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Financial Markets Authority

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CONSULTATION: FAIR OUTCOMES FOR CONSUMERS AND MARKETS

Thank you for the opportunity to provide submissions on FMA's proposed Fair outcomes for consumers and markets guide. Cygnus Law Limited's submissions are enclosed. Cygnus Law provides legal advice and support to a wide range of businesses in the financial services sector. These submissions are made on Cygnus Law's own behalf. Simon Papa has over 20 years' experience as a corporate and commercial lawyer.

Yours sincerely
Cygnus Law Ltd

Simon Papa
Director



Feedback form

Consultation: Fair Outcomes for Consumers and Markets

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Question number	Response
<p>1. 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.</p>	<p>The way the outcomes described in the draft guide is not clear. The outcomes are mostly described at a high level of abstraction. Fairness itself is a moral concept and so it is inherently unclear as different people will interpret fairness differently. So we don't consider that the draft guide is correct when it says "We all know what is fair when we see it". This echoes the often quoted legal test espoused by Justice Potter Stewart in the United States Supreme Court in a 1964 judgment about whether a motion picture was "obscene". Justice Stewart said he wouldn't define obscenity and rather stated that "I know it when I see it...". The reason that that part of the judgment is often quoted is that it highlights that "I know it when I see it" falls fundamentally short as a way to regulate conduct. While the FMC Act includes "promote and facilitate the development of fair, efficient, and transparent financial markets" as a purpose, that serves as a high-level principle that is applicable to the regulation of markets as a whole. In contrast, in the draft guide "fairness" is being used as a primary tool to seek to directly influence conduct by financial service providers ("FSPs") across all aspects of their businesses. Efficiency and transparency are barely mentioned in the guide. As we highlight in these submissions, we consider that some of the fair outcomes are likely to result in a reduction in efficiency.</p> <p>One example of a fair outcome in the guide is that "consumers receive fair value for money" (in effect requiring that prices are fair). New Zealand operates a market economy. With some exceptions, markets are left to set prices rather than requiring providers of products or services to set "fair" prices. In practice fairness in pricing is determined by the interplay of market participants and their particular needs, resources and initiative. There is no reason to think that what an FSP thinks is "fair" with respect to prices will be shared by consumers. In fact there's almost always likely to be a divergence of view and markets operate to develop a degree of consensus. This is one example of how "fairness" falls short as a standard to regulate conduct.</p>

	<p>While fairness is applied as a legal standard in various parts of the law, it mostly relates to areas where moral considerations are paramount (e.g. law related to family matters) or is otherwise limited to areas of law where this can be applied in an objective way. An example of the use of a fairness standard in law is the unfair contract term (“UCT”) provisions in the Fair Trading Act. The Fair Trading Act excludes from the scope of the UCT law the core subject matter of a contract, and the upfront price. The reason for that is that those matters were assumed to be best left to the markets, not the law or regulators. However, the guide proposes regulating both those areas (via fair outcomes 1 and 3) by reference to vague fairness considerations. In our view the concept of “fairness” is inherently unsuited to address those matters. Any further elucidation of what fairness means in those areas is unlikely to resolve the central problem, which is that “fairness” falls fundamentally short as a standard to regulate conduct in those areas. For example the following clarification provides no further effective guidance- “Value needs to be considered from many dimensions.... Different approaches to different groups can be justified but they must be fair.” We are not going to propose improvements to such descriptions because we do not consider that the fair outcomes proposed are linked to existing laws (in most respects), and because we don’t consider they are amenable to more sound clarification for the reasons noted.</p> <p>For those reasons and others we don’t consider FMA has evidenced that some of the fair outcomes will, in fact, achieve better outcomes for consumers, FSPs or markets.</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>We don’t agree that fair outcomes are an appropriate tool in some areas to guide FMA’s approach to its role. In our view the guide is seeking to impose the fair outcomes as <i>de facto</i> legal standards. This is demonstrated in the following statements in the guide:</p> <ul style="list-style-type: none"> • “Our monitoring activities will focus on whether we are seeing these outcomes in the market. This will inform our conversations with providers to help them understand whether they are on track. We plan to communicate to firms their level of conduct maturity on an ongoing basis, so they know if they have more work to do.” • “These outcomes will be the starting point for decision-making at the FMA. In particular, for our supervisory approach, we will use them as the basis for how we frame our discussions with and assessments of providers.” • “To support the delivery of this regulatory approach, we will make use of our full range of tools, including engagement, influence and advocacy. We will be proportionate and deliberate, which will be reflected in our supervisory and enforcement culture. Where we see unfair outcomes, we will consider the best use of our toolkit to respond.” • “Our monitoring activities will focus on whether we are seeing these outcomes in the market. This will inform our conversations with providers to help them understand whether they are on track. We plan to communicate to firms their level of conduct maturity on an ongoing basis, so they know if they have more work to do.”

Those statements highlight that FMA is proposing to orient its whole operation to give effect to the fair outcomes including, as noted, via “These outcomes will be the starting point for decision-making at the FMA”, “how we frame our discussions with and assessments of providers” and “Our monitoring activities will focus on whether we are seeing these outcomes in the market”. However, as we note below, a number of fair outcomes are not linked to existing laws regulated by FMA.

A core part of New Zealand’s constitution is the Bill of Rights 1688. A key part of the Bill of Rights is in the very first section. This prohibits the King from passing laws without the consent of Parliament. This underpins NZ’s parliamentary system. In modern terms that means that the Government cannot pass laws without the consent of parliament. FMA is part of the State and so is subject to that constitutional provision. However FMA is in our view, in effect, attempting to create laws via the fair outcomes that are not based on existing laws or subordinate powers to make law. While we accept that the State can do things without express authorisation, including setting aspirational goals not supported by law, we consider that it is unconstitutional to use the full power of the State to give effect to standards that are not laws or implemented via statutory powers. FMA is proposing to give effect to the fair outcomes using its full resources and focus as noted above. The guide indicates that FMA plans to use enhanced monitoring and engagement as a means to induce particular conduct in individuals and organisations for purposes ancillary to compliance with, and enforcement of, actual laws. While this approach is common in some countries, in our view it would be illegal to do so in New Zealand.

FMA in other statements claims that the proposed fair outcomes are a “lens” that evidence compliance with law, so seeking to link the fair outcomes to actual law. However, as we note below, some of the fair outcomes have little, if any link, to existing law. We submit that the language of the guide needs to be changed to make it clear that the fair outcomes are aspirational goals and not mandatory requirements, where they are not linked to existing law. If the outcomes are linked to existing laws then the relevant laws should be stated in the guide, to support FSPs to much better understand the function of the fair outcomes.

In our view seeking to regulate financial markets through pervasive “fairness” standards undermines the rule of law, which is another underlying principle of New Zealand’s constitution. The rule of law not only requires that laws are passed appropriately (i.e. by approval of Parliament, directly or indirectly) but that they are clear and can be understood in advance. Just as (to quote Monty Python) “Strange women lying in ponds distributing swords is no basis for a system of government”, “I know it when I see it” is no basis for regulating financial markets. This substantially undermines the rule of law since it is inherently subjective; what “fairness” means will depend substantially on the person who is assessing its meaning at the time. Again this supports making the fair outcomes aspirational goals, if they are not clearly supported by, and referenced to, existing law.

	<p>We don't consider that FMA has validated how an outcomes-based approach will in fact achieve the stated objectives at reasonable cost. In the early 1990s New Zealand building law (via the Building Act 1991) was reformulated to be outcomes-based. That played a very significant part in causing the leaky building crisis that arose during the 1990s. That's not to suggest that an outcomes-based approach to regulation is not appropriate in some circumstances. Rather we are suggesting that it needs to be validated to confirm it is an appropriate approach, not assumed to be appropriate.</p>
<p>3. What are your views on <i>Outcome 1: Consumers have access to appropriate products and services that meet their needs?</i></p>	<p>We do not consider that the "access" section described in this fair outcome is appropriate. No part of financial markets law mandates what products and services should be provided by FSPs. Rather the law regulates financial products and services that are actually offered to, or purchased by, consumers. This is consistent with the Fair Trading Act's unfair contract term provisions. The Act excludes the core subject matter of the contract from the ambit of those provisions. The fact that the law does not impose an obligation to provide particular products and services to particular categories of people reflects that New Zealand operates a market economy. That is based on an understanding that there is no obvious reason to think that legislators and regulators are generally better than market participants at efficiently allocating resources within markets. In essence the "access" section of this fair outcome is seeking to replace the market as a tool for allocating resources. We do not consider that FMA is configured to regulate the financial products and services that should be provided or that it is appropriate to attempt to do so. FMA states in the guide that "Success will come from building the FMA's understanding of consumers' perspectives and experiences across different demographics." That is fine but we don't consider it will be appropriate for FMA to use that information to, as a key focus, seek to influence what financial products and services the market actually provides.</p> <p>Also FMA has provided no validation of why this fair outcome is required. The draft guide states that "Māori communities were more likely to buy into riskier investments such as cryptocurrency, and may have lower trust in the banking sector. This indicates that more needs to be done to improve access to appropriate products and ensure our financial system is accommodating of a te ao Māori worldview to encourage participation." We fully agree that that is a desirable goal. However the <i>Consumer Experience with the Financial Sector Survey 2022</i> research report, which is the basis for that statement, in no way validates that issues of poor financial decision making and poor financial outcomes arise because of failures in the conduct of FSPs. To state the obvious, correlation is not causation. It's likely that poor financial outcomes are largely a result of various factors outside of FMA's ambit including ingrained inequality. These are not matters that FMA can reasonably influence. We also suggest that FMA reconsider singling out particular groups as an example with respect to purchase of riskier investments. We appreciate that FMA does so with good intent. But the research report found that various groups, including Pacific Peoples and Indians, were equally likely to acquire such risky products. If FMA is seeking to improve confidence of such groups in the financial markets it</p>

	<p>is unhelpful, in our view, to selectively highlight specific groups when they are not obviously making worse financial decisions than others.</p> <p>We consider that the “appropriateness” element of the standard is generally suitable. However, we don’t consider the following is appropriate as a general requirement- “There is also a consumer protection element, for example, having checks and balances to prevent consumers from accessing products and services that are not suitable for them.” It’s not at all clear how that would be applied in practice. It appears to suggest that FSPs will have to pro-actively check suitability, which would likely require FSPs to provide financial advice. We don’t consider that is appropriate because it will often not be feasible for FSPs to pro-actively vet purchasers and it would likely be inefficient to do so in some cases. We suggest that it is better to focus on design of products and how they are described and marketed. Existing fair dealing law already provides a powerful tool to regulate such matters.</p>
<p>4. What are your views on <i>Outcome 2: Consumers receive useful information that aids good decisions?</i></p>	<p>We don’t have any comments on this fair outcome and consider it is generally appropriate.</p>
<p>5. What are your views on <i>Outcome 3: Consumers receive fair value for money?</i></p>	<p>We can see no basis whatsoever for that fair outcome except in relation to misleading and deceptive pricing and KiwiSaver fees. It essentially seeks to mandate that FSPs set “fair prices”. The fact that the guide attempts to avoid that term via equivalent concepts such as “equity in exchange of value” does not change the essence of what FMA is seeking to achieve. In most areas of law that FMA regulates price setting is not a matter within FMA’s ambit. There are limited exceptions including in the KiwiSaver Act, which prohibits “a fee that is unreasonable”. In our view FMA has neither the mandate nor the expertise to seek to regulate prices except in limited areas.</p> <p>Price setting and price discovery are a core function of markets. History is littered with examples of misguided and counterproductive attempts to regulate market prices. FMA has provided no cogent validation as to why it is necessary for FMA to get involved in the setting of prices and how that would actually lead to better market outcomes. The Commerce Commission has powers to regulate prices in some areas and to undertake market studies to identify potential market failures. As at the date of this submission the Commerce Commission is carrying out a market study with respect to retail banking in New Zealand to identify reasons for the consistently high profits of the large banks. Again we see no basis for FMA to replicate elements of the Commerce Commission’s functions or to think that FMA has the resources and level of expertise required to do so.</p>
<p>6. What are your views on <i>Outcome 4: Consumers can trust providers to act in their interests?</i></p>	<p>In our view it appears that the guide supports an assumption that markets primarily consist of FSPs and the regulator. As we note below, the guide does not properly acknowledge the existence and role of other market participants including financial advice providers. That does not enhance the integrity of markets but rather undermines integrity. Markets are complex systems with many interacting parts. By</p>

	<p>failing to properly acknowledge that the guide will weaken markets, if implemented as proposed.</p> <p>In the case of financial markets, information asymmetry (that is, one party to a transaction has more information than another) is often cited as a key example of a market failure justifying regulation. Markets themselves develop solutions (though imperfect) to address such asymmetry. An obvious example of such a solution is the independent financial advice sector, which acts as an intermediary between consumers and FSPs. The financial advice sector is now fully regulated and provides many consumers with advice and support with respect to acquiring and managing financial advice products. However, the draft guide doesn't even mention financial advisers except to highlight a 2018 report that criticised the conduct of a relatively small group of financial advisers with respect to advice on replacement life insurance. Rather, the draft guide promotes FSPs as the predominant conduit for the provision of information and advice to consumers. We consider it crucial that the guide acknowledges the important role the financial advice sector plays in financial markets and has as a stated goal of supporting the growth of the sector and the ability of consumers to get access to financial advice.</p> <p>The guide appears to reflect a view that consumers are passive recipients of financial products and services and cannot be trusted to make rational decisions for themselves, as exemplified in this fair outcome. The outcome does not focus on consumers but rather the activities of FSPs. None of the fair outcomes provide for or acknowledge the core role of consumers in markets. Our view is that this fair outcome should be focused on consumers. It should state as a goal that consumers have access to advice, information and education that helps to improve their financial literacy, decision making and financial outcomes. This will also help to address an issue the guide ignores, which is moral hazard. There are many studies that show that increasing safety of products and services (cars being one example) lead to more hazardous behaviour by the users of those products and services. By focusing excessively on FSPs the guide risks taking away consumer agency and empowerment with the result that moral hazard is increased.</p>
<p>7. What are your views on <i>Outcome 5: Consumers receive quality ongoing care?</i></p>	<p>We don't have any comments on this fair outcome and consider it is generally appropriate.</p>
<p>8. What are your views on <i>Outcome 6: Markets are trusted based on their integrity and transparency?</i></p>	<p>We don't have any comments on this fair outcome and consider it is generally appropriate.</p>
<p>9. What are your views on <i>Outcome 7: Markets enable sustainable innovation and growth?</i></p>	<p>We consider that this fair outcome is largely appropriate. We query why the standard focuses on "sustainable innovation". The further description of that provides no further helpful guidance as to what is intended. Our view is that FMA should place greater focus on innovation.</p>

	<p>We consider that mandating fair outcomes in the manner proposed is not conducive to supporting or encouraging innovation. FMA states that innovation “risks excluding those who do not or cannot use certain forms of technology”. We agree that is an issue. This relates to the first fair outcome, which would involve FMA regulating what financial products and services are provided in the market. Again, we see no basis for FMA to involve itself in regulating what financial products services should be provided or their means of delivery. This is another example of where “fairness” simply doesn’t work as a standard to regulate conduct. There are various arguments for and against innovation and their effects on some parts of society but these are very complex matters with no clear right or wrong answers.</p> <p>The imposition of regulation often (but not always) stifles innovation rather than increasing it. The fair outcomes guide is, in effect, another form of regulation. It will further burden FSPs, who have faced a wave of regulation in recent years. Multiple FSPs have stated new regulations have taken up resources and management time that would otherwise have been focused on other areas including innovation. Also, additional regulation often makes it more difficult for new entrants (who are often more innovative) to enter markets. We are not suggesting that existing regulations are not appropriate (most are) or that new regulations should not be introduced to address specific issues. But the point comes where ever increasing regulation, no matter how well-intentioned, starts to impose costs (including through the stifling of innovation) that outweigh the value of any benefits the regulation achieves. The guide, in seeking to impose a fundamentally new way for FSPs to consider compliance, will impose very significant costs on FSPs including through requirements to comply with abstruse requirements such as “take ownership of the outcomes and consider how their leadership, management, governance and operations all work together to deliver them in a way that is most appropriate and effective within their business context”. It’s easy for FMA to write these words but it’s not at all clear what they mean in practice. By imposing abstract standards on thousands of FSPs, FMA will be imposing very significant costs on them with no evidence that there will be commensurate benefits. FMA has not provided any form of cost/benefit analysis to validate its approach in the guide, which we’d usually expect to see in any initiative to develop <i>de facto</i> legal standards of similar breadth and ambition. FMA provides no evidence to support its very ambitious statement that “outcomes-focused approach will encourage more engagement and dynamism in our financial markets – supporting an economy that New Zealanders have confidence to invest in, and is attractive to overseas capital, new ideas, and innovation. A focus on the fair outcomes and new ways of thinking required to support them should create more choice for consumers, and more competition and innovation in our financial markets, products & services.” We consider that there’s a very real risk that this initiative will impose costs on thousands of FSPs, many of which are already highly regulated, that will exceed the value of resulting benefits to consumers. Those costs will ultimately be borne by consumers.</p>
10. Is anything missing that should be included in	See the answer to question 2 above.

<p>the fair outcomes? Please explain.</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>NA</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>NA</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>See the answer to question 2 above.</p>
<p>Feedback summary</p> <p>We don't agree that fair outcomes are an appropriate tool in some areas to guide FMA's approach to its role. In our view the guide is seeking to impose the fair outcomes as <i>de facto</i> legal standards. We don't consider that is permitted by law. We submit that the language of the guide needs to be changed to make it clear that the fair outcomes are aspirational goals and not mandatory requirements, where they are not linked to existing law. If the outcomes are linked to existing laws then the relevant laws should be stated in the guide, to support FSPs to much better understand the function of the fair outcomes.</p> <p>We do not consider that the "access" section described in the "Consumers have access to appropriate products and services that meet their needs" fair standard is appropriate. This seeks to give FMA the ability to intervene in what products and services FSPs provide. However, no part of financial markets law mandates what products and services should be provided by FSPs. Rather the law regulates financial products and services that are actually offered to, or purchased by, consumers. We do not consider that FMA is configured to regulate the financial products and services that should be provided or that it is appropriate to attempt to do so.</p> <p>We can see no basis whatsoever for the "Consumers receive fair value for money" fair outcome except in relation to misleading and deceptive pricing and KiwiSaver fees. It essentially seeks to mandate that FSPs set "fair prices". The fact that the guide attempts to avoid that term via equivalent concepts such as "equity in exchange of value" does not change the essence of what FMA is seeking to achieve. In</p>	

most areas of law that FMA regulates price setting is not a matter within FMA's ambit. Price setting and price discovery are a core function of markets. History is littered with examples of misguided and counterproductive attempts to regulate market prices. FMA has provided no cogent validation as to why it is necessary for FMA to get involved in the setting of prices and how that would actually lead to better market outcomes.

The guide does not properly acknowledge the existence and role of other market participants including financial advice providers. By failing to properly acknowledge that the guide will weaken markets, if implemented as proposed. We consider it crucial that the guide acknowledges the important role the financial advice sector plays in financial markets and has as a stated goal of supporting the growth of the sector and the ability of consumers to get access to financial advice. Our view is that the "Consumers can trust providers to act in their interests" fair outcome should be focused on consumers. It should state as a goal that consumers have access to advice, information and education that helps to improve their financial literacy, decision making and financial outcomes.

We consider that mandating fair outcomes in the manner proposed is not conducive to supporting or encouraging innovation. The imposition of regulation often (but not always) stifles innovation rather than increasing it. The fair outcomes guide is, in effect, another form of regulation. It will further burden FSPs, who have faced a wave of regulation in recent years. Multiple FSPs have stated new regulations have taken up resources and management time that would otherwise have been focused on other areas including innovation.

FMA has not provided any form of cost/benefit analysis to validate its approach in the guide, which we'd usually expect to see in any initiative to develop *de facto* legal standards of similar breadth and ambition. We consider that there's a very real risk that this initiative will impose costs on thousands of FSPs, many of which are already highly regulated, that will exceed the value of resulting benefits to consumers. Those costs will ultimately be borne by consumers.