

Confidential**Our reference**
10000027Financial Markets Authority
Level 2, 1 Grey Street
Wellington, New Zealand

8 March 2024

By email consultation@fma.govt.nz**Consultation: Proposed fair outcomes for consumers and markets**

- 1 This is DLA Piper's submission on the FMA's Consultation: Proposed fair outcomes for consumers and markets. DLA Piper is a global business law firm with offices in over 40 countries. In New Zealand, DLA Piper operates out of Wellington and Auckland. Contributing authors were Alasdair McBeth, Rachel Taylor, Emma Moran, Daniel Street and Tom Barnes. Thank you for accepting this late submission.

General comments

- 2 We support the concept of fairness and the vision of a market delivering good outcomes for all participants – consumers, providers, and the broader economy. We also acknowledge the important and difficult role the FMA has in influencing market conditions to support that vision. However, we have concerns with the proposed outcomes-focused approach to regulation and how it is expressed in the draft guide. Our main reservations are:
- 2.1 Costs v benefits: Like any regulatory change, the guide and the proposed shift in regulatory approach will impose costs on the market as providers spend time and money understanding the change and taking action to address it. Given that cost, it would be helpful to understand why the change is being made (ie what problem the change is seeking to address and how the change would address that problem) so providers can understand the rationale and are best placed to respond. We are not sure this has been articulated in the FMA's work to date.
- 2.2 Hindsight bias and the fairness of judging based on outcomes: The FMA has formidable investigation and enforcement powers. The consequences of being subject to those powers can be severe. The suggestion that those powers would be exercised by reference to "outcomes" is concerning, particularly given outcomes are outside one's control and judged with the inevitable bias of hindsight. We think the better and fairer reference points are the more traditional measures of conduct (what one does) and intention (what one seeks to achieve). We are also uncomfortable with the implication that the risk attached to a failure to achieve an outcome sits solely or primarily with the provider. This seems unfair.
- 2.3 New regulatory uncertainty: We do not think it is entirely clear what the outcomes mean, who will assess them and how that assessment will be done. We worry about the new uncertainty this would introduce into the regulatory landscape, and the challenges this would create for providers and consumers. For providers, uncertainty would make navigating the landscape more difficult, increasing costs and risks. We expect this would suppress innovation and competition as providers divert limited resources from new ventures to compliance efforts or, worse, stay out of the market entirely due to risk. Competition (and by extension, innovation) is essential for a properly functioning market. For consumers, the knock-on effects would be less

choice, higher prices (or price regulation) and/or the need for government to enter the market as a provider. We would have difficulty supporting this.

- 2.4 Relationship with existing rules: It is also not clear to us how the outcomes relate to existing legal obligations and FMA guidance, including COFI and the 2017 conduct guide. The draft guide says the outcomes are not new rules and do not change or even supplement legal obligations. But elements of the outcomes are similar to (but not the same as) those legal obligations and, in practice, providers tend to treat FMA guidance as if they were rules anyway. So the discordance between the draft guide and existing law / FMA guidance creates confusion about what action one must, or should, or is expected to take. The issue is particularly evident with COFI given COFI addresses similar subject matter ("fair conduct principle" v "fair outcomes"), is currently under review, and its future shape is not yet clear.
 - 2.5 Legal basis: The outcomes-focused approach to regulation has been a feature of the UK's financial services regulatory regime for some time. Elements of that, in particular the Consumer Duty, bear a strong resemblance to the proposed outcomes in the draft guide. But the UK Parliament has conferred broad rule making powers on the FCA and, commensurate with that power, the FCA engages in extensive policy work and consultation before introducing new rules. In NZ, the FMA's formal rule making powers are much more limited and the policy basis for what appears to be a fundamental shift in regulatory approach is not apparent. We appreciate and support the FMA's function of issuing guidelines and making comments, but we think more is required before we could be confident that the guide would advance fair, efficient and transparent financial markets in the New Zealand context.
- 3 We therefore suggest the following:
- 3.1 Pause: Wait until the COFI rewrite is complete (or well advanced) before progressing further work on the guide. This will enable the two initiatives to work together, and mitigate the risk of inconsistency, duplication, and potential confusion.
 - 3.2 Explain: Explain the reason(s) for the guide. What problem(s) is the guide seeking to solve, what options were considered for solving it and why was the approach set out in the guide considered the best of those options? This would better enable market participants to understand the purpose and therefore respond to it.
 - 3.3 Reframe: Reframe the guide as a statement of how the FMA will assess products, participants, and market segments to identify why, where, and how to focus its regulatory attention – within the context of the law. Explain the factors the FMA will consider and the process/methodology it will apply. This would avoid the guide being perceived as imposing new and uncertain rules outside the existing legal framework while also providing useful guidance about the FMA's regulatory approach that positively influences market behaviour.
 - 3.4 Clarify: Minimise uncertainty by expressing ideas using language that is clear, consistent, and direct. Apply objective standards where possible and, where subjective standards are used, explain how those standards will be tested. Clarify the relationship between the guide, existing legal rules and other FMA guidance to bring more certainty to the status and meaning of the guidance. This would avoid wasted compliance effort and the potentially adverse consequences of adding unnecessary uncertainty into the regulatory landscape.

- 3.5 Consult further: Given the significant nature of the change, consult further before finalising anything.
- 4 We would welcome the opportunity to discuss our submission with the FMA.
- 5 To be clear, we are not necessarily against an outcomes-based approach to regulation – further thought would be required to determine if that is the right approach for NZ – but we do think the introduction of any outcomes-focused approach to regulation should have the following features:
- 5.1 An explicit legal basis: The current law does not provide for outcomes-based regulation; it is based on disclosure and conduct. While there is an argument that an outcomes-based regime could be accommodated through the FMA's discretion as to enforcement (on the one hand) and the FMA's exemption or no action powers (or on the other), it is not a natural fit under current law. Accordingly, seeking to apply it would come with legal risk.
- 5.2 Regulatory sandbox: Hand in glove with an outcomes-based approach to regulation is the idea that if providers are responsible for achieving certain outcomes, they must also have the freedom to choose how they go about achieving them ie the concept of the regulatory sandbox. While this is hinted at in the guide, again, it is not clear how this could be safely achieved within the current rules. A sandbox requires the ability to provide compliance relief on a basis, and within a framework, that seems much broader than the FMA's current exemption and no action powers. With that said, we think there is serious merit in exploring a regulatory sandbox and would welcome further conversations about this.
- 5.3 Independent arbiter: The FMA has the power to grant and revoke licences; it is effectively a gatekeeper to the market and recourse for FMA decisions is generally limited (and, where available, is expensive and uncertain). If NZ were to move to an environment where providers are judged based on subjective, outcomes-based measures, then, as a matter of fairness, the determination of market access and other existential matters for providers should be determined by an arbiter independent of the FMA.
- 6 If an overarching outcomes-based regulatory regime were to be implemented, this should be done through law reform and only after the normal rigorous policy and public consultation processes. If there were such a process, careful consideration should be given as to whether this approach is the right approach in the NZ context.

Responses to consultation questions

Is the way we have described our outcomes-focused approach to regulation clear, and do you understand how a focus on outcomes will be reflected in our work? Please explain.

- 7 We do not think so. We had difficulty understanding the proposed outcomes-focused approach and it was not apparent to us how the focus on outcomes would be applied by the FMA.
- 8 The language used to describe the approach and the FMA's role in that is high level and aspirational. While this goes some way to putting colour on the underlying philosophy, we think a more detailed and precise explanation is needed. The FMA's guidance has a material influence on market behaviour and, perhaps as a consequence of the FMA's licensing and enforcement powers, many providers treat the FMA's guidance as if it were law. It follows that

where the FMA issues guidance, there should be a strong preference for that to be certain and clear. Although the underlying philosophy is useful context, we think more detail is required.

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?

- 9 We support the ideas of fairness and seeking to calibrate market settings to provide good outcomes. We also acknowledge the role of the regulator in that calibration exercise, and the difficult and complex trade-offs that are sometimes required. However, we have a level of discomfort with a regulatory approach that uses outcomes as the starting point and some concerns about how the outcomes are described.

The outcomes basis

- 10 Outcomes are, by definition, judged in hindsight. This gives us pause in a few respects:
- 10.1 Once a bad outcome crystallises, the behaviour that contributed to that outcome has already occurred. At this point, it is too late to take action to change that behaviour. If prevention is better than cure, a regulatory approach based on outcomes seems flawed.
 - 10.2 Outcomes are not within the control of the provider. Provider conduct is just one factor that determines outcomes. External factors affecting outcomes could be as diverse as an unexpected change in the consumer's personal circumstances to market movements. Using outcomes as the basis for a regulatory standard seems unfair and risks hindsight bias.
 - 10.3 It implies that providers are guarantors of outcomes. Normally, guarantees need to be explicitly and voluntarily offered and, where provided, are for a specific and defined matter. However, the guide could be read as extending this to require providers to underwrite the proposed outcomes to all their customers.

Uncertainty

- 11 We support the intent behind each of the draft's seven outcomes. It is hard to argue against the intent and we would be surprised if anyone said, for example, that consumers should *not* have access to appropriate products and services that meet their needs.
- 12 However, if providers are to apply the guide, they need to understand what the outcomes mean in practice. That is not entirely clear from the current drafting, primarily due to its use of imprecise and subjective standards.
- 13 The "fair" standard is a good example. We might all know what fair is when we see it – but different people can reasonably have very different views about what is fair in any given situation (Is it fair to keep a performance fee legitimately earned in a bumper year if performance is poor in following years? Is it fair to impose a financial penalty on a co-operative for overcharging members when the financial burden of the penalty will be borne by those same members?). The same is true for the standards of "appropriate", "suitable", "useful", "quality", "integrity" and "sustainability".
- 14 In our view, this introduces too much uncertainty into the regulatory landscape. For the reasons set out above, we are worried about the challenges this will pose for providers, the cost to the market and potentially adverse downstream effects for consumers. This comment applies to all the outcomes.

What are your views on Outcome 1: Consumers have access to appropriate products and services that meet their needs?

- 15 The scope of "access" should be clarified. Is this an aspiration for the market as a whole or something that individual providers should be concerned about? If it's an aspiration for the market as a whole, then what (if anything) is the FMA expecting individual providers to do in response to it? If it's something individual providers need to concern themselves with then what is the extent of the expectation? For example, would a boutique fund manager specialising in New Zealand equity strategies be expected to offer, say, diversified funds? Or a life insurer be expected start offering health insurance?
- 16 The meaning of "appropriateness" (or "suitability") should also be clarified. How is suitability determined and by whom? And is it sufficient that a product "meets a consumer's needs" or is more required for that product to be "appropriate" / "suitable"?

What are your views on Outcome 2: Consumers receive useful information that aids good decisions?

- 17 This outcome introduces broad novel concepts in terms of "useful" and "aids good decisions" in a manner that creates some duplication and risks confusing pre-existing regimes. In particular, it appears to overlap substantially with the COFI duty to treat consumers fairly including by assisting them to make informed decisions. However, it appears to extend that obligation, potentially placing a heavy burden on providers.
- 18 The draft identifies life insurance replacement an example of how this might work, noting the FMA's 2018 *Thematic review of insurance replacement business practices* found instances of poor-quality advice where firms failed to advise customers that replacing their life insurance could lead to worse cover or loss of benefits. However, it is unclear to us how this new outcome would substantially assist the position under COFI and not risk confusion.
- 19 It is possible that a consumer provided with sufficient information to be "informed" may make a different view of what is a "good decision" from a provider. Placing an obligation on providers to achieve this objective assumes that there is an objective "good decision".

What are your views on Outcome 3: Consumers receive fair value for money?

- 20 We have some concerns with this outcome. Value is a subjective concept and ultimately it is the role of the market to determine what is fair value. The regulatory regime supports that by requiring truthful disclosure of material information. Overlaying this by setting "fair value for money" as an explicit regulatory objective feels like a move towards price regulation.
- 21 The FMA's value for money initiative in the funds management sector has resulted in material additional compliance costs. It is not clear whether the cost has been justified by the result. We worry that this "fair value for money" outcome foreshadows an extension of that initiative to the wider market.

What are your views on Outcome 4: Consumers can trust providers to act in their interests?

- 22 The "trusted provider" definition seems too narrow. It focuses on protecting customer data and assets, and operational resilience. We think trust is a deeper concept, including that the provider can be depended on to do their job properly and will, subject to the terms of the bargain struck with the consumer, diligently attend to the consumer's needs.

What are your views on Outcome 5: Consumers receive quality ongoing care?

23 See our earlier comments.

What are your views on Outcome 6: Markets are trusted based on their integrity and transparency?

24 See our earlier comments.

What are your views on Outcome 7: Markets enable sustainable innovation and growth?

25 See our earlier comments.

Is anything missing that should be included in the fair outcomes? Please explain.

26 See our earlier comments.

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?

27 Not applicable. While this is primarily an issue for providers, we think there may be merit in the FMA more clearly articulating how it expects providers to demonstrate ownership and delivery of the fair outcomes.

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?

28 Not applicable.

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?

29 See our earlier comments.

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?

30 See our earlier comments.

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?

31 Not applicable.

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?

32 While this is not applicable to us directly, these are matters we expect to be providing advice on. We have reservations that the outcomes are understandable and relevant for the reasons outlined in this submission.

What are your views on the examples provided in the guidance? Are they helpful, and are there any other examples we should include?

- 33 Many of the examples seem to cite the FMA's previous publications. This information is already available so while it is useful to link the outcomes to the FMA's previous work it does not add significantly to the understanding of the outcomes.
- 34 What would be useful is hypothetical examples of how the FMA expects that it (as the regulator) and providers (as market participants) will respond to each outcome. These could usefully cover a range of common situations in which the FMA and providers find themselves in. For example, how is the "consumers receive quality ongoing care" outcome to be responded to in relation to customers who have low-interest transactional accounts with persistently high balances?

Do you need any further guidance or support from the FMA in relation to outcomes-focused regulation or the fair outcomes?

- 35 See our earlier comments.

Yours sincerely

DLA Piper New Zealand