and designations under the FMA Act – this is vital but unglamorous work, often unseen outside of a small circle of lawyers and market participants
    i. This reflects our strong focus on trying to mitigate wherever we can, the compliance burden of the new legislation; and avoiding a one-size-fits-all approach
    ii. It involves a significant resource commitment - often on sectors or products that do not feel part of our mainstream regulatory responsibilities but nonetheless are caught by the FMC Act
4. Engagement with newly regulated sectors – we get a lot of good feedback on this – and it may be worth adding that just because we don't always agree does not mean that the engagement is not worth doing. Quite the opposite.
5. Impact of NZX oversight – you can track our influence on and oversight of the NZX's regulatory obligations through the GOR. This is a relationship with healthy tension, which is how it should be. Right now we are working well together in looking to develop NZ's capital markets.
6. Relationship with other agencies/government depts. Sharing information, contributing to policy, collaborating on things like the use of Behavioural Insights within KiwiSaver. In our space, this is the SFO, MBIE, ComCom, RB, CFFC.
7. Corporate Governance – we have done significant work in this space, often in partnership with IOD, and we are working closely with the NZX.
8. International connectedness – we work hard at our relationship with other regulators – esp. ASIC, and our contribution at global organisations such as IFIAR (on audit regulators) and IOSCO (for securities regulation).

What's gone less well. Or has just been more of a challenge

1. The switch in enforcement focus from post-mortems on dead bodies to treating live ones brings some challenges. Mostly, this is about getting the balance right in important areas. Such as:
    - Speed versus thoroughness of investigation
    - Openness versus secrecy: in particular, transparency about what we look at (and why)/what we take action on (and why) and what we don't take action on (and why)
    - Developing understanding of the broader range of powers and tools at our disposal than just going to court. I'll talk about that in more detail.
2. A new regulatory landscape
    - There is an element of culture shock for firms that have not been regulated before and indeed those that are regulated elsewhere but can't grasp why the same needs to happen here in NZ.
    - It can be difficult for management and their advisors to adjust to the end goal of higher regulatory expectation and customer outcome, being achieved through the means of pragmatic and open dialogue

- To flesh that out, we still see defensive and adversarial positions taken in scenarios where a grown-up – and early – conversation would be infinitely preferable

From my perspective, let's call it a pass. If I look at what investors are saying in our Investor Confidence Survey, with just over 60% saying they're confident in the regulation of our financial markets, which sounds like a pass too. A pass is OK, but we can do a lot better. Let's talk about how.

First. We need to talk about conduct.

Conduct is what the FMC Act says on the tin. It's vital to markets that are fair, efficient and transparent. It impacts directly the confident and informed participation of businesses, investors and consumers in our markets.

Our conduct regulation mandate is a notable shift in emphasis for NZ's securities regulator - in terms of the relationship with, and understanding of, the sectors we regulate and what we look for to be confident that a regulated business or individual has the interests of their customers at the centre of what they do and how they do it.

This conduct emphasis is also a shift for the businesses and professionals we regulate. It means thinking differently about what they do with their people and organisational culture, and their processes and controls, to **show** us – and their customers – that they understand and can demonstrate good conduct.

Our main focus will be ensuring that regulated businesses and individuals:

- are demonstrably delivering the outcomes their customers want
- have designed processes, systems and governance with that goal in mind – not solely for profit
- can clearly articulate, and support with examples, how their conduct reflects the appropriate alignment of customer, business and, where relevant, shareholder interests
- are disclosing to investors and the public what they are doing to meet their regulatory obligations and the principles of good conduct, and how they are doing it.

How are we going to enforce all of that?

First, if firms can't show us those things and convince us they have customers' interests at the centre of what they do, we'll regard them as a higher conduct risk. That their customers have a higher risk of getting poor outcomes. And we will pay more attention to that firm.

Second, if we become aware, for example through complaints, that customers are getting poor outcomes; and after looking into it are satisfied that poor conduct is wholly or partly to blame for those outcomes; then we will take action.

Conduct is what actually happens to customers, investors and markets. Conduct is behavioural and it comes from culture.

Culture

I talked about this recently at the Infinz awards dinner and its worth reiterating here. **The FMA does not and should not prescribe culture.** Senior leaders of industries and firms , decide culture. They must be accountable for what actually happens inside their organisation, and the outcomes for their customers.

Culture is formed in the peripheral vision. In all workplaces, people look to examples set by their colleagues. Not only what they do, but what they endorse by walking past it. If you ignore something, you accept it, and staff know this.

Our role in this is to get the leadership of firms to think very hard about what they do - as boards, and as senior management teams, and why..

If necessary, we can also focus the mind with object lessons of the regulatory consequences of poor culture.

Let's look a bit deeper at how we plan to enforce.

Enforcement

We have – we are – a law enforcement agency within a broader supervisory regulator. We have lawyers and policy wonks and investor capability tragics and we have interrogators and door kickers. And they all love their work. This gives us the ability to be flexible. To have a proportionate response to what we see.

Some in the media like to portray this as being soft. Blood, after all, is much better copy than a warning. But effective, as opposed to entertaining, regulation does NOT always involve court proceedings when things go wrong (though our credible will and ability to take that action is critical).

Court proceedings involve delay, expense and uncertain outcomes. So it's great we don't have the constraints of having only a sledge hammer and treating everything like a nail.

But sometimes court is the best deterrent. It can offer the best punishment for wrong-doing or the best option for getting compensation for victims; or it helps clarify the law.

You don't have to use the biggest stick, of course. In all but the nastiest cases, its **shadow** can be a most effective deterrent.

In a "live" environment, where there are important lessons for firms or sectors or other reasons why an early resolution is critical (such as certain and earlier payments for victims), we will always consider all the options. But rest assured, that where we decide court proceedings are the best option, we will pursue them rigorously and enthusiastically (and we have plenty in the pipe-line).

Our decision-making about when to punish and how is, by necessity, not always completely transparent. We constantly assess whether we have got the balance right. But the views of management and our external advisors is rigorously tested by our board.

This assists us in ensuring we are objective, fair and consistent in our decisions across a space where many of the legislative requirements are either new to those involved or substantially changed.

Current and future focus areas.

Deepening and broadening our perimeter –what's inside our remit, what's outside and are those the right settings?

You might think I am talking here about – FX trading, overseas entities, FSPR, scams etc. – and for sure there has been plenty of that. But our anxiety about where our perimeter lies actually reflects that the biggest pieces of financial services in NZ sit outside it – by which I mean the Banks and Insurers. We don't license them, but their sales practices are covered by the Fair Dealing provisions of the FMC Act

There is an issue of how far our conduct remit under the FMC Act can be stretched to cover what goes on at banks and insurers and how that can harm customers.

We'll be making enthusiastic use of our Fair Dealing powers under the Act. And, where we believe it's merited, we'll also look to initiate debate about the extent to which our laws should address conduct that is not caught by those provisions, focused as they are on sales practices..

KiwiSaver – defining our role

As a mass-market "savings" or retirement planning mechanism, KiwiSaver may seem more of a natural fit for government and the Commission for Financial Capability. But as KiwiSaver is typically the main or only "investment", for most NZers it's a critical risk area for us as market regulator.

In addition to having oversight of fair treatment and good outcomes for KiwiSaver customers, we are beginning to put significant time on helping them to understand the barriers to and benefits of good investment decision-making. Setting objectives and understanding risk. The impact of fees and how to compare them. This is also relevant to managed funds generally.

There are more fundamental hurdles to understanding, of course. Disengagement and lack of knowledge. The lack, among many New Zealanders, of any critical framework to bring to a discussion about fees even if they are transparent. Many KiwiSaver members don't even know who their provider is.

So we also focus on how providers engage with their members to assist them to make sound decisions in their own interest. Particularly default providers who have signed up to, among other things, educate their members.

Managed Funds

I cannot talk about our current and future focus areas without talking about MIS, or managed funds, more generally.

Licensing is a big exercise and it fills the remaining major hole in our regulatory framework, compared to the rest of the developed world.

Licensing is good as a standard-setting process but it gets you only so far. We see it as the means to an end. It enables us to:

1. establish a platform from which we can build our knowledge of the licensed business or individual;
2. set our expectations about governance, conduct, systems and controls. And then monitor how they are being met; and
3. establish a relationship and a dialogue which we can continue through supervision.

We're conscious of the need not to unnecessarily penalise smaller/start-up entrants with over-burdensome process. And that one size does not fit all. Customers' needs can be met with all sorts of business models and this is a key assumption of the FMA Act. But we're also conscious that this is our first and best opportunity to make clear our high expectations of conduct, regardless of scale or nature of business.

On this point, I just returned from IOSCO's annual conference and regional committee meetings. From there it was good to have validated that many of the areas we are working on in New Zealand are common across the globe. The performance and charging model for managed funds is an issue that is quickly rising up the list of priorities for securities regulators everywhere.

In that respect the FM industry globally has not helped itself or its customers by being product- rather than customer-outcome driven; and having complex, opaque fee structures.

Wholesale market conduct

Currently we're figuring out where we play here, relative to other frontline regulators and oversight bodies .

To date, our focus has been on market manipulation/trading activity and insider trading; and on continuous disclosure for listed companies and their engagement with investors.

We are interested to understand how banks have responded to the global issues and those across the Tasman in benchmarks such as BKBM and other areas. We have asked the question - have you looked at your current practices in light of what has transpired elsewhere? Have you looked back at your practices in the past?

And so - do you have anything to tell us?

Many jurisdictions have looked at bringing submissions to benchmarks and FX trading more generally into the securities framework so that market manipulation rules etc. will catch it. Currently, fair dealing is our only angle on this under the FMC Act.

But it is important for it to be properly captured, as we can't allow institutions to sit back and allow the gaming of the markets when individuals can be taken to court for the same activity in other areas of the market.

Financial Advice

I am going to leave this topic largely aside on the basis that the FAA review is soon to reach its conclusion with MBIE recommendations to the Minister.

I will say however that financial advice continues to be a core focus area given that many interactions of NZers with financial services either do – or should – involve some degree of advice.

I will also add that we strongly support the proposal to level the playing field across advice by ensuring that anyone delivering it be subject to the requirement that they do not put their interests before those of the customer.

This sounds incredibly simple although I know that some object to it. I would add that I support the imposition of this as a basic standard across the entire financial services industry and not just financial advice.

In the context of advice and its accessibility, I believe that what we should be aiming for is the existence of robust, well-regulated and trustworthy offerings that include:

- independent non-aligned advisers
- well-trained and thoughtfully incentivised sales forces in banks etc.
- robo or digital advice channels – which may often be constructed and managed offshore, and which will become a major influence for the generations below 40-45.

Wrapping up

Making investment decisions is hard. And once you've made one, it can also be hard to tell when something has gone wrong until it's too late to fix it. Which, of course, can include choosing the wrong thing in the first place. Or, as is so often and so depressingly the case here in New Zealand, because you've actually not made a choice at all.

We are not buying TVs or phones. We are buying something to provide for our families when we die or get sick. We are investing our savings so we can enjoy our retirement, or help our children to have better lives. We are engaging not with a product, but with our own futures and it is incredibly important for that to be brokered fairly, honestly and effectively.

Financial services is different. People deserve to be treated fairly and to know that the individual or business they are dealing with is operating with their interests at heart, not ripping them off. They need to be confident that the massive knowledge asymmetry in the investment decision conversation is not being used against them.

Providing someone with a phone or a TV is a transaction. Being trusted with someone else's money and future objectives is a privilege. I don't imagine anyone in this room will feel differently. And that's what our conduct regime is all about.

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