New Zealand Shareholders Association Inc.
NZSA®
Many Investors, One Voice

FMA Consultation,
Wellington.
18 July 2017.
By email

Re: Submission by New Zealand Shareholders Association on the proposed exemption to facilitate personalize robo-advice.

Relationship of Submitter:

The New Zealand Shareholders Association (NZSA) is the only independent organisation representing New Zealand retail equity and debt investors. The Association has 6 regional branches across New Zealand, with a separate Head Office and executive function in Auckland. NZSA is regularly consulted as a "key participant" by MBIE, market regulators and a wide range of other capital market participants. Most of the Association's members are active investors, and many utilise financial advice services at a range of levels, both generic and personalised. While our interest is primarily in the areas noted above, we are also concerned to see that all advice is regulated in such a way that those giving it are competent to do so and that it is "fit for purpose."

Executive Summary

NZSA has previously submitted on various aspects of the Financial Advisors Act (FAA) review. We have expressed concern about the availability and cost of personalised financial advice, particularly for smaller or beginning investors. We acknowledge that technological change must be embraced to best achieve outcomes and are not opposed to the concept of robo-advice, whether generic or personalised, so long as the limitations are clearly evident to consumers.

We acknowledge the argument that having some level of NZ regulated robo-advice in place sooner than when the FAA is operative does help counteract the potential influence of overseas robo-advice sites that may or may not be suitable for the local market. However, this must be tempered by risk of bringing the whole process into disrepute if it is inadequately set up, monitored and enforced.

We are particularly concerned that the proposed exemption will pre-date the work of the new Code Committee, and may be unreasonably influential on its deliberations. Providers who develop exempt services may endeavour to leverage their investment by claiming they have created a precedent on which the FAA and the new Code conditions should be based and interpreted. We note that FMA has said that the final form may be different to anything developed under the exemption, but do not consider this is spelled out strongly enough.

There is also a strong likelihood that only the largest providers could take advantage of the exemption as smaller providers would lack the resources to "have two bites at it" should the final requirements materially differ. This risks reducing the range of options for consumers and could threaten the viability of some smaller providers who lose clients as a result. We would be concerned if this potential consequential outcome was not mitigated in some way.

We consider the proposed complaints process for robo-advice should be more clearly defined. In particular any exemption needs to spell out that complaints can be directed to a real person and that contact information for both written and verbal complaints must be provided to robo-advice clients.

Responses to FMA Questions

Q1. In broad terms NZSA supports the proposal, but we suggest some additional clarification and safeguards below. The main reason is to accelerate access to cost effective advice for smaller investors. Secondly, to provide a New Zealand centric service rather than have investors try to get potentially unsatisfactory advice from offshore robo-advice.

Q2. We believe it is right for FMA to consider all options. In regard to timing, we give qualified support to introducing the changes now, subject to some additional safeguards detailed in other answers. We draw your attention to our concerns that early adoption could influence the new Code Committee and that providers may use their first iteration as a precedent to influence the final form of regulations and the new Code.

Q3. Without the exemption, we think it is unlikely that the costs to comply with the "natural persons" requirement would be sustainable. The overall cost would likely be higher than simply using an AFA. This is because the cost of developing the robo-advice portal would have to be amortised via an additional charge.

Q4. We support a class exemption on the basis that it creates a level playing field for all and is less susceptible to manipulation to the benefit of an individual provider or small group or class of providers.

Q5. Refer to the executive summary and the answers to other questions.

Q6. The main risk for consumers if an exemption is not granted is that cost effective advice will remain out of reach for longer. A second risk is that consumers will be tempted to use overseas based robo-advice which is not tailored to the New Zealand situation. The situation is less clear for providers because they still have the opportunity to apply for an individual exemption if they really want to. This is likely to be more costly in the short term, but could give a competitive advantage as an "early adopter". The last part of the question is not applicable to NZSA.

Q7. Yes. The absolute minimum at present for face to face advice appears to be $50k, and then only if additional funds will be invested over time. We would expect this to drop substantially if robo-advice is utilised.

Q8. Not applicable.

Q9. Generally the conditions and limits appear satisfactory. However, we take some issue with the comment that the advice is limited to products that are easy to exit. While that may be true, there is usually a cost to the consumer to do this. By the time the inadequacy of the advice is recognised, this can be substantial. FMA itself recognises that some "easy to exit" products such as equities are not so easy to automate with standard algorithms. With a human AFA, there is a clear pathway to remedy costs due to inadequate advice and FMA itself can be involved. We are less sure that such a clear path exists

with robo-advice. FMA itself acknowledges that most of its usual enforcement tools would not apply. We think this aspect needs more thought given that comprehensive new rules are some time away.

Q10. Not applicable.

Q11. Investment planning is often a short step from advice and it does not seem unreasonable that it should be included in the exemption. Currently, many AFA's uses a set of standardised questions to determine the clients risk profile and then apply a largely standardised set of investment matrixes. All this would seem to be within the capacity of a robo-advice algorithm.
We do not see the DIMS services in the same light because a) they are subject to different restrictions and rules and b) the DIMS service effectively acts like a focussed active fund manager. DIMS services may not be trying to give the broad service that other advisors do. Their mandate which is agreed with the client, may be limited to narrow areas (for example, Australian small cap stocks). This is the attraction for some investors, but could lead to conflict with the intent of the exemption. For example, the client might insist on investment into an area that is performing poorly. From the DIMS providers' point of view, how does that sit with the requirement to act in the best interests of the client? Also, some DIMS providers may invest in less liquid assets, again depending on the client mandate.

Q12. We agree, but like FMA have concerns about some more sophisticated insurance products.

Q13. We see robo-advice as a viable way for insurance companies to reduce premiums by cutting out the advisor (more accurately often a commission salesperson). Whether this would happen is another matter.
However, more personal insurance products such as income protection or health insurance often require an in depth assessment of client needs. This is probably best done by a suitably qualified person. In any event, the fees for these are usually incorporated into the product itself, so there is a much lower cost to obtaining appropriate advice compared with other financial advice or financial planning. Consequently, we see little need for an exemption in this area prior to the new Code being developed.

Q14. See the answer to Q15. Rather than a set duration, it may be better to limit the exemption to products that can be withdrawn from at any time, at the consumer's request, and with a refund (pro-rated?) payable.

Q15. An investment limit in dollars is a blunt instrument. We would suggest that if a limit is applied, this should relate to the total liquid (or readily able to be liquidated) assets that each client has. This is information that would normally be sought during the assessment (robo or otherwise), so should be able to be easily incorporated into an algorithm. Perhaps a limit of 20% of liquid funds could apply to robo-advice, at least during the exemption period. This could be in conjunction with a de minimis dollar figure (say $5000 or $10,000) to ensure smaller investors get advice based on a meaningful investment amount. At the other end of the scale, we are less concerned. Investors with large portfolios are more likely to seek appropriate advice and can more easily afford to do so.

Q16. See the answer to Q15. We do not see any reason for a higher limit for QFE's. The concern should be to protect the consumer from over exposure to a new technology that is untried in the New Zealand setting and as yet is not subject to comprehensive assessment by the new Code Committee – who may have a different view to that taken by FMA.

Q17. Yes. A clear and concise, plain English standardised form will ensure this information is provided to consumers in a manner most can understand.

Q18. A degree of flexibility is sensible. However, FMA should develop a list of matters which must be addressed in the disclosure to ensure all key matters are included. It would then be up to the provider how they complied.

Q19. Yes. This is the only way to impress on people that this is a specific form of advice and has some limitations. While many may not read it, over time we think it will encourage better understanding of the product. It is a very inexpensive check and balance. Additionally, it would make sense to insist that unless this acknowledgement is made, the consumer cannot proceed further in the system.

Q20. We support the Conduct obligations. Without these, the advice is not of a standard to be considered personalised. It is up to the providers to determine how or if they can meet these fundamental standards.

Q21. See answer to Q 22.

Q22. We believe that the additional requirements in Code standard 6 (recommendations only for products that have been assessed or reviewed) are important and should be included. At this time, we consider it unlikely that robo-advice can be automated to the point that it can digest and formulate a view of the suitability of a product from (for example) a PDS. Therefore we believe there will continue to be human interaction at that level (at least until the revised FAA and Code are in place). In those circumstances, the additional Code Standard 6 obligation is appropriate to remain in force.

Q23. We do not agree. Advice should be accurate and concise regardless of the level of funds. A small investment may well be more valuable to a poor person than a large investment is to a rich person. They both deserve the same standard of advice regardless.

Q24. No comment.

Q25. Not applicable

Q26. We consider it desirable that a list of providers should appear on the FMA website. This is an easy way for consumers to check that the service they intend to interact with is actually subject to New Zealand regulation. Failure to produce and maintain this list leaves open an opportunity for overseas based fraudsters pretending to be based in New Zealand. They could, for example, defraud local consumers by persuading them to “invest” in nonexistent entities. We note that a precedent exists with other services and providers already required to be listed on the FMA website and see this as protection for both consumers and legitimate providers. .

Q27. Robo-advice is easily understood. Digital is a poor terminology because it is widely used in situations where people are still very much involved – for example digital TV. Automated tends to imply a simplistic service which good robo-advice will certainly not be. For example – an automated answering service.

Q28. In the "Capability "section, we would like a specific obligation that the service provider is responsible for the actions of its contractors as well as its employees. Unless this is addressed, we see potential for a set-off of responsibility.

In the "Disclosure" section, where a provider makes it possible to speak to a human advisor, the cost of this needs to be made clear in advance. In the case of complaints, there should be no cost involved.

In the "Record Keeping" section, we consider that providers should have to keep all client advice records. As written, we interpret the FMA proposal to mean that only the current, up-to-date information must be kept. In the event there is a problem to be resolved, we submit that a full trail will be an essential component of any investigation.

Summary

NZSA gives qualified support to the intention to provide an exemption allowing the early provision of robo-advice. Our major reason is the urgent need to make "fit for purpose" personalised advice available to a wider range of consumers, particularly those with smaller amounts to invest.

We add the important caveat that a stronger message needs to be given that any robo-advice developed under the exemption will not provide any precedent or influence the considerations of the new Code Committee and that development of such advice is entirely at the risk of the provider.

NZSA has made a number of other suggestions in answering FMA's questions and also in the executive summary. These largely relate to ensuring a balance between adequate consumer protection and the earlier introduction of technology based solutions.

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