

22 February 2018

# Regulatory Impact Statement:

## Exemption to enable personalised digital advice

This document is for financial adviser entities, advisers, and other interested parties. It discusses an exemption to enable the provision of personalised digital advice services.

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# Executive summary

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This Regulatory Impact Statement (RIS) discusses an exemption to enable the provision of personalised digital advice services under the Financial Advisers Act 2008 ('FA Act'). It summarises the problem we are seeking to address, our objectives, the options and their associated impacts, and the consultation process we undertook before deciding to grant the exemption.

Digital advice offers an alternative way to deliver personalised financial adviser services to retail clients in a cost-effective and innovative manner.

We think this exemption has the potential to improve consumer access to advice and promote innovation, while providing consumer protection safeguards – promoting the overall purposes of the FA Act. Granting the exemption removes the rigidity in the current law, which did not contemplate digital advice. Without this exemption, the offer of personalised digital advice tools for consumers would not be possible until legislative change occurs, meaning the current environment of reduced access to advice and barriers to technological innovation would continue.

Our analysis of whether to grant an exemption was based on the statutory test that applies to use of the FMA's exemption powers. This requires the FMA *"to be satisfied that the costs of compliance with the relevant obligation would be unreasonable or would not be justified by the benefit of compliance"*.

We must also be satisfied that the exemption would be consistent with, and promote, one or more of the purposes of the FA Act.

## Exemption granted

After carefully considering both regulatory and non-regulatory impacts, we decided to grant an exemption, subject to conditions. This will permit financial adviser entities ('providers') to provide personalised financial advice and investment planning services to retail clients through a digital advice channel. Providers need to apply to us to be approved to rely on the exemption.

# Background

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## What is digital advice?

Digital advice (also known as ‘robo-advice’ or ‘automated advice’) is financial advice generated by automated algorithms without the direct involvement of a human adviser – usually through a website or mobile app. Digital advice providers range from small fintech businesses to large financial institutions.

## Growth of digital advice internationally is improving access to advice

Internationally, digital advice is growing rapidly. Many digital advice services target young, internet-savvy consumers. Some services offer low-cost advice options aimed at those with limited ability to access financial advice, such as those with simple needs or small assets. Other jurisdictions have recently progressed changes to facilitate the development of digital advice as a low-cost advice option.

Digital advice has the potential to offer New Zealand consumers greater access to lower-cost financial advice. This offers a potential way to increase the low numbers of consumers currently receiving personalised financial advice. For example, our review of KiwiSaver sales in 2015 showed most consumers do not obtain personalised advice on KiwiSaver<sup>1</sup>. Personalised digital advice services could help address this advice gap.

## Giving personalised financial advice

The FA Act, passed in 2008, did not contemplate the advances in technology that now enable personalised advice to be provided through a digital channel. Under the FA Act, personalised advice to a retail client must be given by a natural person. This rigidity in the current law has impeded the development of digital advice models in the local market and means New Zealand is lagging behind other comparable jurisdictions in this sector.

The FA Act allows an entity to provide class digital advice<sup>2</sup>. However, the line between personalised and class advice is unclear. Industry feedback also indicates this does not meet consumer demand for personalised digital advice; for example, on KiwiSaver products.

In mid-2016, Cabinet approved changes to enable the provision of personalised digital advice as part of the broader reforms to financial adviser laws arising from the FA Act review. The new financial advice regime will be ‘technology

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<sup>1</sup> The FMA’s [review of KiwiSaver sales and advice practices](#) in 2015 found that only three in 1000 sales or transfers had occurred with personalised advice. Personalised advice is advice provided to a named or readily identifiable client taking into account the individual’s situation or goals.

<sup>2</sup> Generic recommendations based on characteristics such as age and gender.

neutral'. This will enable providers to use a digital delivery channel if they wish. The new regime is not expected to come into effect until 2019.

# Objectives

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In line with our legislative mandate to promote innovation and flexibility, we considered whether the use of our exemption powers could facilitate personalised digital advice under the current FA Act.

Before granting an exemption under the FA Act we must be satisfied that the costs of complying with the relevant obligation would be unreasonable, or would not be justified by the benefit of compliance. In this context, the compliance cost is the cost of incorporating a human adviser ('natural person') into the digital advice process.

The exemption must also be consistent with, and promote, one or more of the purposes of the FA Act, which incorporates the purposes of the Financial Markets Conduct Act 2013 ('FMC Act'). These include:

- promoting the sound and efficient delivery of financial adviser services (FA Act)
- encouraging public confidence in the professionalism and integrity of financial advisers (FA Act)
- promoting innovation and flexibility in the financial markets (FMC Act).

Accordingly, we assessed the possible options against these objectives. In doing this, we considered the interests of stakeholders including:

- financial adviser entities
- existing financial advisers with traditional (non-digital) business models
- consumers.

# Options and impact analysis

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## We considered two options

- Option 1 (selected): Exemption
- Option 2 (not selected): No exemption (status quo)

## Option 1: Exemption

### Description

We considered the option of a class exemption to permit providers to provide personalised services to retail clients through a digital channel (eg website or mobile app). The exemption would cover services provided through a digital channel, limited to:

- financial advice or investment planning services – the exemption would not apply to discretionary investment management services
- certain eligible products, including:
  - interests in KiwiSaver schemes and other managed funds
  - listed equity, debt securities or managed investment products
  - government bonds
  - general and personal insurance products
  - mortgages and other credit contracts
  - savings products.

Under this option, providers would need to apply to us to be approved to rely on the exemption. The list of approved providers would be set out in Schedule 1 of the exemption notice. As part of the application process, providers would need to provide us with information showing their directors and senior managers meet good character requirements, and the provider meets minimum standards of capability and competency to provide the personalised financial advice or investment planning services through a digital channel.

Exemption conditions would apply, to ensure providers take an appropriate degree of care in providing the personalised services and consumer protection safeguards are in place. The conditions relate to disclosure, procedures to comply with the code of conduct for Authorised Financial Advisers (AFAs), record-keeping, and notifying the FMA of certain events.

### Impact analysis

*Option 1 promotes the efficient delivery of financial adviser services, and innovation and flexibility in the financial markets*

Digital advice offers the ability to deliver personalised financial advice and investment planning services to consumers in a cost-effective and innovative manner. Providers would have the opportunity to use technological advances to develop

innovative and flexible ways to deliver personalised services to consumers at scale through a digital channel, which should result in reduced costs for consumers. Feedback indicated strong industry interest in this.

Granting the exemption has the potential to improve consumer access to financial advice. Submitters believed that anticipated lower costs, and the convenience of being able to receive financial advice through a digital platform, would increase consumer access and engagement. Submitters identified that access was likely to increase among those who are accustomed to, and prefer, using digital channels. An advantage of digital channels is that consumers can access these any time or place, sometimes anonymously, with the advice typically generated and provided at the time. As the number of digital advice offerings increases, consumers' choice and ability to compare different investment or product recommendations, including costs and fees, should also grow.

Increasing consumer access to advice may help address the advice gap. Many submitters believed that personalised digital advice was likely to engage consumers who do not currently use financial advice services, including those who cannot afford financial advice provided by individuals. Submitters also identified that digital advice tools could help improve financial literacy.

Digital advice services are often directed at consumers who are not served by existing advisers. However, digital advice could cause disruption to existing financial advisers with traditional business models. For example, some submitters saw the potential for a negative effect if consumers choose digital advice in preference to face-to-face advice, and for pressure to reduce adviser fees and commissions in order to compete with a low-cost delivery channel. Other submitters regarded digital advice as complementing rather than substituting human advisers. This is reflected in international trends. A number of overseas providers offer 'hybrid' models, which combine automated personalised advice with human interaction. International trends have also shown existing providers increasingly taking the opportunity to innovate how they deliver their service and reach new sources of business.

*Option 1 promotes the sound delivery of financial adviser services, and encourages public confidence in the professionalism and integrity of financial advisers*

As with all advice, personalised digital services carry a risk of poor consumer outcomes and associated reputational risk for the industry. Digital advice poses many of the same risks for consumers as advice developed and delivered by human advisers – for example, in terms of suitability of advice and product selection. Digital advice also poses greater risks in some areas. For example, poor consumer outcomes could arise because:

- the digital advice tool does not recognise situations not suited to the tool and fails to filter out consumers for whom digital advice is not appropriate
- a digital interface has limitations compared to human interaction, including the absence of body language and tone cues
- digital advice tools rely on the data provided by the consumer being complete and input correctly
- consumers may be limited in their ability to ask questions or seek clarification
- digital advice tools may be less responsive to variables such as market changes
- the algorithms contain biases or errors that result in unsuitable advice being generated
- the provider has insufficient capability to manage a digital offering and detect problems with the technology as they arise
- there is increased potential for cyber-security and data protection breaches
- consumers do not appreciate the limitations of getting financial advice via a digital platform.

Due to the scalability of digital advice, poor advice outcomes may affect a larger number of consumers. Potential harm to consumers from unsuitable digital advice or the failure of one of the first digital advice offerings could undermine consumer confidence and have a negative effect on the development of this sector.

To help address these risks and protect consumers, we decided to put in place the following measures:

- In order to rely on the exemption, a provider must apply to the FMA with information showing that its directors and senior managers meet good character requirements, and that the provider meets minimum standards demonstrating their capability and competency to provide the personalised services through a digital channel
- The exemption would be subject to conditions (described above) that require the services to be provided in a manner that is consistent with requirements that apply to AFAs. The conditions seek to ensure providers take an appropriate degree of care and consumer protection safeguards are in place.

Granting the exemption subject to these measures should promote the sound delivery of advice and encourage public confidence in the professionalism and integrity of the providers. The exemption requirements also include that providers must belong to a dispute resolution scheme. This provides a way for consumers to seek redress if unsuitable advice is provided.

*Option 1 avoids compliance costs that would be unreasonable and not justified by the benefit of compliance*

Compliance with the ‘natural person’ requirement would require providers to use individual advisers to review, approve, and deliver each piece of advice generated by a digital advice tool. To date, no provider has taken this approach, and feedback indicated the costs of complying would be significant and would negate the key benefits of the digital advice model. This includes the ability for providers to achieve scale by automating the advice process, resulting in reduced costs for consumers.

The cost of complying with the natural person requirement is unnecessary and not justified by the benefit of compliance. Technological advances mean that personalised digital advice can now be delivered without the direct involvement of individual advisers in a manner that does not undermine consumer protection and promotes the objectives of the FA Act. Some submitters considered that a properly constructed digital advice process can offer advantages over a human advice process – such as the speed, objectivity and consistency of advice generated – particularly for relatively simple or limited forms of personalised advice.

### Decision and reasons

We decided Option 1 (Exemption) best met the objectives. This option has the potential to increase consumer access to advice and promote innovation while providing consumer protection safeguards – promoting the purposes of the FA Act.

## Option 2: No exemption (status quo)

### Description

The alternative option we considered was not to grant any exemption. This would mean providers would continue to be able to provide class digital advice, but not personalised digital advice. The FA Act requirement for personalised advice to retail clients to be provided by one of the specified types of human adviser would continue to apply. This means providers would need to use individual advisers to review, approve, and give each piece of advice generated by a digital advice facility.

## Impact analysis

If no exemption had been granted, this would have continued the current advice environment under which low numbers of consumers are receiving personalised financial advice. Although this could be partially mitigated through class digital advice – which provides generic recommendations – feedback indicated there was limited appetite to develop additional tools for this. This would also not address the personalised advice gap, and ignore an efficient, low-cost alternative channel for delivering advice.

Providers would not have been able to develop innovative personalised digital advice tools. New Zealand would have fallen further behind other jurisdictions in the development of this technology. This could have placed New Zealand businesses at a competitive disadvantage to offshore providers who are already able to develop, test and offer personalised digital advice tools in their home jurisdictions. This may also have encouraged New Zealand consumers to access offshore digital advice platforms, which may make redress more difficult.

Some submitters were concerned about the risks of poor consumer outcomes that may arise from new technology, and considered that it may be prudent to wait and learn from relevant international developments. If no exemption had been granted, this would have avoided the potential risks described under Option 1. However, the current advice environment, under which many consumers are not accessing personalised advice, also carries the risk of poor consumer outcomes.

## Decision and reasons

We decided Option 2 (no exemption – status quo) did not meet the objectives of the FA Act. The current advice environment creates poor outcomes for unadvised consumers and barriers to technological innovation for providers, and does not meet the objective of avoiding costs of compliance that are not justified by the benefit of compliance.

## Summary assessment of options against objectives

**KEY:** ✓✓ Meets the policy objectives   ✓ Partially meets the policy objectives   ✗ Does not meet the policy objectives

	Option 1: Exemption (preferred)	Option 2: No exemption (status quo)
<b>Promote the sound and efficient delivery of financial adviser services (FA Act)</b>	<p>Enabling access to personalised digital advice in advance of law reform means consumers would have the benefits of digital advice – being able to access financial advice in a fast, convenient and easy way, and at potentially lower cost – at an earlier stage. ✓✓</p> <p>(Refer to box below in relation to sound delivery.)</p>	<p>The status quo presents significant barriers to the provision of personalised digital advice. Not granting the exemption would continue the current advice environment with limited options, which creates poor outcomes for unadvised consumers. This would also ignore a more efficient channel for delivering advice. ✗</p> <p>(Refer to box below in relation to sound delivery.)</p>
<b>Encourage public confidence in the professionalism and integrity of financial advisers (FA Act)</b>	<p>We would require providers to apply to us to rely on the exemption. Appropriate exemption conditions would seek to ensure providers take an appropriate degree of care in providing advice and consumer protection safeguards are in place. These measures should promote the sound delivery of the advice and encourage public confidence in the professionalism and integrity of the provider. ✓✓</p>	<p>The current regime encourages public confidence in the professionalism and integrity of advisers, ensures sound delivery of the advice and safeguards consumers by ensuring there is an individual adviser who is required to take an appropriate degree of care in providing advice and is individually regulated and accountable for that advice (occupational regulation). ✓✓</p>
<b>Promote innovation and flexibility in the financial markets (FMC Act)</b>	<p>Granting the exemption would give providers the opportunity to use technological advances to develop innovative, flexible and cost-effective ways to deliver personalised services to consumers through a digital channel. ✓✓</p>	<p>Offering personalised digital advice options to consumers would not be permitted. New Zealand would fall further behind other jurisdictions in the development of innovative personalised digital advice tools. ✗</p>
<b>Avoid compliance costs that would be unreasonable and not justified by the benefit of compliance (FA Act)</b>	<p>The current requirement for personalised digital advice to be provided by a natural person has become a barrier in light of technological advances that enable personalised financial advice to be provided through a digital channel in a manner that meets the objectives of the FA Act. Granting the exemption would remove this rigidity in the law. ✓✓</p>	<p>A provider would need to use individual advisers to review, approve and deliver each piece of advice generated by the digital tool. This would be uneconomic and would offer limited compliance benefits given that suitable personalised financial advice can now be generated by a digital tool without the direct involvement of individual advisers. ✗</p>

# Consultation

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In June and July 2017 we publicly [consulted](#) on whether we should facilitate personalised digital advice by using our FA Act exemption powers. We received 49 written submissions from a wide range of stakeholders including financial advisers, product providers, dispute resolution schemes, industry bodies, and law firms.

In October 2017 we published a [submissions report](#) setting out the key themes raised in submissions and appending copies of the individual submissions. The key themes were:

- strong support for an exemption
- opposition to limits
- digital advice should meet the same standards that apply to AFAs
- exemption conditions should be aligned with new advice regime requirements
- exemption applicants should be pre-approved or licensed.

Please see the [submissions report](#) for our summary of each theme and our response.

Following our policy decision to proceed with the exemption, in November and December 2017 we conducted a second public [consultation](#) to seek feedback on the draft exemption notice, information sheet and application documents. We received 30 written submissions. The policy decision to proceed with the exemption was not open for review. Please see our second [submissions report](#) for the key themes raised in submissions and our response.

# Conclusion and selected option

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Having carefully considered regulatory and non-regulatory impacts, we decided that Option 1 (exemption) addresses the identified problems and will achieve the objectives of:

- promoting the sound and efficient delivery of financial adviser services
- encouraging public confidence in the professionalism and integrity of financial advisers
- promoting innovation and flexibility in the financial markets
- avoiding compliance costs that would be unreasonable and not justified by the benefit of compliance.

Option 2 would not achieve these objectives and would continue the current environment of reduced access to advice for consumers, which creates poor outcomes for unadvised consumers, and barriers to technological innovation for providers.

On this basis we have decided to grant a class exemption notice to implement our policy proposal. The exemption will permit providers to provide personalised financial advice and investment planning services to retail clients through a digital advice channel. Providers will need to apply to us to be approved to rely on the exemption. The exemption will be granted subject to conditions that seek to ensure providers take an appropriate degree of care in providing the service and that consumer protection safeguards.