



Royal Commission into Misconduct in the Banking,  
Superannuation and Financial Services Industry

# **Information about Selected Aspects of Foreign Financial Services Regulation**

## **Background Paper 30**

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The views expressed are the author's views and are not to be understood as  
expressing the views of the Commission.

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# 1. INTRODUCTION

This technical paper is prepared for the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (the ‘Royal Commission’). It contains information, requested by the Royal Commission, about aspects of the regulation of financial product and service providers in the United Kingdom (UK), the Netherlands, New Zealand and the United States (US). These jurisdictions have broadly similar levels of participation by households in markets for financial products and services<sup>1</sup> (including banking, insurance, wealth management and private retirement savings products) and broadly similar financial choice architecture to Australia. They are also of interest because of recent reforms to their regulatory arrangements for retail financial services.

The purpose of the paper is to provide an insight into the approach taken in these peer jurisdictions to some of the issues raised by the Royal Commission in its Interim Report provided to government in September 2018. The issues the Royal Commission has asked me to examine are:

- controls on remuneration arrangements inside financial services firms (executive remuneration and variable remuneration)
- controls on remuneration in connection with financial advice and financial product sales and distribution (commissions and ongoing advice fees)
- laws requiring the separation of financial product sales from financial advice and addressing conflicts in the distribution of proprietary financial products
- financial product hawking and other forms of unsolicited sales practices, and
- regulators, including regulatory architecture, enforcement options and accountability.

What follows identifies, and explains something of the context of, legislation and codes of conduct that are germane to these issues in the selected jurisdictions. The discussion is necessarily high level. As the Commission’s work to date demonstrates, the regulatory arrangements for the provision of financial products and services to households are complex and can be highly path-dependant. There are inherent dangers in isolating particular rules and practices from their local history and conditions. Nevertheless, the peer

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<sup>1</sup> See generally, OECD (2017), *G20/OECD INFE report on adult financial literacy in G20 countries*.

jurisdictions have, over the decade since the Global Financial Crisis (GFC), grappled with these issues and the manner in which they have sought to address them is relevant to the second phase of the Royal Commission's work.

This paper is a research report on extant legislation and codes. It does not examine the rich academic literature on the ways in which regulatory systems might optimally respond to these issues. Nor does it seek to draw out differences between the political, social and economic conditions in the different jurisdictions. These differences may be important in understanding why a particular regulatory response was adopted or why it was structured in a particular way (for example, as legislation rather than as a code).

Two of the jurisdictions – the UK and the Netherlands – are member states of the European Union (EU) and what follows assumes a basic understanding of the relationship between EU law and national law. Many of the matters discussed in this paper are the subject of either EU regulations or EU directives (see Appendix A). Regulations are legal instruments that apply automatically and uniformly to all EU countries as soon as they come into force, without needing to be incorporated (transposed) into national law. They are binding in their entirety on all EU countries. Directives require EU countries to achieve a certain result, but leave it to each country to determine how to do so. EU countries must adopt measures to transpose directives into national law to achieve the objectives set by the directive, usually within an agreed time frame. National authorities must communicate the measures adopted to the European Commission.

A number of EU bodies are relevant to the operation of financial consumer protection regulators in members states, including the European Securities and Markets Authority (ESMA), which is both an advisory body for the European Commission and a cooperative body for the securities regulators involved, the European Banking Authority (EBA) and the European Insurance and Occupational Pensions Authority (EIOPA) (jointly, the European Supervisory Authorities or ESAs), the Joint Committee of the ESAs, and the European Systemic Risk Board (ESRB).

In New Zealand, several reviews of aspects of financial services regulation are currently underway. These include 'the Financial Services Legislation Amendment Bill, the Reserve Bank Act review, the review of insurance contract law and conduct regulation, and

the review of consumer credit legislation'.<sup>2</sup> The Financial Services Legislation Amendment Bill, which amends the law relating to financial advice, is expected to pass late in 2018.<sup>3</sup>

These reforms are mentioned in the recent examination of the culture and conduct of New Zealand financial institutions (prompted in part by the Royal Commission's examination of events in Australia) by the Financial Markets Authority (FMA) and Reserve Bank of New Zealand (RBNZ) which reported on 5 November 2018.<sup>4</sup>

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<sup>2</sup> Reserve Bank of New Zealand and Financial Markets Authority, *Bank Conduct and Culture - Findings from an FMA and RBNZ review of conduct and culture in New Zealand retail banks* (5 November 2018). Available at <https://fma.govt.nz/assets/Reports/versions/11883/Bank-Conduct-and-Culture-Review.1.pdf>.

<sup>3</sup> See <https://fma.govt.nz/news-and-resources/new-financial-advice-regime/frequently-asked-questions/>.

<sup>4</sup> Ibid.

## 2. REMUNERATION IN FINANCIAL INSTITUTIONS

This Part discusses legislative provisions, binding regulatory rules and codes of conduct that govern how directors, senior executives and other staff in financial institutions are remunerated.

The manner in which remuneration within financial institutions is and should be structured was reviewed in most jurisdictions after the GFC. Broad principles for bank remuneration in significant institutions were proposed by the Financial Stability Forum in the immediate aftermath of the crisis,<sup>5</sup> to ‘address misaligned incentives that could be created by compensation practices in financial institutions. Since the issuance of the Principles and Standards, supervisors and firms have directed considerable attention to improving the link between risk governance and compensation practices to more effectively align compensation with sound risk-taking behaviour, with a view to the long-term health of financial institutions’.<sup>6</sup> In March 2018, the Financial Stability Board issued Supplementary Guidance on sound compensation practices, in response to ‘significant incidents of misconduct at financial institutions’.<sup>7</sup>

Controls on remuneration reflect the perceived link between incentives created by particular types of remuneration design and conduct that is undesirable, for example because they lead to excessive risk-taking, short-termism or undue focus on sales at the expense of quality customer outcomes. In some jurisdictions, controls on financial sector remuneration are also linked to broader social disquiet about apparent income inequality or excessive remuneration.

Internationally, there are three main types of controls on remuneration design in financial institutions. These are:

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<sup>5</sup> See Financial Stability Forum, *Principles for Sound Compensation Practices* (2 April 2009) available at [http://www.fsb.org/wp-content/uploads/r\\_0904b.pdf](http://www.fsb.org/wp-content/uploads/r_0904b.pdf); Financial Stability Board *Principles for Sound Compensation Practices Implementation Standards* (25 September 2009) available at [http://www.fsb.org/wpcontent/uploads/r\\_090925c.pdf](http://www.fsb.org/wpcontent/uploads/r_090925c.pdf).

<sup>6</sup> See <http://www.fsb.org/2018/03/supplementary-guidance-to-the-fsb-principles-and-standards-on-sound-compensation-practices-2/>.

<sup>7</sup> Ibid.

- generally applicable corporate governance codes or listing rule requirements, that apply to all listed entities in the relevant jurisdiction and are not specific to financial institutions,
- self-regulatory guidelines and principles on remuneration design for financial institutions that are considered persuasive, and
- binding regulations made by governments or regulators that are specific to financial institutions – these include rules made in the UK and the Netherlands pursuant to CRD IV (see below) and in the United States under the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank).<sup>8</sup>

### Governance codes

In all four jurisdictions, for financial institutions that are listed entities, the design of executive remuneration is subject to corporate governance rules and principles of general application. These typically take the form of code provisions against which listed entities must report on a ‘comply or explain’ basis (except in the US, where the codes are not linked to disclosure in this way), and binding or advisory shareholder votes on remuneration (that is, ‘say-on-pay’ requirements).<sup>9</sup>

In the UK, the Financial Reporting Council’s *UK Corporate Governance Code* (revised July 2018)<sup>10</sup> deals with remuneration in Principles P,<sup>11</sup> Q<sup>12</sup> and R<sup>13</sup> and Code Provisions 32 – 41. A listed entity is required by the Listing Rules to make certain disclosures, including stating how they have applied the Principles, and report against the Provisions on a ‘comply or explain’ basis. In the Netherlands, Chapter 3 of the *Dutch Corporate Governance Code* (2016) deals with remuneration. There are four applicable

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<sup>8</sup> Pub. L. No. 111-203, 124 Stat. 1899 (2010).

<sup>9</sup> For a comparison of the ‘say-on-pay’ regimes in the UK, the US and the Netherlands (among others) see Randall S Thomas, Randall and Christoph Van der Elst, ‘Say on Pay Around the World’ *Vanderbilt Law and Economics Research Working Paper 14-10* (20 January 2014).

<sup>10</sup> The new Code takes effect from 1 January 2019.

<sup>11</sup> Remuneration policies and practices should be designed to support strategy and promote long-term sustainable success. Executive remuneration should be aligned to company purpose and values, and be clearly linked to the successful delivery of the company’s long-term strategy.

<sup>12</sup> A formal and transparent procedure for developing policy on executive remuneration and determining director and senior management remuneration should be established. No director should be involved in deciding their own remuneration outcome.

<sup>13</sup> Directors should exercise independent judgement and discretion when authorising remuneration outcomes, taking account of company and individual performance, and wider circumstances.

Principles<sup>14</sup> supported by a number of best practice provisions that ‘regulate relations between the management board, the supervisory board and the shareholders’ which are ‘aimed at defining responsibilities for long-term value creation, risk control, effective management and supervision, remuneration and the relationship with shareholders’. Companies may depart from these best practice provisions, provided that they give reasons for doing so in the manner required by the Code. In New Zealand, the *NZX Corporate Governance Code* (2017) deals with remuneration at Principle 5;<sup>15</sup> this is supported by three recommendations against which the entity must report under Listing Rules.<sup>16</sup>

The US adopts a different approach. There are corporate governance codes promulgated by business and institutional investor groups that contain recommendations on remuneration design, but these are only persuasive and have no formal status. They are not widely adopted or reported against by US financial institutions. They include the *Commonsense Corporate Governance Principles*,<sup>17</sup> the Investor Stewardship Group’s *Corporate Governance Principles for U.S. Listed Companies*,<sup>18</sup> the Business Roundtable’s

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<sup>14</sup> Principle 3.1 is, ‘The ‘remuneration policy applicable to management board members should be clear and understandable, should focus on long-term value creation for the company and its affiliated enterprise, and take into account the internal pay ratios within the enterprise. The remuneration policy should not encourage management board members to act in their own interest, nor to take risks that are not in keeping with the strategy formulated and the risk appetite that has been established. The supervisory board is responsible for formulating the remuneration policy and its implementation.’ Principle 3.2 is, ‘The supervisory board should determine the remuneration of the individual members of the management board, within the limits of the remuneration policy adopted by the general meeting. The remuneration committee should prepare the supervisory board’s decision-making regarding the determination of remuneration. The inadequate performance of duties should not be rewarded.’ Principle 3.3 is, ‘The supervisory board should submit a clear and understandable proposal for its own appropriate remuneration to the general meeting. The remuneration of supervisory board members should promote an adequate performance of their role and should not be dependent on the results of the company.’ Principle 3.4 is, ‘In the remuneration report, the supervisory board should render account of the implementation of the remuneration policy in a transparent manner. The report should be posted on the company’s website.’

<sup>15</sup> The remuneration of directors and executives should be transparent, fair and reasonable.

<sup>16</sup> Listing Rule 10.4.5(i) requires an issuer to provide NZX with a statement on its corporate governance reporting. The statement must disclose the extent to which the issuer has followed the recommendations set by NZX during the reporting period.

<sup>17</sup> See <http://www.governanceprinciples.org/wp-content/uploads/2018/10/CommonsensePrinciples2.0.pdf>. These include Principle VII relating to compensation of management.

<sup>18</sup> See <https://isgframework.org/corporate-governance-principles/>. This includes Principle 6, ‘Boards should develop management incentive structures that are aligned with the long-term strategy of the company’.

*Principles of Corporate Governance*,<sup>19</sup> and The Clearing House's *Guiding Principles for Enhancing U.S. Banking Organization Corporate Governance*.<sup>20</sup>

In New Zealand, the FMA and the RBNZ have noted the Sedgwick Report into bank remuneration released in Australia in 2017.<sup>21</sup> In May 2018, the New Zealand Bankers' Association wrote to the FMA and the RBNZ, saying:

The April 2017 Retail Banking Remuneration Review by Stephen Sedgwick AO made a series of recommendations regarding conduct and incentives. While some of the recommendations may not apply in New Zealand, or may be unable to be adopted due to local legislative requirements, the industry is committed to adopting the rest of those recommendations, as appropriate for each bank. In some cases this work has already been completed and the relevant recommendations have already been implemented. The FMA's current work on sales incentives will also inform industry actions in this area.<sup>22</sup>

It is worth noting that largest retail banks in New Zealand are Australian owned. The recent joint report of the FMA and the RBNZ into bank conduct and culture included the following among its 'recommendations for banks':

Banks' incentive structures need to be designed and controlled in ways that sustain good customer outcomes. Removing incentives linked to sales measures is a significant step toward this goal. We expect banks to revise their sales incentive structures for frontline salespeople and through all layers of management. Most banks have acknowledged the need to make significant changes to their incentive schemes. Progress

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<sup>19</sup> See <https://www.businessroundtable.org/policy-perspectives/corporate-governance/principles-of-corporate-governance>. This includes Principle 6, 'The compensation committee of the board develops an executive compensation philosophy, adopts and oversees the implementation of compensation policies that fit within its philosophy, designs compensation packages for the CEO and senior management to incentivize the creation of long-term value, and develops meaningful goals for performance-based compensation that support the company's long-term value creation strategy'.

<sup>20</sup> See <https://www.theclearinghouse.org/-/media/files/association%20related%20documents/20150624%20tch%20guiding%20principles%20for%20enhancing%20u%20s%20bank%20organization%20corporate%20governance.pdf>. This includes useful commentary in Section 8, dealing with Compensation Committees and board oversight of executive compensation.

<sup>21</sup> Stephen Sedgwick AO, *Retail Banking Remuneration Review – Report* (Australian Bankers Association, 19 April 2017). It is worth noting that New Zealand's largest banks are Australian-owned.

<sup>22</sup> Letter from the New Zealand Bankers' Association to the chief executives of the RBNZ and FMA dated 1 May 2018, available at <https://www.nzba.org.nz/wp-content/uploads/2018/05/Letter-to-RBNZ-FMA-re-Royal-Commission-WEBSITE-4.pdf>. See also, New Zealand Bankers' Association, *Submission to the Finance and Expenditure Committee on the Australian Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry* (13 July 2018).

appears to be in a positive direction, with banks generally reducing the focus on sales performance. However, none of the changes announced by banks to date go far enough to create a sustainable culture of good conduct.

We expect banks to implement changes to their incentives programmes no later than the first performance year after 30 September 2019. In March 2019, we will ask all banks how they will meet our expectations regarding incentives, and we will report on their responses. Any bank that does not, at that date, commit to removing sales incentives for salespeople and their managers will be required to explain how they will strengthen their control systems to sufficiently address the risks of poor conduct that arise with such incentives.<sup>23</sup>

The following discussion focuses on the final category of controls on remuneration – that is, binding regulations specific to remuneration design in financial institutions.<sup>24</sup>

## 2.1 Executive remuneration

This part discusses the specific regulatory rules that relate to the structure of remuneration arrangements in financial institutions in the UK, the Netherlands and the US. New Zealand has not adopted these types of formal controls on executive remuneration in financial institutions.

### *The EU Rules*

All EU member states, including the UK and the Netherlands, are subject to the Capital Requirement Regulation (CRR) and the Capital Requirements Directive (CRD). These instruments implement the Basel III rules in Europe, and are referred to as CRD IV. They contain some (but not all) of the rules relating to remuneration structures in financial institutions.<sup>25</sup> Both the UK and the Netherlands have adopted more extensive restrictions

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<sup>23</sup> FMA and RBNZ, above n 2, 11.

<sup>24</sup> See generally, Norton Rose Fulbright, *Remuneration Requirements for Banks – A Global Analysis* (2015) available at <http://www.nortonrosefulbright.com/knowledge/technical-resources/banking-reform/remuneration-requirements-for-banks---a-global-analysis/>.

<sup>25</sup> For example, one Dutch bank lists the following EU instruments as containing rules related to its remuneration policy: CRD IV and CRR: The fourth Capital Requirements Directive (Directive 2013/36/EU) and the Capital Requirements Regulation (Regulation (EU) No 575/2013); RTS on Identified Staff and RTS on Instruments: delegated regulations supplementing CRD IV with regard to regulatory technical standards related to the selection of identified staff (Commission Delegated Regulation (EU) No 604/2014) and the use of instruments for the purpose of variable remuneration (Commission Delegated Regulation (EU) No 527/2014); EBA Guidelines: European Banking Authority guidelines concerning a controlled remuneration policy under CRD IV and the CRR

and control than those required by CRD IV and implemented by some other EU member states.<sup>26</sup> However they depart sharply from each other on the question of capping bonuses (a regulation the UK does not favour).

CRD IV applies to credit institutions (that is, banks) and certain other financial services firms (insurers, investment firms, fund managers and payment services providers) in the EU.<sup>27</sup> It is made up of the:

- Capital Requirements Directive (2013/36/EU) (CRD) which must be implemented through national law
- Capital Requirements Regulation (575/2013) (CRR), which is directly applicable to firms across the EU.

These instruments are supplemented by guidelines and technical standards issued by the EBA, including the EBA's Guidelines on Sound Remuneration Practices, released in 2015.<sup>28</sup>

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(EBA/GL/2015/22); EBA Guidelines for sales staff: concerns the remuneration policy and the remuneration practices relating to the sale and provision of retail banking products and services (EBA/GL/2016/06); Solvency II Directive and Regulation: Solvency II (Directive 2009/138/EC) and Solvency II Delegated Regulation (Commission Delegated Regulation (EU) 2015/35); EIOPA Guidelines: guidelines on the system of governance under the Solvency II Directive (EIOPABoS-14/253 NL) and on reporting and public disclosure (EIOPA-BoS-15/109 NL) issued by the European Insurance and Occupational Pensions Authority; MiFID II Directive: Directive 2014/65/EU of 15 May 2014 concerning markets for financial instruments and to amend Directive 2002/92/EC and Directive 2011/61/EU (recast) (OJEU 2014, L173/349); MiFID II delegated regulation: (EU) 2017/565 of the Committee of 25 April 2016 containing a supplementation of Directive 2014/65/EU of the European Parliament and the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive; ESMA – MiFID guidelines: the remuneration policy and remuneration practices guidelines (MiFID) (3 June 2013/ESMA/2013/606) ; AIFM Directive: Directive on Alternative Investment Fund Managers (Directive 2011/61/EU); ESMA – AIFM guidelines: guidelines on sound remuneration policies under the AIFM Directive published by the European Securities and Markets Authority; ECB Dividend Recommendation: recommendation of the ECB of 13 December 2016 on dividend distribution policies (ECB/2016/44); ECB Letter to Banks: letter of the ECB of 13 December 2016 on variable remuneration policy. See <https://asrnl.com/media/2983/remuneration-policy-2018.pdf>.

<sup>26</sup> Adopting a stronger rule than is required by an EU directive is often described as 'gold plating'.

<sup>27</sup> CRD IV provides for regulators to ensure compliance with the requirements on remuneration for firms on a consolidated basis, that is at the level of the group, parent undertakings and subsidiaries, including the branches and subsidiaries established in third countries. Non-EEA based firms must apply the remuneration requirements to their EEA subsidiaries and EEA branch operations.

<sup>28</sup> European Banking Authority, *Final Report - Guidelines on Sound Remuneration Policies under Articles 74(3) and 75(2) of Directive 2013/36/EU and Disclosures under Article 450 of Regulation (EU) No 575/2013* (21 December 2015).

The remuneration requirements are intended to ensure that remuneration policies are consistent with and promote sound and effective risk management, do not provide incentives for excessive risk taking and are aligned with the long-term interests of the institutions across the EU. There is a set of general principles that apply to remuneration across the whole firm, and specific requirements and restrictions that apply to particular staff, known as ‘Identified staff’ or, in the UK, ‘Material Risk Takers’ or ‘Remuneration Code staff’. Identified staff are those whose professional activities have a material impact on the firm’s risk profile, such as senior management, risk takers, staff engaged in control functions and any employee receiving total remuneration that takes them into the same remuneration bracket as senior management and risk takers.

The key requirements under CRD IV that apply to a firm as a whole include:

- remuneration policies and practices should be consistent with and promote sound and effective risk management;<sup>29</sup>
- remuneration policies should be in line with the business strategy, objectives, values and long-term interests of the firm, and incorporate measures to avoid conflicts of interest;<sup>30</sup> and
- the implementation of the remuneration policy should be subject to central and independent internal review by the firm’s management body at least annually.

CRD IV was intended to strengthen requirements concerning the relationship between the variable (or bonus) component of remuneration and the fixed component

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<sup>29</sup> The EBA Guidelines on sound remuneration policies that ‘the remuneration policy for all staff, including identified staff, must be consistent with and promote sound and effective risk management. The remuneration policy should be consistent with the long-term strategy of the institution including the overall business strategy, the corresponding risk strategy and its risk appetite, including all risk types (e.g. credit, market, operational, liquidity, reputational and other risks). To be sound and effective, risk management must be in line with the relevant regulatory requirements, including Articles 74 to 87 of the CRD, the requirements on governance in Articles 88 to 91 of the CRD, the EBA guidelines on internal governance, the requirements on the internal capital adequacy assessment process and the requirements of the CRR for specific risk categories, including the appropriate risk measurement approaches’. See EBA, above n 28, 9.

<sup>30</sup> This contemplates conflicts of interest arising from staff holding shares. For example, the EBA Guidelines note that, ‘Conflicts in this area can emerge as the staff receives an economic interest that is linked to a specific instrument that is payable at a specific point of time. Hence there may be the danger that short-term measures are taken to influence the price of instruments. In the long run there should not be a conflict of interest caused by holding instruments of an institution where one is employed’. See EBA, above n 28, 127.

(or salary). It also introduced additional transparency and disclosure requirements for firms relating to staff earning more than €1,000,000 per year. It requires firms to ensure that their remuneration policy makes a clear distinction between criteria for setting fixed remuneration and variable remuneration.

CRD IV introduced hard limits to the relationship between the variable component of remuneration and the fixed component. The basic fixed to variable ratio is 1:1 (that is, maximum bonuses are required to be equal to fixed salary paid to an individual). This ratio can be increased to 2:1 with shareholder approval (with a quorum of 50% of shareholders, 66% of votes in favour would be required; and, if that quorum is not reached, 75% of votes in favour). For the purposes of calculating the maximum ratio, the use of deferred and bail-in-able instruments<sup>31</sup> is encouraged by CRD IV through the application of a notional discount factor to up to 25% of total variable remuneration provided that it is paid in instruments which are deferred for more than five years. It gives members states certain discretions including that they may lower the upper limit set for bonuses and place restrictions on or prohibit certain types of deferred instrument.

CRD IV also provides that:

- variable remuneration is to be subject to malus<sup>32</sup> or claw-back<sup>33</sup> arrangements;
- guaranteed variable remuneration should not form part of an institution's prospective remuneration plans. The payment of a guaranteed bonus should be exceptional, only occur where the firm has a sound and strong capital base and it should be limited to the first year of employment; and
- remuneration packages concerning compensation or buy-outs of previous employment contracts (golden hellos) must be aligned with the firm's long-term interests, including retention, deferral, performance and claw-back arrangements.

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<sup>31</sup> This is a form of contingent capital that is held by banks.

<sup>32</sup> This refers to an arrangement that permits the institution to reduce the value of all or part of deferred variable remuneration based on ex post risk adjustments before it has vested: see EBA, above n 28, 23.

<sup>33</sup> This refers to an arrangement under which the staff member has to return ownership of an amount of variable remuneration paid in the past or which has already vested to the institution under certain conditions: see EBA, above n 28, 23.

It has been said that ‘the interpretation and application of the obligations created by the Directives remains something of a moving feast as the European Commission, EMSA and national regulators ... each produce and from time to time revise their guidance on how the various directive requirements are to be applied, with the concept of "proportionality" being a particularly hot topic’.<sup>34</sup> (Proportionality refers to the extent to which implementation can be tailored to the size and complexity of the subject institution.)

### ***The United Kingdom***

The main rules dealing with remuneration in UK financial institutions are in the Financial Conduct Authority (FCA) Remuneration Codes.<sup>35</sup> The FCA Handbook<sup>36</sup> contains five Codes dealing with remuneration in different types of financial institutions; these are:

- SYSC 19A – IFPRU Remuneration Code<sup>37</sup>
- SYSC 19B – AIFM Remuneration Code<sup>38</sup>
- SYSC 19C – BIPRU Remuneration Code<sup>39</sup>
- SYSC 19D – Dual-regulated firms Remuneration Code<sup>40</sup>
- SYSC 19E – UCITS Remuneration Code.<sup>41</sup>

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<sup>34</sup> See Fieldfisher LLP, *The Regulation of Remuneration: Where are we now with the Remuneration Codes?* (July 2016). Available at <https://www.fieldfisher.com/media/4537495/regulation-of-remuneration-where-are-we-now-with-the-remuneration-codes-online-version.pdf>.

<sup>35</sup> These are explained at <https://www.fca.org.uk/firms/remuneration>.

<sup>36</sup> The FCA Handbook is the document that contains the rules and guidelines promulgated by the FCA that govern the conduct of authorised and registered firms.

<sup>37</sup> IFPRU refers to the Prudential sourcebook for Investment Firms. Broadly, firms that are regulated by the FCA providing investment services under MiFID that have been categorised as being of sufficient importance to be subject to full prudential supervision under CRD IV. This excludes firms that are only authorised to carry on one or more of the following MiFID investment activities/services: (a) reception and transmission of orders, (b) execution of orders on behalf of clients, (c) discretionary portfolio management, and (d) investment advice provided that they do not safeguard and administer assets or hold client money or assets and place themselves in debt with clients: see FCA Handbook, IFPRU 1.

<sup>38</sup> AIFM refers to Alternative investment fund managers.

<sup>39</sup> BIPRU refers to the Prudential sourcebook for Banks, Building Societies and Investment Firms. Broadly, firms that are sole regulated by the FCA providing investment services under MiFID but not falling within the IFPRU Investment Firm definition and so not subject to full CRD IV prudential supervision.

<sup>40</sup> This is, building societies, banks, and all other investment firms authorised in the UK that have not been designated by the Prudential Regulation Authority (PRA) as being of sufficient importance to be subject to prudential supervision by the PRA.

<sup>41</sup> UCITS refers to Undertakings for Collective Investment in Transferable Securities.

The structure reflects the fact that different types of financial institutions are subject to different (and sometime difficult to reconcile) EU rules.<sup>42</sup>

The FCA Remuneration Codes require that remuneration policies and practices are consistent with and promote sound and effective risk management. The FCA summarises the principal requirements of the Codes as including the following:

- At least 40% of a bonus must be deferred over a period of at least three years. At least 60% must be deferred for the most senior management (for SYSC 19A and SYSC 19D only) or when an individual's bonus is a particularly high amount.
- At least 50% of a bonus must be made in shares, share-linked instruments or other equivalent non-cash instruments (or units of shares of the alternative investment fund for firms subject to SYSC 19B or units or shares of the UCITS, equivalent ownership interests in the UCITS, share-linked instruments relating to the UCITS concerned, or equivalent non-cash instruments with equally effective incentives). These shares or instruments should be subject to an appropriate retention period.
- Ensure guarantees are only given in exceptional circumstances to new hires for the first year of service.
- Ensure senior management adopts and periodically reviews the general principles of the firm's remuneration policy and ensure its implementation as well as disclosure of details of their firm's remuneration policies at least annually.

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<sup>42</sup> The following note is helpful: 'The IFPRU Remuneration Code, BIPRU Remuneration Code and Dual-Regulated Firms Remuneration Code generally include very similar provisions, with minor differences in wording. There are really only two major substantive differences between them. One is the guidance on how proportionality is to be applied to the requirements and in relation to some of the rules about variable remuneration and reporting, reflecting the greater systemic importance of the generally larger firms caught by the IFPRU Remuneration Code and the Dual-Regulated Firms Remuneration Code. The other is that the IFPRU Remuneration Code and the Dual Regulated Firms Remuneration Code do, but the BIPRU Remuneration Code does not, include the so-called "bonus cap" - the controversial requirement to cap variable remuneration at one times fixed remuneration (or up to two times fixed remuneration if specifically authorised by shareholders). There is also an interesting technical difference affecting IFPRU firms and Dual-Regulated Firms that if a contract contains a provision that breaches certain of the rules in the relevant Code, that provision is rendered void, whereas there is no equivalent provision in the other Codes. The AIFM Remuneration Code and the UCITS Remuneration Code also include extremely similar provisions to one another with only minor differences in wording and they generally also follow very similar wording to the other rules with changes reflecting the different aims for these codes.' See <https://www.fieldfisher.com/media/4537495/regulation-of-remuneration-where-are-we-now-with-the-remuneration-codes-online-version.pdf>.

- Variable remuneration is risk-adjusted and ensures performance is assessed with respect to financial and non-financial factors and is based on the overall performance of the firm, relevant business unit and the individual concerned.
- Ensure that any variable remuneration, including a deferred portion, is paid or vests only if it is sustainable according to the financial situation of the firm as a whole, and justified on the basis of the overall performance of the firm, the relevant business unit and the individual concerned.<sup>43</sup>

### *The Netherlands*

There are also myriad and complex requirements relating to remuneration in the Netherlands. By way of example, the English language version of the Remuneration Policy adopted by the Dutch bank ASR Nederland N.V. runs to 40 pages.<sup>44</sup> In addition to the relevant EU rules, applicable Dutch law includes the Dutch Restrained Remuneration Regulation 2017 (Rbb 2017) and the Dutch Financial Undertakings (Remuneration Policy) Act (Dutch acronym: Wbfo) contained in Section 1:111-129 of the Dutch Financial Supervision Act.

Wbfo applies to all financial institutions which have their offices registered in the Netherlands and to all roles. Under Wbfo, variable remuneration is capped at a maximum of 20% of the fixed salary component (other than for employees covered by a collective bargaining agreement). In 2017, the Dutch Ministry of Finance undertook an evaluation of Wbfo, to determine whether the intended effects have been achieved, and to study the consequences of the Wbfo on the competitive position of Dutch financial institutions and the business climate in the Netherlands. Its findings were released on 30 August 2018.<sup>45</sup>

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<sup>43</sup> See <https://www.fca.org.uk/firms/remuneration>.

<sup>44</sup> See <https://asrnl.com/media/2983/remuneration-policy-2018.pdf>.

<sup>45</sup> The findings included that 'the bonus cap of 20% helps contain the incentive to take prudential risks more than the European bonus cap of 100%. However, there is no proof that the Dutch bonus cap of 20% better protects the customer's interests. There is also no indication that employees' fixed remuneration now fully compensates the possible loss of variable remuneration'. In the report, 'the Dutch Minister for Finance has proposed three additional rules for fixed remuneration. The first is a clawback provision applicable to part of the fixed remuneration of managing directors, in case a bank or insurance company receives state aid. The second is the possibility to retain the fixed remuneration that relates to the market value of the organisation, such as shares, for a number of years. Finally, a legal obligation will be introduced to account for the relationship between the organisation's social function and its remuneration policy'. These proposed measures are subject to consultation. See Debrauw Blackstone Westbrook, 'Evaluation of Remuneration Policy Act for financial enterprises

### *The United States*

US financial institutions<sup>46</sup> are subject to the formal principles-based policy issued jointly by the US banking authorities, known as the *Guidance on Sound Incentive Compensation Policies*.<sup>47</sup> The Guidance includes three principles:

- the 'incentive compensation arrangements at a banking organization should provide employees with incentives that appropriately balance risk and financial results in a manner that does not encourage employees to expose their organizations to imprudent risk;
- these arrangements should be compatible with effective controls and risk-management; and
- these arrangements should be supported by strong corporate governance, including active and effective oversight by the organization's board of directors.

In 2015 the Securities and Exchange Commission (SEC) adopted its CEO Pay Ratio rule, which was required under Dodd-Frank and applies to public companies from 2018. Companies must reveal the ratio of the CEO's annual total pay to the annual total pay of the median employee.<sup>48</sup>

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(Wbfo)' (18 September 2018). Available at <https://www.debrauw.com/publication/evaluation-of-remuneration-policy-act-for-financial-enterprises-wbfo/#>

<sup>46</sup> The Guidance applies to all the banking organizations supervised by the Agencies, including national banks, State member banks, State non-member banks, savings associations, U.S. bank holding companies, savings and loan holding companies, the U.S. operations of foreign banks with a branch, agency or commercial lending company in the United States, and Edge and agreement corporations. The guidance differentiates between the obligations of Larger bank organisation (LBOs) and other (smaller) banking organisations to implement these principles.

<sup>47</sup> See *Guidance on Sound Incentive Compensation Policies*, Office of the Comptroller of the Currency, Treasury, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation and Office of Thrift Supervision, Treasury, 75 Fed. Reg. 36,396 (June 25, 2010).

<sup>48</sup> See US Securities and Exchange Commission, *SEC Adopts Interpretive Guidance on Pay Ratio Rule* (September 21, 2017). There are some exemptions for which employees must be included in the median calculation, such as employees located outside the US, where a company cannot obtain the necessary information to make the disclosure without violating data privacy laws, or non-US employees where these account for less than 5% of a company's total employee population.

US regulators did significant work after the enactment of Dodd-Frank on controls on remuneration, but the current Administration has not progressed the draft rules. Those proposed controls, which are not in force, were:

- Incentive-Based Compensation, § 956: In April 2016, as required by § 956 of the Dodd Frank Act, the SEC, Federal Reserve, FDIC, OCC and NCUA, and FHFA proposed regulations with respect to incentive-based compensation practices at financial institutions with \$1 billion or more in assets, and includes more stringent requirements for larger institutions. Under the proposed regulations, covered financial institutions would be subject to a general restriction on incentive compensation arrangements that encourage inappropriate risks by providing a covered person with excessive compensation that could lead to material financial loss. Some financial institutions' incentive compensation arrangements would also require a mandatory deferral, forfeiture and downward adjustment reviews, and clawbacks. Though rules under § 956 do not appear to be advancing, that does not indicate that all financial firms will avoid the core mandates of the rule—the proposed § 956 rules closely mirror the Banking regulators' 2010 Interagency Guidance on Sound Incentive Compensation Policies, to which most banks are still subject.
- Pay-Versus-Performance, § 953(a): The SEC proposed a rule to implement the Dodd-Frank mandated Pay-Versus-Performance requirement in 2015. The proposed rule would require disclosure of a table comparing four figures over a five-year period: 1) compensation “actually paid” to the CEO; 2) average of compensation “actually paid” to the company's other four named Executive Officers; 3) company's cumulative [total shareholder return (TSR)]; and 4) cumulative TSR of a peer group selected by the company.
- Clawbacks, § 954: In 2015, the SEC proposed rules directing the National Securities Exchanges to implement listing requirements for companies to adopt a clawback policy. This would require recoupment of incentive compensation from current or former officers, without a finding of fault, following a material restatement of financials.
- Hedging, § 955: In 2015, the SEC proposed rules requiring companies to disclose in their annual proxy statement whether they permit employees or directors to engage in transactions. This would

hedge or offset any decrease in the market value of company stock granted to or owned by an employee or board member.<sup>49</sup>

## 2.2 Variable remuneration below executive level

Many of the rules and restrictions discussed in 2.1 apply across the whole financial institution and are therefore relevant here. CRD IV requires that financial institutions have in place a remuneration policy for all staff, which specifies all components of remuneration and includes the pension policy, including, where relevant, the framework for early retirements. In preparing that policy, institutions must consider whether to adopt elements of the restrictions that apply to Identified staff to others.

The related EBA Guidelines on sound remuneration policies note that:

Remuneration has a direct or indirect influence on staff's behaviour. Variable remuneration may encourage staff to take undesirable, irresponsible and excessive risks or to sell unsuitable products in the hope of generating more turnover or making more profit in the short run and thus increasing staff's variable remuneration. Furthermore, staff members may be tempted to game with or manipulate information with a view to making their (measured) performance look better. For example, if the variable part of the remuneration consists predominantly of remuneration instruments that are paid out immediately, without any deferral or ex post risk adjustment mechanisms (malus or clawback), or are based on a formula that links variable remuneration to current year revenues rather than risk-adjusted profit, there are strong incentives for staff to shy away from conservative valuation policies, to ignore concentration risks, to rig the internal transfer pricing system in their favour and to ignore risk factors, such as liquidity risk and concentration risk, that could place the institution under stress in the future. By connecting risk management elements to the remuneration policy, the aforementioned risks can be counterbalanced.<sup>50</sup>

The Guidelines go on to provide that the remuneration policy 'should also set a framework for other persons acting on behalf of the institution (e.g. tied agents), ensuring that the payments made are not providing any incentive for excessive risk-taking or the mis-selling of products. Institutions should 'ensure that remuneration practices are aligned with their overall risk appetite, taking into account all risks, including reputational risks and risks

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<sup>49</sup> Aon McLagan *Dodd Frank Regulatory Update: Signals from Financial Regulators' Spring Agendas* (August 2017).

<sup>50</sup> EBA, above n 28, 14.

resulting from the mis-selling of products... [and] also take into account the long-term interests of shareholders'. Where variable remuneration is used, it 'should be based on the institutions', business units' and staff's performance and take into account the risks taken. The remuneration policy should make a clear distinction with regard to the variable remuneration and the performance assessment between the operating business units, corporate and control functions'.<sup>51</sup>

MiFID II,<sup>52</sup> which commenced in January 2018, also addresses remuneration. In financial institutions to which it applies, the remuneration policy of persons involved in the provision of services to clients should encourage 'responsible business conduct, fair treatment of clients as well as avoiding conflict of interest' (Article 9(3)(c)). An 'investment firm which provides investment services to clients should not remunerate or assess the performance of its staff in a way that conflicts with its duty to act in the best interests of its clients. In particular, it should not make any arrangement by way of remuneration, sales targets or otherwise that could provide an incentive to its staff to recommend a particular financial instrument to a retail client when the investment firm could offer a different financial instrument which would better meet that client's needs.' (Article 24(10)).

ESMA technical guidance on this requirement includes the following

### **Scope**

The provisions below shall apply to all relevant persons who can have a material impact, directly or indirectly, on investment and ancillary services provided by the investment firm or on its corporate behaviour, regardless of whether the clients are retail or professional, to the extent that the remuneration of such persons and similar incentives – including nonfinancial remuneration such as in-kind benefits and career progression – may create a conflict of interest that encourages them to act against the interests of any of the firm's clients.

### **Design criteria**

Investment firms shall define their remuneration policies under appropriate internal procedures taking into account the interests of all

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<sup>51</sup> EBA, above n 28, 25.

<sup>52</sup> That is, the Markets in Financial Instruments Directive II 2014/65/EU. MiFID II is discussed in Part 3 below.

the clients of the firm, with a view to ensuring that clients are treated fairly and their interests are not impaired by the remuneration practices adopted by the firm in the short, medium or long term. In particular, remuneration policies and practices shall be designed in such a way so as not to create incentives that may lead relevant persons to favour their own interests or the firm's interests to the potential detriment of any client.

### **Governance**

The design of the investment firm's remuneration policy shall be approved by the management body of the firm after taking advice from the compliance function.

The day-to-day implementation of the remuneration policy and the monitoring of compliance risks related to the policy shall be the responsibility of the senior management of the investment firm.

### **Variable remuneration**

Remuneration and similar incentives shall not be solely or predominantly based on quantitative commercial criteria, and shall take fully into account appropriate qualitative criteria reflecting compliance with the applicable regulations, the fair treatment of clients and the quality of services provided to clients.

An appropriate balance between fixed and variable components of remuneration shall be maintained at all times, so that the remuneration structure does not favour the interests of the investment firm or its relevant persons against the interests of any client.<sup>53</sup>

In the UK, the FCA Handbook includes SYSC 19F, which implements MiFID II Article 24(10) requirements on staff incentives and the remuneration of sales staff and advisers. The FCA has stated that 'all firms subject to SYSC 19F must ensure that their remuneration policies and practices:

- do not remunerate or assess the performance of staff in a way that conflicts with their duty to act in the best interests of the firm's clients
- ensure that client interests and the right to be treated fairly are not impaired by the remuneration practices adopted by the firm in the short, medium or long term.'<sup>54</sup>

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<sup>53</sup> European Securities and Markets Commission, *Final Report - ESMA's Technical Advice to the Commission on MiFID II and MiFIR* (19 December 2014) 98-9.

<sup>54</sup> See <https://www.fca.org.uk/firms/remuneration>.

Also, the FCA published guidance in January 2013 (on financial incentives)<sup>55</sup> and July 2015 (on performance management)<sup>56</sup> that emphasise the need for firms to mitigate the risks to consumers that could arise through their incentive schemes and performance management of staff. The FCA advises regulated firms that ‘the key issues that firms should focus on when managing their incentive arrangements include:

- Checking for incentive features that are high risk because they strongly promote aggressive sales behaviour, and ensuring they are appropriately controlled.
- Using management information to check for spikes and trends in the sales patterns of individuals to identify areas of increased risk.
- Doing more to identify inappropriate staff behaviour in face-to-face sales conversations.
- Managing the risk in discretionary schemes and balanced scorecards.
- Monitoring non-advised sales to ensure staff are not giving advice.
- Improving oversight of incentives used by appointed representatives.
- Recognising that remuneration that is effectively 100% variable pay based on sales increases the risk of mis-selling, and managing this risk’.<sup>57</sup>

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<sup>55</sup> See <https://www.fca.org.uk/publication/finalised-guidance/fsa-fg13-01.pdf>.

<sup>56</sup> See <https://www.fca.org.uk/publication/finalised-guidance/fg15-10.pdf>.

<sup>57</sup> See <https://www.fca.org.uk/firms/risks-customers-financial-incentives>.

### 3. COMMISSIONS AND ONGOING ADVICE FEES

This Part looks at restrictions on remuneration in connection with financial advice and financial product sales and distribution – in particular, the ban on commissions in the UK and the Netherlands, and the requirements relating to the deduction of fees for advice on an ongoing basis from client accounts.

In Europe, the regulation of these matters was affected by MiFID II, was adopted in 2014 and came into operation in January 2018. It replaced the Markets in Financial Instruments Directive (2004/39/EC) (MiFID) which operated in the EU from November 2007. MiFID contained:

- conduct of business and organisational requirements for investment firms;
- authorisation requirements for regulated markets;
- regulatory reporting to avoid market abuse;
- trade transparency obligations for shares; and
- rules on the admission of financial instruments to trading.

The revisions to MiFID adopted by the European Parliament and the Council of the European Union in 2014 are referred to as MiFID II and MiFIR. ESMA notes that MiFID II strengthens investor protection through:

the introduction of new requirements on product governance and independent investment advice, the extension of existing rules to structured deposits, and the improvement of requirements in several areas, including on the responsibility of management bodies, inducements, information and reporting to clients, cross-selling, remuneration of staff, and best execution.<sup>58</sup>

MiFID II deals primarily with investment products. Distribution of insurance is covered by Insurance Distribution Directive (EU) 2016/97 which regulates the way insurance products are designed and sold both by insurance intermediaries and directly by insurance undertakings. It prescribes the information that should be given to consumers before they sign an insurance contract; it imposes certain conduct of business and transparency rules on distributors; it clarifies procedures and rules for cross-border business and it contains rules

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<sup>58</sup> See <https://www.esma.europa.eu/policy-rules/mifid-ii-and-mifir>.

for the supervision and sanctioning of insurance distributors in case they breach the provisions of the Directive.<sup>59</sup>

In the United States, fees may include ‘sales commissions, mark-ups or mark-downs, administrative and management charges, and costs associated with the sale or redemption of an investment’.<sup>60</sup> These must be disclosed under the general anti-fraud rules administered by the SEC.

### **3.1 Commissions and inducements paid by product issuers**

This section discusses restrictions and disclosure requirements relating to commissions or other inducements paid by product issuers to advisers who recommend their products to clients.

The payment of certain commissions or inducements in connection with the distribution of some financial products is banned in the UK and in the Netherlands. In New Zealand, they may be paid but must be disclosed in accordance with the Financial Advisers (Disclosure) Regulation 2010 (NZ).<sup>61</sup> In the US, commissions and inducements from product issuers are regulated (but not prohibited) under the relevant conduct of business laws; they must be disclosed because they give rise to a conflict of interest.

#### ***The United Kingdom***

In the UK, the ban on inducements, including commissions paid by product issuers, was introduced following the FSA’s Retail Distribution Review (RDR) in 2012. The RDR resulted in a ban on commissions for retail investment advice in the United Kingdom which was implemented in COBS 6.1A.4R at the end of 2012. This ban on commissions is applicable to all investment advisers irrespective of whether they give independent or restricted advice to retail clients, with the minor exception of basic advice on stakeholder

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<sup>59</sup> The Insurance Distribution Directive is discussed at <https://eiopa.europa.eu/consumer-protection/insurance-distribution-directive>.

<sup>60</sup> See <http://www.finra.org/investors/working-your-investment-professional>.

<sup>61</sup> See <https://fma.govt.nz/investors/getting-financial-advice/paying-for-advice/>. The website states that, ‘If you are dealing with an Authorised Financial Adviser (AFA), they are legally required to tell you about any fee and commission details. A Registered Financial Adviser (RFA) is not legally required to disclose commission and fees but you are entitled to ask and be told. A QFE adviser (for example bank staff) doesn’t usually receive commission but will be rewarded by some form of bonus. Again, you’re entitled to ask’. The different categories of advisers are explained in Part 3 below.

products.<sup>62</sup> It applies in connection with retail investment products, including certain life policies, pension policies, investment trusts, savings schemes, securities, equities and structured capital-at-risk products. However insurance<sup>63</sup> and mortgages are not covered, and therefore it is more limited in scope than the Dutch regime.

The ban on inducements or ‘soft commissions’ is explained by the FCA in these terms:

MiFID II introduces new inducement bans for firms providing independent investment advice and portfolio management services. The FCA has implemented these new bans alongside, and in such a way as to broadly reflect the application of, the existing RDR adviser charging rules. This means, for example, that for firms providing advice to retail clients in the UK, the new ban applies both in respect of the provision of independent and non-independent (restricted) advice, and in such a way as to prevent rebating. Firms to which the new MiFID II inducement bans apply may only accept certain minor non-monetary benefits. These may include ‘hospitality of a reasonable de minimis value’ (provided that certain conditions are met). However, we note that the list of potentially acceptable minor non-monetary benefits does not include ‘sporting and cultural events’.<sup>64</sup>

The (lengthy) rules are contained in the FCA Handbook, which deals with inducements in COBS 2.3 and COBS 2.3A.<sup>65</sup> The Handbook also includes rules covering adviser charging, product provider and platform service provider rules in COBS 6.1A, COBS 6.1B and COBS 6.1E. The Handbook was amended from January 2018 to implement MiFID II.

The basic adviser charges rule is in COBS 6.1A, which (subject to exceptions) provides that a firm which makes a personal recommendation to a retail client in relation to a retail investment product or P2P (that is, peer-to-peer) agreement<sup>66</sup> must:

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<sup>62</sup> Basic advice (COBS 9.6) is a short, simple form of financial advice which uses pre-scripted questions to determine whether a range of stakeholder products will be suitable for a customer.

<sup>63</sup> Other than certain investment linked insurance products. Under the rules relating to insurance distribution, commissions and other remuneration must be disclosed: see ICOBS 4.3.

<sup>64</sup> See <https://www.fca.org.uk/firms/mifid-ii-retail-investment-advice-firms>.

<sup>65</sup> The former covers ‘inducements relating to business other than MiFID, equivalent third country or optional exemption business and insurance-based investment products’ and the latter applies to ‘inducements relating to MiFID, equivalent third country or optional exemption business and insurance-based investment products’. This is because the restrictions imposed in relation to the second category are more onerous than the first. The terms are defined in the FCA Handbook. The second category comprises the more complex investment products.

<sup>66</sup> These terms are defined in the FCA Handbook.

- only be remunerated for the personal recommendation (and any other related services provided by the firm) by adviser charges; and
- not solicit or accept (and ensure that none of its associates solicits or accepts) any other commissions, remuneration or benefit of any kind in connection with the firm's business of advising or any other related services, regardless of whether it intends to refund the payments or pass the benefits on to the retail client; and
- not solicit or accept (and ensure that none of its associates solicits or accepts) adviser charges in relation to the retail client's retail investment product or P2P agreement which are paid out or advanced by another party over a materially different time period, or on a materially different basis, from that in or on which the adviser charges are recovered from the retail client.

'Adviser charges' is defined and essentially means any charges agreed between the adviser and the client under COBS 6.1A.

The prohibition is subject to grandfathering of commissions relating to transactions before 31 December 2012; the grandfathering rules are in COBS 6.1A.4A and 6.1A.4AB.

If the adviser is the product issuer or an associate, it must set its adviser charges at a reasonable rate, to ensure a level playing field with unaffiliated advisers. This is the effect of COBS 6.1A.9R, which says that if the firm or its associate is the retail investment product provider, platform service provider or operator of an electronic system in relation to lending, it must ensure that the level of its adviser charges is at least reasonably representative of the cost of the services associated with making the personal recommendation (and related services). Where the firm is a retail investment product provider or a platform service provider it must comply with the rules in COBS 6.1B (retail investment product provider, operator of an electronic system relating to lending, and platform service provider requirements relating to adviser charging and remuneration) and, where relevant, COBS 6.1E (platform services: platform charges using a platform service for advising).

The inducement rules are contained in COBS 2.3 and COBS 2.3A. Prior to MiFID II, inducement had been permitted in certain circumstances as long as it did not impair a MiFID investment firm's duty to act in the best interests of its client, 'enhanced the quality' of the service being provided to the client and was disclosed to the client. The new rule in

COBS 2.3A applies to a firm that provides independent advice, restricted advice or portfolio management services; it is prohibited from receiving inducements (other than acceptable minor non-monetary benefits) in relation to those services under COBS 2.3A.15R and COBS 2.3A.16R. However compliance with COBS 2.3B allows such a firm to receive third party research without breaching that prohibition.<sup>67</sup>

COBS 2.3A.2G, 2.3A.3G and 2.3A.4G explain the relationship between the inducements rules and the adviser charging, product provider and platform service provider rules in COBS 6.1A.

### *The Netherlands*

In the Netherlands, the payment of inducements (also known as commissions or provisions) is prohibited by article 168a of Besluit gedragstoezicht financiële ondernemingen (Bgfo). Inducements are defined as any form of reward or compensation for financial or related services provided to retail investors. Financial institutions are allowed to receive rewards or compensation for independent investment advice or asset management services, but only directly from clients. As in the UK, an in-house adviser must put a price on its services that reflects the cost of providing them, to create a level playing field with independent advisers.

The Dutch rule is wider than MiFID II; it applies to more types of financial services (investment and savings products, mortgages and life and income protection insurance products) and applies to all distribution forms, not only independent advisers.<sup>68</sup>

Grandfathering is provided by Article 168aa of Bgfo:

The commission ban is not applicable to the provision of investment services or additional services with regard to transactions in financial instruments which are not participation rights in an open-ended investment institution or an icbe, carried out before 1 January 2014. The 'old' Article 168a Bgfo remains applicable to these services (par.1). With regard to transactions in participation rights in an open-ended investment institution or an ICBE, receiving or providing

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<sup>67</sup> See Martin Sandler, Bobby Schrader and Sara Evans, 'MiFID II inducement rule: the impact on investment research and market commentary' *Butterworths Journal of International Banking and Financial Law* (July/August 2016) 409.

<sup>68</sup> The Dutch ban is discussed in PWC, 'The Dutch Disadvantage?' (September 2017) available at <https://www.pwc.nl/nl/assets/documents/pwc-the-dutch-disadvantage.pdf>.

commission (such as distribution fees) is still allowed up to and including 31 December 2014, provided the commission as a whole is paid to the client and the requirements under (i) and (ii) as represented above are met.<sup>69</sup>

### *New Zealand*

As noted, commissions are not banned in New Zealand. In its recent review of financial advice laws, the Ministry of Business, Innovation and Employment addressed the question of whether commissions ought to be banned and observed:

We recognise that banning commissions is a more direct way to ensure consumer protection from the risks presented by conflicted remuneration. However, we are not recommending this option in the first instance because:

- There is a significant risk that banning commissions in New Zealand (where people are already reluctant to pay for financial advice) will further limit access to advice.
- It would not address conflicts of interest where financial products are sold through in-house distribution channels, such as bonuses (and may increase the prevalence of such conflicts of interest since there would likely be a significant increase in advice provided through in-house distribution models).
- Our recommendations address the same ‘conflict of interest’ issues that banning commissions would seek to address. In particular, they include:

- o introducing clear conduct obligations on all providing advice

- o improving the ability for the FMA to monitor and take enforcement action for breaches of those conduct obligations – like insurance churn

- o requiring conflicts to be disclosed clearly and consistently by all financial advisers and agents.

There is a clear trend internationally toward more direct interventions, including bans on commissions. This comes in the wake of the global financial crisis (GFC) and several major mis-selling scandals (e.g. widespread mis-selling of income protection insurance in the United

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<sup>69</sup> Van Benthem & Kuelen, ‘Commission Ban for Investment Companies in Force from January 2014’ (31 December 2013).

Kingdom), and as behavioural economics increasingly points to the limitations of disclosure by itself to address conflicts of interest.

Given the significant risk of harming access to advice, our recommendations represent a more prudent approach in the first instance.<sup>70</sup>

### ***The United States***

A US broker-dealer is required, by the SEC's Customer Confirmation Rule (Rule 10b-10 and MSRB rule G-15) to provide its customers, at or before the completion of a transaction, with certain information, including the source and amount of any third-party remuneration it has received or will receive. The purpose of this disclosure is 'to inform the customer of the nature and extent of a broker-dealer's conflict of interest. Broker-dealers are neither required to disclose the precise amount of these payments nor any formula that would allow a customer to calculate this amount'. The SEC states that, 'Nevertheless, Rule 10b-10 is not a safe harbor from the anti-fraud provisions. Recent enforcement actions have indicated that failures to disclose the nature and extent of the conflict of interest may violate Section 17(a)(2)' of the Securities Act of 1933 (1933 Act).<sup>71</sup>

Section 206 of the Investment Advisers Act of 1940 imposes a fiduciary duty on investment advisers to act in their clients' best interests, including an affirmative duty to disclose all conflicts of interest. A conflict of interest arises when an adviser receives compensation (either directly or indirectly through an affiliated broker-dealer) for selecting a more expensive mutual fund share class for a client when a less expensive share class for the same fund is available and appropriate.<sup>72</sup> That conflict of interest must be disclosed. These payments to advisers by mutual fund operators are known as 12b.1 fees, which technically cover marketing and distribution costs. In February 2018, the SEC recently

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<sup>70</sup> Ministry of Business, Innovation and Employment (MBIE) *Final Report Review of the Operation of the Financial Advisers Act 2008 and the Financial Service Providers (Registration and Dispute Resolution) Act 2008* (July 2016) 78-9.

<sup>71</sup> See Edward D Jones & Co, LP, Securities Exchange Act Release No. 50910 (Dec. 22, 2004); Morgan Stanley DW, Inc, Securities Exchange Act Release No. 48789 (Nov. 17, 2003) at <https://www.sec.gov/reportspubs/investor-publications/divisionsmarketregbdguidehtm.html#foot6> footnote 6.

<sup>72</sup> The structure adopted for the payment of these commissions is that many mutual funds offer a variety of share classes, including some that paid 12b-1 fees and others that did not for eligible clients.

announced an amnesty in respect of past breaches of the conflicts duty in relation to these payments.<sup>73</sup>

The SEC ‘takes the position that an investment adviser must disclose to clients all material information regarding its compensation, such as if the adviser’s fee is higher than the fee typically charged by other advisers for similar services (in most cases, this disclosure is necessary if the annual fee is three percent of assets or higher). An investment adviser must disclose all potential conflicts of interest between the adviser and its clients, even if the adviser believes that a conflict has not affected and will not affect the adviser’s recommendations to its clients. This obligation to disclose conflicts of interest includes the obligation to disclose any benefits the adviser may receive from third parties as a result of its recommendations to clients’.<sup>74</sup>

### **3.2 Payment for ongoing advice**

This section explains special rules that apply when advisers charge fees that are periodically debited to the client’s account.

#### ***The United Kingdom***

In the UK, arrangements for ongoing payment of adviser charges are governed by FCA Handbook COBS 6.1A.22R. This restriction was introduced following the RDR. It provides that a firm must not use an adviser charge which is structured to be payable by the retail client over a period of time unless:

- the adviser charge is in respect of an ongoing service for the provision of personal recommendations or related services, the firm has disclosed that service along with the adviser charge, and the retail client is provided with a right to cancel the ongoing service, which must be reasonable in all the circumstances, without penalty and without requiring the retail client to give any reason; or
- the adviser charge relates to a retail investment product or arrangement with an operator of an electronic system in relation to lending for which an instruction from

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<sup>73</sup> See <https://www.sec.gov/enforce/announcement/scsd-initiative>.

<sup>74</sup> See <https://www.sec.gov/divisions/investment/iaregulation/memoia.htm>.

the retail client for regular payments is in place and the firm has disclosed that no ongoing personal recommendations or service will be provided.

The guidance to the rule says that, to comply with the rule on providing a retail client with the right to cancel an ongoing service for the provision of personal recommendations or related services without penalty (COBS 6.1A.22R (1)(b)) a firm should ensure that any notice period of the retail client's right of cancellation is reasonable; not make any charge in respect of cancellation of the ongoing service except for an amount which is in proportion to the extent of the service already provided by the firm up to the date of cancellation of the ongoing service; and not make cancellation conditional on, for example, requiring the retail client to sell any retail investment products or to assign any P2P agreements to which the ongoing service relates.

### *New Zealand*

In New Zealand, advisers may receive 'an ongoing fee, management fee or service fee for providing an ongoing service'.<sup>75</sup>

### *The United States*

Broker-dealers do not charge ongoing adviser fees – this is one of the features that distinguish them from investment advisers. SEC Rule 206(4)-4, made under the Investment Advisers Act of 1940, requires every SEC-registered investment adviser that has custody or discretionary authority over client funds or securities, or that requires prepayment six months or more in advance of more than \$500 of advisory fees, to disclose promptly to clients and prospective clients any financial conditions of the adviser that are reasonably likely to impair the ability of the adviser to meet contractual commitments to clients. Subject to exceptions, s 205(a)(1) of the Advisers Act prohibits an investment adviser from receiving performance fees – that is, any type of advisory fee calculated as a percentage of capital gains or appreciation in the client's account.

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<sup>75</sup> See <https://fma.govt.nz/investors/getting-financial-advice/paying-for-advice/>.

## 4. SEPARATION OF PRODUCT ISSUERS FROM ADVICE

This Part identifies the legal requirements and restrictions that apply to the provision of advice about financial products by individuals or entities that are, or are associates of, the product issuer. In the US this is usually characterised as the sale of ‘proprietary products’. These situations can give rise to conflicts of interest and duty. As the FMA in New Zealand observed in 2015:

If they are not properly identified and managed, conflicts of interest can result in poor customer outcomes. Vertically integrated distribution models, where a business is the provider, manager and distributor of a product, can exacerbate conflicts of interest. Remuneration and incentive arrangements can also reinforce conflicts of interest, particularly when sales staff are remunerated on a volume basis or through certain bonus structures.<sup>76</sup>

None of the jurisdictions examined prohibits a product issuer or its associate providing personalised recommendations to customers about products. In other words, they do not necessarily require that a person or entity giving advice be structurally independent of the product issuer or to refrain from selling proprietary products. However all require that conflicts of interest arising from that relationship be appropriately managed. Guidance from the EU indicates that merely disclosing the existence of the conflict will not satisfy this requirement.

Comparative discussions of the regulation of ‘advice’ is complicated because the term can mean different things in different contexts.<sup>77</sup> To frame the discussion, I distinguish

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<sup>76</sup> Financial Markets Authority, *Sales and Advice* (November 2015) 10.

<sup>77</sup> For example, ESMA has provided extensive guidance on when a person or entity will be providing advice for the purposes of MiFID. It states that, according to MiFID, investment advice means the provision of personal recommendations to a client, either upon his request or at the initiative of the investment firm, in respect of one or more transactions relating to financial instruments (Article 4(4)). For the purposes of the definition of investment advice, that recommendation must be presented as suitable for that person or must be based on a consideration of the circumstances of that person (Article 52 of the MiFID Implementing Directive). The Directive also sets out a number of other tests for firms to consider in determining whether they are providing such personal recommendations... [There are] five key tests [that all] have to be met in order for a service to be considered investment advice under MiFID’. See ESMA, *Understanding the definition of advice under MiFID* (April 2010). Available at [https://www.esma.europa.eu/sites/default/files/library/2015/11/10\\_293.pdf](https://www.esma.europa.eu/sites/default/files/library/2015/11/10_293.pdf).

between three types of one-to-one communications<sup>78</sup> that a person or entity might have with an individual customer who is being offered, or is considering acquiring, a financial product where the person or entity knows something of the customer's circumstances. These are:

- guidance about the product, including as part of a sales discussion (for example, 'This product has these features and is good for people nearing retirement who want a conservative, low cost savings product')
- a recommendation given when the person or entity is not purporting to be acting for the customer or to be impartial (for example, 'This product offered by our bank has these features, and is suitable for someone like you')
- a recommendation given by an impartial adviser, retained by the customer and required to act in the best interests of the customer (for example, 'Having considered a range of options, my independent professional judgement is that this is a good product for you').

Different jurisdictions (including Australia) delineate each of these categories slightly differently, and regulate each category differently. Also, the institutional arrangements for advice are different – for example, in the United States most households rely on broker-dealers<sup>79</sup> for investment product advice but in the Netherlands this is

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<sup>78</sup> Other than the communication of factual information about a financial product; this is not advice.

<sup>79</sup> The FINRA website provides the following useful information about broker-dealers in the US. **'What they are:** While many people use the word broker generically to describe someone who handles stock transactions, the legal definition is somewhat different—and worth knowing. A broker-dealer is a person or company that is in the business of buying and selling securities—stocks, bonds, mutual funds, and certain other investment products—on behalf of its customers (as broker), for its own account (as dealer), or both. Individuals who work for broker-dealers—the sales personnel whom most people call brokers—are technically known as registered representatives. **Who regulates them:** With few exceptions, broker-dealers must register with the Securities and Exchange Commission (SEC) and be members of FINRA. Individual registered representatives must register with FINRA, pass a qualifying examination, and be licensed by your state securities regulator before they can do business with you. You can obtain background information on broker-dealers and registered representatives—including registration, licensing, and disciplinary history—[through FINRA].... **What they offer:** Broker-dealers vary widely in the types of services they offer, falling generally into two categories—full-service and discount brokerage firms. Full-service firms typically charge more for each transaction, but they tend to have large research operations that representatives can tap into when making recommendations, can handle nearly any kind of financial transaction you want to make, and may offer investment planning or other services. Discount broker-dealer firms are usually cheaper, but you may have to research potential investments on your own—though the broker-dealer websites may have a lot of information you can use. Registered representatives are primarily securities salespeople and may also go by such generic titles as financial consultant, financial advisor, or investment consultant. The products they can sell you depend on the licenses they hold. For example, a representative who has passed the Series 6 exam can sell only mutual funds, variable annuities, and

typically provided by banks. This makes direct comparisons difficult.<sup>80</sup> Nevertheless, the general pattern is that the first category is not regulated as ‘advice’ but is subject to general prohibitions on misrepresentations;<sup>81</sup> the second category is permitted as long as the affiliation is disclosed and the advice is suitable; and the third category may effectively require the person or entity to be independent in order to be able to discharge its fiduciary duty to the client. These jurisdictions therefore rely on customers being able to distinguish between the different categories and access the guidance or advice they require (and wish to pay for).

#### 4.1 Structural separation and independence

This section explains how the different systems treat financial advisers that are affiliated with product issuers, for example in vertically or horizontally integrated financial institutions.

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similar products, while the holder of a Series 7 license can sell a broader array of securities. When a registered representative suggests that you buy or sell a particular security, he or she must have reason to believe that the recommendation is suitable for you based on a host of factors, including your income, portfolio, and overall financial situation, your tolerance for risk, and your stated investment objectives.’ See <http://www.finra.org/investors/brokers>.

<sup>80</sup> For a useful overview and comparison of the regulation of financial advice in different markets, see Rand Corporation, *Financial Advice Markets – A Cross-Country Comparison* (2015). Available at [https://www.rand.org/content/dam/rand/pubs/research\\_reports/RR1200/RR1269/RAND\\_RR1269.pdf](https://www.rand.org/content/dam/rand/pubs/research_reports/RR1200/RR1269/RAND_RR1269.pdf).

<sup>81</sup> As in Australia in relation to ‘general advice’, concerns are often expressed by product issuers that when they know something about a customer’s circumstances (for example, because they have access to the customer’s account information) it is difficult to be confident that anything other than factual information is guidance only. This means that issuers can be reluctant to provide guidance to customers in selecting products. This is a concern addressed directly by the FCA in the Financial Advice Market Review (FAMR), see <https://www.fca.org.uk/firms/financial-advice-market-review-famr>.

***The United Kingdom***

In the UK, the FCA regulates the provision of advice about ‘retail investment products’.<sup>82</sup>

Advice is distinguished from guidance. The FCA provides this summary of the difference between advice and guidance.<sup>83</sup>

	Advice	Guidance
<b>What will the service provide?</b>	<p>It will recommend what you should do, for example, to buy or sell.</p> <p>The recommendation will be about a specific investment, for example shares in XYZ plc or ABC’s Low Risk UK Shares Fund.</p> <p>The recommendation must be suitable for you, for example, for your personal financial situation and investment goals.</p>	<p>It will not tell you what to do or which products to buy. The information provided will help you to identify your options.</p> <p>The guidance might include information about different types of investments or set out general principles for you to consider before you decide what to invest your money in.</p>
<b>Who provides the service?</b>	<p>Advice on products can only be offered by FCA regulated firms (you can check which firms are regulated by us on the <a href="#">Financial Services Register</a>).</p>	<p>Anyone can provide guidance. Some organisations that provide guidance are regulated by the FCA.</p>
<b>Will you have to pay for the service?</b>	<p>You will normally pay a fee for advice.</p> <p>You should be told about any fees before you are given advice.</p>	<p>Guidance is normally free.</p> <p>Firms that are regulated by the FCA should tell you about any fees before they give you any guidance.</p>
<b>What are providers of the service responsible for?</b>	<p>Advisers are responsible and liable for the accuracy, quality and suitability of the recommendations they make.</p>	<p>Guidance providers are responsible for the accuracy and quality of the information they provide.</p>

<sup>82</sup> ‘Retail investment product’ is defined in the Handbook as: (a) a life policy; or (b) a unit; or (c) a stakeholder pension scheme; or (d) a personal pension scheme; or (e) an interest in an investment trust savings scheme; or (f) a security in an investment trust; or (g) any other designated investment which offers exposure to underlying financial assets, in a packaged form which modifies that exposure when compared with a direct holding in a financial asset; or (h) a structured capital-at-risk product; whether or not any of a) to h) are held within an ISA or a child trust fund (CTF).

<sup>83</sup> See <https://www.fca.org.uk/consumers/understanding-advice-guidance-investments>. See also, *Consumer explanations of “advice” and “guidance” Prepared by the Financial Advice Working Group for HM Treasury and the Financial Conduct Authority – Final Report* (March 2017). Available at <https://www.fca.org.uk/publication/research/fawg-consumer-explanations-advice-guidance.pdf>.

	Advice	Guidance
<b>Complaints about the service and access to the Financial Ombudsman Service</b>	<p>If you are dissatisfied with the advice, you should complain to the firm that gave you the advice in the first instance.</p> <p>If you are not happy with the firm's response, they reject your complaint or you do not hear from them within 8 weeks you may be able to refer your complaint to the Financial Ombudsman Service.</p> <p>The <a href="#">Financial Ombudsman Service</a> (link is external) is a free, independent service for settling disputes between financial services firms and their customers. It has power to award redress (often known as compensation).</p>	<p>If you are dissatisfied with the service you have received you should complain to the organisation that gave you the guidance in the first instance.</p> <p>If the organisation is regulated by the FCA and you are not happy with the firm's response, they reject your complaint or you do not hear from them within 8 weeks you may be able to refer your complaint to the Financial Ombudsman Service.</p> <p>If the organisation is not regulated by the FCA, you will probably not be able to refer your complaint to the Financial Ombudsman Service. But you may have other options and may want to consider seeking independent legal advice.</p>
<b>Compensation if the provider has stopped trading or has gone into administration and you have a legal claim against them</b>	<p>If you have a legal claim against the firm that gave you advice and it stops trading, you may be able to obtain compensation from the <a href="#">Financial Services Compensation Scheme</a> (link is external) . This will depend on your legal claim satisfying the requirements of the compensation scheme.</p>	<p>If you have a legal claim against an FCA-regulated firm that gave you guidance and it stops trading, you may be able to claim compensation from the <a href="#">Financial Services Compensation Scheme</a> (link is external). This will depend on your legal claim satisfying the requirements of the compensation scheme.</p> <p>If the organisation that gave you guidance is not regulated by the FCA, you cannot claim compensation from the Financial Services Compensation Scheme, but may wish to seek independent legal advice.</p>

Investors in the UK typically seek advice ‘from financial advice firms, banks, employee benefits consultants, and wealth managers’.<sup>84</sup> Firms providing advice must be authorised by the FCA<sup>85</sup> and advisers must satisfy professional standards.<sup>86</sup>

Reflecting MiFID II, the UK regulatory system distinguishes between *independent* and *restricted* financial advisers. Independent advisers make recommendations in respect of a full range of financial products and issuers; restricted advisers focus on a limited selection of products or issuers.<sup>87</sup>

The distinction is drawn having regard to the standard for independent advice. ‘Independent advice’ is defined in the Handbook as ‘a personal recommendation to a retail client in relation to a retail investment product where the personal recommendation provided meets the requirements of the rule on independent advice (COBS 6.2A.3R)’. These are ‘that the personal recommendation is: (a) based on a comprehensive and fair analysis of the relevant market; and (b) unbiased and unrestricted’.<sup>88</sup> This is the standard for independent advice.

The FCA states that, to satisfy the standard for independent advice, ‘a firm should ensure that it is not bound by any form of agreement with a retail investment product provider that restricts the personal recommendation the firm can provide or imposes any obligation that may limit the firm's ability to provide a personal recommendation which is unbiased and unrestricted’ (COBS 6.2A.15G). Importantly, COBS 6.2A.16G says:

A firm may be owned by, or own in whole or part, or be financed by or provide finance to, a retail investment product provider without contravening the ‘unbiased, unrestricted’ requirement provided the firm ensures that that ownership or finance does not prevent

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<sup>84</sup> Rand Corporation, above n 80, 7.

<sup>85</sup> The Perimeter Guidance Manual provides guidance on when advice on investments is regulated by the FCA, in particular 8.24 to 8.30 and 13.3 Q19-Q20.

<sup>86</sup> See <https://www.fca.org.uk/firms/professional-standards-advisers>. This includes complying with the Statements of Principle and Code of Practice for Approved Persons (APER) in the FCA Handbook.

<sup>87</sup> The term ‘restricted adviser’ replaced ‘tied adviser’ and ‘multi-tied adviser’ after the Retail Distribution Review. See G McMeel, ‘International Issues in the Regulation of Financial Advice: A United Kingdom Perspective—The Retail Distribution Review and the Ban on Commission Payments to Financial Intermediaries’ *St John's Law Review*, Vol 87, No 2, April 2014, pp 595–627.

<sup>88</sup> Financial Services Authority, *Retail Distribution Review: Independent and restricted advice* (February 2012) [2.1] – [2.2].

the firm from providing a personal recommendation which is unbiased and unrestricted.

Both independent and restricted advisers must meet the same qualification requirements and ensure they are providing suitable advice. Each must 'act honestly, fairly and professionally in accordance with the best interests of its client' (COBS 2.1.1). This is known as the client's best interests rule; it applies in relation to designated investment business carried on for a retail client; MiFID, equivalent third country or optional exemption business for any client;<sup>89</sup> and insurance distribution for any client.

An adviser or firm must inform the client in writing whether they offer independent or restricted advice. The operative provision is COBS 6.2B.11R. It provides that:

If a firm informs a client that it provides independent advice, that firm must assess a sufficient range of relevant products available on the market which must:

(1) be sufficiently diverse with regard to their:

(a) type; and

(b) issuers or product providers,

to ensure that the client's investment objectives can be suitably met; and

(2) not be limited to relevant products issued or provided by:

(a) the firm itself or by entities having close links with the firm; or

(b) other entities with which the firm has such close legal or economic relationships, including contractual relationships, as to present a risk of impairing the independent basis of the advice provided.

In contrast a restricted adviser or firm can only recommend certain products, product providers, or both. The adviser or firm must clearly explain the nature of the restriction; some examples of restricted advice are where:

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<sup>89</sup> See footnote 65.

- the adviser works with one product provider and only considers products that company offers
- the adviser considers products from several – but not all – product providers
- the adviser can recommend one or some types of products, but not all retail investment products
- the adviser has chosen to focus on a particular market, such as pensions, and considers products from all providers within that market.

### *The Netherlands*

The approach to regulating financial advice in the Netherlands also reflects MiFID II in that it distinguishes between advice on an independent basis and on a non-independent basis. Before providing advice, an investment firm must inform a client whether this advice is being provided on an independent or a non-independent basis.

The AMF states that:

Firms that provide investment advice on an independent basis will generally not be allowed to receive inducements and are required to assess a sufficient range of financial instruments or structured deposits in the advice. Different types of financial instruments offered by various providers must be included in the independent advice. Independent advice may not be limited to financial instruments that are issued or provided by the investment firm itself or related entities. If the advice does not satisfy these requirements, then the advice is not independent.<sup>90</sup>

### *New Zealand*

New Zealand's existing financial advice laws were adopted in 2008, but they are to be replaced with new laws that will come into operation in 2020.

Currently, financial advisers in New Zealand fall into three categories: Qualifying Financial Entities (QFEs), Registered Financial Advisers (RFAs) and Authorised Financial Advisers (AFAs). QFEs are financial institutions with in-house financial advisers. Individuals who work for QFEs can give investment advice, but that advice is limited to the

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<sup>90</sup> See <https://www.afm.nl/en/professionals/onderwerpen/mifid-2/beleggersbescherming-onafhankelijk-beleggingsadvies>.

products offered by the QFE. However, if the individual is an AFA within the institution, he or she can then advise on products beyond those offered by the QFE. RFAs are required to 'register' with the FMA to provide advice on category 2 products, which are classed as having less risk and complexity. Category 2 products include, for example, consumer loans, term deposits (i.e. CDs) and insurance products. AFAs can provide comprehensive financial planning advice, including personalised advice and advice related to category 1 products. Category 1 products are investment-related products, deemed to be more 'complex' and riskier.

The proposed reforms are, in part, a response to a view that the 2008 laws were unnecessarily complex and had 'not adequately raised standards for all financial advice services'.<sup>91</sup>

The Financial Services Legislation Amendment Bill (Bill) was introduced to Parliament in August 2017 .... In parallel with the Bill's passage through Parliament, MBIE is developing regulations that will set the disclosure regulations in the new regime. In addition, a Code Working Group appointed by the Minister of Commerce and Consumer Affairs is developing a Code of Conduct, which will apply to everyone in the new financial advice regime.

The Bill removes many of the categories that exist in the current regime, including the different types of advisers and businesses, and different categories of products. The Bill also removes the distinction between class [that is, general] and personalised advice. The Bill will allow consumers to access financial advice in a range of ways and through a range of different channels, including in-person, online and over the phone.

Some individuals and firms will be able to give advice on certain products (e.g. mortgages or insurance), while others will be able [to] provide comprehensive planning services. Some will be able to consider products from a wide range of product providers, while others will have a more limited range of providers and some will only be able to consider those of the business they are employed by.<sup>92</sup>

As this indicates, neither the existing laws nor the new laws in New Zealand require the separation of advice providers from product issuers. Instead the emphasis remains on

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<sup>91</sup> Ministry of Business, Innovation & Employment, *Final Report - Review of the Operation of the Financial Advisers Act 2008 and the Financial Service Providers (Registration and Dispute Resolution) Act 2008* (July 2016), 4.

<sup>92</sup> Ministry of Business, Innovation & Employment, *Discussion paper - Disclosure requirements in the new financial advice regime* (April 2018) [9] – [11].

disclosure as a means to address conflicts arising in such relationships. The disclosure requirements proposed for the new regime were released for public consultation in April 2018;<sup>93</sup> submissions closed in late May 2018.

### *The United States*

In the United States, households typically receive advice about investment either from investment advisers (IAs)<sup>94</sup> or broker-dealers.<sup>95</sup> As noted, the two groups are separately regulated. Special rules apply to the broker-dealer activities of banks.<sup>96</sup> Insurance intermediaries are separately regulated.<sup>97</sup>

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<sup>93</sup> Ibid.

<sup>94</sup> The FINRA website includes the following description of IAs. ‘Many investment advisers are also brokers—but these two types of investment professional aren’t the same.... **What they are:** An investment adviser is an individual or company who is paid for providing advice about securities to their clients. Although the terms sound similar, investment advisers are not the same as financial advisors and should not be confused. The term financial advisor is a generic term that usually refers to a broker (or, to use the technical term, a registered representative). By contrast, the term investment adviser is a legal term that refers to an individual or company that is registered as such with either the Securities and Exchange Commission or a state securities regulator. Common names for investment advisers include asset managers, investment counselors, investment managers, portfolio managers, and wealth managers. Investment adviser representatives are individuals who work for and give advice on behalf of registered investment advisers. **Who regulates them:** The SEC regulates investment advisers who manage \$110 million or more in client assets, while state securities regulators have jurisdiction over advisers who manage up to \$100 million. Advisers with less than \$100 million in assets under management (AUM) must register with the state regulator for the state where the adviser has its principal place of business. When a state-registered adviser’s AUM reach the \$100 million threshold, the adviser may elect to register with the SEC—but when the adviser’s AUM exceeds \$110 million, it generally must register with the SEC. It is important to find out exactly which services a professional who wears multiple hats will provide for you and what they will charge for their services. You can get background information on both SEC- and state-registered investment advisers [through FINRA].... **What they offer:** In addition to providing individually tailored investment advice, some investment advisers manage investment portfolios. Others may offer financial planning services or, if they are properly licensed, brokerage services (such as buying or selling stock or bonds)—or some combination of all these services.

<sup>95</sup> See footnote 79. There are a number of exemptions from the requirement to register as a broker-dealer with the SEC: see <https://www.sec.gov/reportspubs/investor-publications/divisionsmarketregbdguidehtm.html>.

<sup>96</sup> The Securities Exchange Act of 1934 also contains special provisions relating to brokerage and dealing activities of banks: sections 3(a)(4)(B) and 3(a)(5)(C) and related provisions. Aspects of bank dealer activity are discussed in a publication issued by the SEC's Division of Trading and Markets, entitled "Staff Compliance Guide to Banks on Dealer Statutory Exceptions and Rules," available at: <http://www.sec.gov/divisions/marketreg/bankdealerguide.htm>. Bank brokerage activity is addressed in Regulation R, which was adopted jointly by the SEC and the Board of Governors of the Federal Reserve System. See Exchange Act Release No. 56501 (September 24, 2007) <http://www.sec.gov/rules/final/2007/34-56501.pdf>.

<sup>97</sup> Insurance agents are regulated at a state level: see <https://www.finra.org/investors/insurance-agents>. Insurance agencies make insurance products that are also securities (such as variable annuities) available to their customers without registering as broker-dealers under certain conditions. This is

A recent report for the DOL on financial advice usefully explains that:

IAs and BDs have distinct definitions: A BD is defined as someone who conducts transactions in securities on behalf of others, while an IA is defined as someone who provides advice to others regarding securities. Brokers tend to be compensated by transaction-based commissions, while the vast majority of IAs charge fees based on assets under management. Despite differences in definition and compensation, both BDs and IAs provide clients with financial advice.

However, many firms are both.<sup>98</sup> The SEC explains that:

Broker-dealers offering certain types of accounts and services may also be subject to regulation under the Investment Advisers Act. (An investment adviser is defined as a person who receives compensation for providing advice about securities as part of a regular business.... In general, a broker-dealer whose performance of advisory services is "solely incidental" to the conduct of its business as a broker-dealer and that receives no "special compensation" is excepted from the definition of investment adviser. Thus, for example, a broker-dealer that provides advice and offers fee-based accounts (i.e., accounts that charge an asset-based or fixed fee rather than a commission, mark-up, or mark-down) must treat those accounts as advisory because an asset-based fee is considered "special compensation." Also, under a recently proposed rule, a broker-dealer would be required to treat (1) each account over which it exercises investment discretion as an advisory account, unless the investment discretion is granted by a customer on a temporary or limited basis and (2) an account as advisory if the broker-dealer charges a separate fee for, or separately contracts to provide, advisory services... Finally, under the same proposed rule, a broker-dealer that is registered under the Exchange Act and registered under the Investment Advisers Act would be an investment adviser solely with respect to those accounts for which it provides services that subject the broker-dealer to the Investment Advisers Act.)

A key difference between broker-dealers and IAs is the statutory and, in the case of broker-dealers, the SRO rule standards they are required to meet in connection with the

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done through "networking" arrangements, where an affiliated or third-party broker-dealer provides brokerage services for the insurance agency's customers, according to conditions stated in SEC no-action letters.

<sup>98</sup> The SEC says, 'See <https://www.sec.gov/reportspubs/investor-publications/divisionsmarketregbdguidehtm.html#6>, Section V(J). The proposed rule is at <http://www.sec.gov/rules/proposed/2007/ia-2652.pdf>.

provision of advice to clients.<sup>99</sup> Broker-dealers are subject to a suitability requirement, while IAs must meet the fiduciary standard. The report describes the distinction as follows:

That is, a BD making a recommendation to a retail customer must have grounds for believing the recommendation is suitable for that customer with respect to his or her portfolio, financial situation, and needs. BDs may also have additional suitability requirements, depending on the products they offer. Unlike BDs, federally registered IAs owe a fiduciary obligation, as articulated in the 1940 Act, to their clients. These obligations require the IA to act solely with the client's investment goals and interests in mind, free from any direct or indirect conflicts of interest that would tempt the IA to make recommendations that would also benefit himself or herself.

The distinction between a fiduciary duty and a best interest duty is discussed at length in a helpful speech by SEC Commissioner Hester Peirce in Washington DC in July 2018.<sup>100</sup> Commissioner Peirce said:

I only see two major differences between the standards.... First, an adviser generally has an ongoing duty to monitor over the course of its relationship with its client, while a broker-dealer generally does not. Second, a broker-dealer must either mitigate or eliminate any material financial conflict of interest it may have with its client. An adviser is required only to disclose such a conflict.<sup>101</sup>

Although they are not (necessarily) subject to fiduciary standard,<sup>102</sup> broker-dealers are subject to a range of rules and requirements that relate to acting in the customer's interest and disclosing and managing conflicts of interest. These comprise:

...comprehensive regulation under the [Securities Exchange Act of 1934] and SRO rules, and a number of obligations attach[ing] when a broker-dealer makes a recommendation to a customer. Under the federal securities laws and SRO rules, broker-dealers have a duty of fair dealing, which, among other things, requires broker-dealers to

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<sup>99</sup> See footnotes 79 and 94.

<sup>100</sup> Commissioner Hester M Peirce, *What's in a Name? Regulation Best Interest v. Fiduciary - Remarks before the NAPA DC Fly-in Forum* (Washington DC, 24 July 2018).

<sup>101</sup> *Ibid.*

<sup>102</sup> As in Australia, US courts have found that the circumstances of an advice relationship can give rise to a fiduciary duty in general law. 'In addition, a broker-dealer may have a fiduciary duty under certain circumstances. This duty may arise under state common law, which varies by state. Generally, courts have found that broker-dealers that exercise discretion or control over customer assets, or have a relationship of trust and confidence with their customers, are found to owe customers a fiduciary duty similar to that of investment advisers': Securities and Exchange Commission, Securities and Exchange Commission, *Regulation Best Interest* (18 April 2018) footnote 15.

make only suitable recommendations to customers and to receive only fair and reasonable compensation. Broker-dealers are also subject to general and specific requirements aimed at addressing certain conflicts of interest, including requirements to eliminate, mitigate, or disclose certain conflicts of interest.<sup>103</sup>

In April of 2016, the DOL promulgated the 'Fiduciary Rule', which expanded the definition of fiduciary in s 3(21) of ERISA to include individuals and entities that provide investment advice for a fee to ERISA-covered plans and their participants and beneficiaries, individual retirement account owners, and health savings account holders. The DOL also published guidance on expanded and amended exemptions under the prohibited transaction rules that would allow certain providers of investment advice to continue to receive fees subject to certain safeguards. The Fiduciary Rule was challenged and in March 2018 it was overturned by the United States Court of Appeal for the Fifth Circuit; on 21 June 2018 the Court issued a mandate, consistent with its March opinion, which officially vacated the Fiduciary Rule.

Under Dodd-Frank, the SEC was granted authority, but not required, to adopt a uniform fiduciary standard of conduct for IAs and broker-dealers when providing personalized investment advice about securities to retail customers. The legislation provides that any such standard be no less stringent than the standard applicable to IAs under the Investment Advisers Act of 1940. Various attempts have been made over the last decade by the SEC to formulate a best-interest rule for broker-dealers.

On 18 April 2018, the SEC proposed a package of rulemakings to address some of the investor protection concerns behind the Fiduciary Rule.<sup>104</sup> It proposed a rule requiring a

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<sup>103</sup> Ibid, 2-13 (footnote omitted). The document goes on to provide a detailed explanation of the existing US regulation of conflicts of interest and duty arising in the relationship between broker-dealers and their retail customers, and how they must be managed.

<sup>104</sup> Ibid and *Proposed Commission Interpretation Regarding Standard of Conduct for Investment Advisers; Request for Comment on Enhancing Investment Adviser Regulation* (18 April 2018) for the text and discussion of the proposed rules and guidelines. Available at <https://www.sec.gov/rules/proposed/2018/34-83062.pdf> and <https://www.sec.gov/rules/proposed/2018/ia-4889.pdf>. The comments submitted to the SEC provide a useful discussion of the nature of the current and proposed rules: see <https://www.sec.gov/comments/s7-07-18/s70718.htm> and <https://www.sec.gov/comments/s7-09-18/s70918.htm>.

broker-dealer to act in the best interest of a retail customer when making a recommendation of any securities transaction or investment strategy involving securities. Under the proposal:

A broker-dealer making a recommendation to a retail customer would have a duty to act in the best interest of the retail customer at the time the recommendation is made, without putting the financial or other interest of the broker-dealer ahead of the retail customer.

A broker-dealer would discharge this duty by complying with each of three specific obligations:

- Disclosure obligation: disclose to the retail customer the key facts about the relationship, including material conflicts of interest.
- Care obligation: exercise reasonable diligence, care, skill, and prudence, to (i) understand the product; (ii) have a reasonable basis to believe that the product is in the retail customer's best interest; and (iii) have a reasonable basis to believe that a series of transactions is in the retail customer's best interest.
- Conflict of interest obligation: establish, maintain and enforce policies and procedures reasonably designed to identify and then at a minimum to disclose and mitigate, or eliminate, material conflicts of interest arising from financial incentives; other material conflicts of interest must be at least disclosed.<sup>105</sup>

A new short-form disclosure document would be required to identify the nature of a client's relationship with their investment professional.<sup>106</sup>

In addition, the SEC noted that investment adviser owes a fiduciary duty to its clients that has been recognised by the US Supreme Court within the Investment Advisers

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<sup>105</sup> Securities and Exchange Commission, 'SEC Proposes to Enhance Protections and Preserve Choice for Retail Investors in Their Relationships with Investment Professionals' Media Release (18 April 2018). Available at <https://www.sec.gov/news/press-release/2018-68>.

<sup>106</sup> The proposal is to: (1) require broker-dealers and investment advisers to deliver to retail investors a short (i.e., four page or equivalent limit if in electronic format) relationship summary; (2) restrict broker-dealers and associated natural persons of broker-dealers, when communicating with a retail investor, from using as part of a name or title the term "adviser" or "advisor" in certain circumstances; and (3) require broker-dealers and investment advisers, and their associated natural persons and supervised persons, respectively, to disclose in retail investor communications the firm's registration status with the Commission and an associated natural person's and supervised person's relationship with the firm. See *Form CRS Relationship Summary; Amendments to Form ADV; Required Disclosures in Retail Communications and Restrictions on the use of Certain Names or Titles*, Release No. 34-83063, IA-4888, File No. S7-08-18.

Act of 1940. It proposed a restated interpretation that reaffirms, and in some cases clarifies, certain aspects of the fiduciary duty that an investment adviser owes to its clients.<sup>107</sup>

One of the goals of the proposed new Regulation Best Interest is to ‘establish obligations under the Exchange Act that do not rely on disclosure alone as the solution to conflicts arising from financial incentives—including conflicts associated with broker-dealer compensation incentives, the sale of proprietary products, and effecting transactions in a principal capacity’.<sup>108</sup>

The public comment period for the SEC’s proposed rules closed in August 2018.<sup>109</sup>

#### **4.2 Disclosure as a means of managing conflicts**

The fact that no jurisdiction mandates the legal or economic separation of advice providers (even independent advice providers) from product issuer means that the potential conflict inherent in advising on proprietary products (that the issuer’s commercial interest in persuading the customer to acquire the product will conflict with the adviser’s duty to provide suitable advice) is always present. In all jurisdictions, this must be either avoided or managed. If the conflict cannot be avoided, it must be disclosed. In all cases, disclosure of the existence of the conflict does not relieve the adviser of their duties to provide suitable advice to clients.

In the UK, PRIN 2.1.1R, Principle 8 of the FCA’s Principles for Businesses is that a firm ‘must manage conflicts of interest fairly, both between itself and its customers and between a customer and another client’. Detailed requirements relating to conflicts are contained in the FCA Handbook, including in SYSC 10.1.3R, which provides that:

A firm must take all appropriate steps to identify and to prevent or manage conflicts of interest between:

- (1) the firm, including its managers, employees and appointed representatives (or where applicable, tied agents), or any person directly or indirectly linked to them by control, and a client of the firm; or

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<sup>107</sup> SEC, above n 102.

<sup>108</sup> SEC, above n 102, 10.

<sup>109</sup> See <https://www.sec.gov/rules/proposed/2018/34-83062.pdf>.

(2) one client of the firm and another client;

that arise or may arise in the course of the firm providing any service referred to in SYSC 10.1.1R including those caused by the receipt of inducements from third parties or by the firm's own remuneration and other incentive structures.

SYSC 10.1.4R goes on to provide, in relevant part:

For the purposes of identifying the types of conflict of interest that arise, or may arise, in the course of providing a service and whose existence may damage the interests of a client, a management company must take into account, as a minimum, whether the firm or a relevant person, or a person directly or indirectly linked by control to the firm:

(1) is likely to make a financial gain, or avoid a financial loss, at the expense of the client;

(2) has an interest in the outcome of a service provided to the client or of a transaction carried out on behalf of the client, which is distinct from the client's interest in that outcome...

A regulated firm has an obligation not just to identify a conflict, but also to manage it. SYSC 10.1.7R says:

A firm must maintain and operate effective organisational and administrative arrangements with a view to taking all reasonable steps to prevent conflicts of interest as defined in SYSC 10.1.3 R from adversely affecting the interests of its clients.

SYSC 10.1.8R imposes a disclosure obligation, in the following terms:

(1) If arrangements made by a firm under SYSC 10.1.7 R are not sufficient to ensure, with reasonable confidence, that risks of damage to the interests of a client will be prevented, the firm must clearly disclose the following to the client before undertaking business for the client:

(a) the general nature or sources of conflicts of interest, or both;  
and

(b) the steps taken to mitigate those risks.

(2) The disclosure must:

(a) be made in a durable medium;

- (b) clearly state that the organisational and administrative arrangements established by the firm to prevent or manage that conflict are not sufficient to ensure, with reasonable confidence, that the risks of damage to the interests of the client will be prevented;
- (c) include specific description of the conflicts of interest that arise in the provision of insurance distribution activities, investment services or ancillary services;
- (d) explain the risks to the client that arise as a result of the conflicts of interest; and
- (e) include sufficient detail, taking into account the nature of the client, to enable that client to take an informed decision with respect to the service in the context of which the conflict of interest arises.

The Guidance provided in SYSC 10.1.9G is that:

Firms should aim to identify and manage the conflicts of interest arising in relation to their various business lines and their group's activities under a comprehensive conflicts of interest policy. In particular, the disclosure of conflicts of interest by a firm should not exempt it from the obligation to maintain and operate the effective organisational and administrative arrangements under SYSC 10.1.7 R. While disclosure of specific conflicts of interest is required by SYSC 10.1.8 R, an over-reliance on disclosure without adequate consideration as to how conflicts may appropriately be managed is not permitted.

Further, the rule in SYSC 10.1.9AR is that:

A firm must treat disclosure of conflicts pursuant to SYSC 10.1.8R as a measure of last resort to be used only where the effective organisational and administrative arrangements established by the firm to prevent or manage its conflicts of interest in accordance with SYSC 10.1.7R are not sufficient to ensure, with reasonable confidence, that risks of damage to the interests of the client will be prevented.

The emphasis on not treating disclosure as a means of managing conflicts of interest reflects the stricter approach taken in MiFID II. It is expressly acknowledged by the FCA in its policy statement on MiFID II, which says that

Our proposal for implementing the new disclosure requirements under MiFID II means that firms should only use disclosure as a measure of last resort. Disclosing a conflict of interest is not a form of managing that conflict of interest. A firm should take appropriate steps to prevent or manage conflicts of interest beforehand, and only disclose a conflict when the firm's administrative and organisational arrangements have failed in this regard. However, it is clear that disclosure is not a mechanism that can be relied on by firms to manage their conflicts. While disclosure of specific conflicts of interest is required by SYSC 10.1.8R, an over-reliance on disclosure without adequate consideration as to how conflicts may appropriately be managed is not permitted.<sup>110</sup>

This approach is mirrored in the Dutch rules.<sup>111</sup>

In the US, both the Securities Exchange Act of 1934 and the Investment Advisers Act of 1940 require an adviser to disclose the conflict of interest that arises when they recommend proprietary products to clients. In December 2014, various subsidiaries of J P Morgan settled an action by the SEC and the CFTC for US\$267 and \$40 million respectively for failing to disclose conflicts of interest to clients of the wealth management business. The SEC investigation found that the firms 'preferred to invest clients in the firm's own proprietary investment products without properly disclosing this preference. This preference impacted two fundamental aspects of money management – asset allocation and the selection of fund managers – and deprived JPMorgan's clients of information they needed to make fully informed investment decisions'.<sup>112</sup> The firms admitted to violating sections 206(2), 206(4) and 207 of the Investment Advisers Act of 1940 and Rule 206(4)-7 and section 17(a)(2) and 17(a)(3) of the Securities Act of 1933.

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<sup>110</sup> Financial Conduct Authority, *Markets in Financial Instruments Directive II Implementation – Policy Statement I* (March 2017).

<sup>111</sup> See Norton Rose Fulbright, 'Impact of MiFID II on EU conduct of business regimes – The Netherlands' (June 2015). Available at <http://www.nortonrosefulbright.com/files/impact-of-mifid-ii-on-eu-conduct-of-business-regimes--the-netherlands-130008.pdf>.

<sup>112</sup> Securities and Exchange Commission *Press Release - J.P. Morgan to Pay \$267 Million for Disclosure Failures* (18 December 2015).

## 5. HAWKING

This Part explains the restrictions on sale practices – including cold-calling and other forms of product hawking – imposed in the relevant jurisdictions. All jurisdictions include a ‘do not call’ register that allows consumer to block telemarketing calls, including from those selling financial products and services.

In the EU, there are restrictions on unsolicited direct marketing by electronic means, including marketing calls, texts, emails and faxes through the Privacy and Electronic Communications (EC Directive) Regulations 2003 (PECR). More specifically, Directive 2002/65/EC (as amended) covers the distance marketing of consumer financial services; Article 10 deals with unsolicited communications. From September 2018, PECR bans cold callers offering to settle personal injury claims or sell payment protection insurance.

In the UK, FCA Handbook COBS 5.1 contains the rules transposing Directive 2002/65/EC. In July 2018, the UK government consulted draft regulations for a ban on cold-calling in relation to pensions (that is, unsolicited direct marketing calls relating to pensions products and services). The government created the power to make secondary legislation to ban pensions cold calling through s 21 of the Financial Guidance and Claims Act 2018 (UK). The policy intention is to ban pensions cold calling, except by regulated firms where the recipient of the call has given specific consent to receiving marketing calls on pensions from the organisation making the call; or the recipient of the call has an existing client relationship with the caller and the relationship is such that the recipient envisages receiving unsolicited calls for the purpose of direct marketing in relation to pension schemes (known as the “soft opt-in”). The exemptions apply to firms regulated by the Financial Conduct Authority (FCA) or to trustees or managers of occupational pension schemes that are regulated by The Pensions Regulator (TPR). The ‘kinds of conversations the government wants covered by the ban’ include:

- offers of a ‘free pension review’, or other free financial advice or guidance
- assessments of the performance of the individual’s current pension funds

- inducements to hold certain investments within a pensions tax wrapper including overseas investments
- promotions of retirement income products such as drawdown and annuity products
- inducements to release pension funds early
- inducements to release funds from a pension and transfer them into a bank account
- inducements to transfer a pension fund
- introductions to a firm dealing in pensions investments
- offers to assess charges on the pension.<sup>113</sup>

The intention is that the Information Commissioner's Office (ICO) should be the enforcement body and the current civil enforcement regime under PECR should apply, and that the Office of Communications (OFCOM) should cooperate with the ICO in the exercise of these functions.

In New Zealand, unsolicited sales approaches in connection with financial products are covered by s 34(1) of the Financial Markets Conduct Act 2013 (NZ). It provides that, 'A person must not offer financial products for issue or sale to a person who is acting otherwise than in trade (A) in the course of, or because of, an unsolicited meeting with A'. There are exceptions to the prohibition in subsection (2).

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<sup>113</sup> HM Treasury, *Consultation Outcome – Ban on Cold Calling in Relation to Pensions* (October 2018).

## 6. REGULATORS

This Part deals with the mandate, enforcement options and oversight of financial regulators.

### 6.1 Regulatory architecture

This section explains in broad terms the regulatory architecture in each jurisdiction.

#### *The United Kingdom*

Between 2001 and 2013, the UK had a single financial regulator – the Financial Services Authority. It was subsequently disbanded by the Financial Services Act 2012 in favour of a twin-peaks model. The two primary agencies now responsible for financial regulation in the UK are the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA), which commenced operations on 1 April 2013.

The PRA is part of the Bank of England and is responsible for prudential regulation of banks, building societies, credit unions, major investment firms and insurers. It is responsible for ‘ensuring that any failing financial firms can fail without affecting taxpayers and thus destabilising the financial markets’. There are over 1,700 financial firms that are treated as systemically significant and regulated by the PRA.

Consumer protection in the financial sector is the responsibility of the FCA. The FCA website indicates that it regulates the conduct of more than 58,000 businesses’ and is ‘the prudential regulator for more than 18,000 of these businesses’. Its regulatory perimeter is established by the Financial Services and Markets Act 2000 (FSMA), which provides for entities to be permitted by the FCA or the PRA to carry on various financial activities which are subject to regulation (referred to as regulated activities). These are specified in the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (RAO). The FCA Handbook includes the Perimeter Guidance Manual (PERG) defines regulated activities and specified investments.

The regulatory functions of the FCA are explained (in broad terms) in a letter from the Chief Executive to the Treasury Select Committee dated 30 January 2018. It explains that:

Certain types of financial services activity require a license or "permission" before they can be carried on. The definition of these activities, and the "specified investments" to which the activity relates, is at the heart of FCA regulation. The activities are described at a high-level in [FSMA], and in more detail in the [RAO]. We usually refer to such activities simply as "regulated activity" or as being within the "FCA's perimeter". Much of the regulatory framework set out in FSMA, and most of the FCA's powers, are targeted at regulating the conduct of this activity. Persons licensed to perform such activities are "authorised persons". Obvious examples of regulated activity are giving advice on whether to invest in particular securities or, since 2014, providing consumer credit. Performing such activities without an FCA permission is a criminal offence.

...

Finally, as of 1 April 2015 the FCA became a competition regulator. The FCA has a specific objective to promote competition in the interests of consumers ... and has also been given what are usually referred to as "concurrent competition powers" available to the Competition and Markets Authority (CMA) and other sectoral regulators. Such powers may be exercised in respect of "financial services activity" rather than being tied to the more specific and narrower concept of "regulated activity" from the RAO.<sup>114</sup>

The FCA's strategic objective is to 'ensure that the relevant markets function well' and its operational objectives are stated as:

- protect consumers – we secure an appropriate degree of protection for consumers
- protect financial markets – we protect and enhance the integrity of the UK financial system
- promote competition – we promote effective competition in the interests of consumers.<sup>115</sup>

The FCA's is accountable to HM Treasury and to Parliament (see below). It is structured as an independent public body funded by levies on regulated firms.

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<sup>114</sup> Letter from Andrew Bailey, Chief Executive, Financial Conduct Authority dated 30 January 2018. Available at <https://www.parliament.uk/documents/commons-committees/treasury/Correspondence/2017-19/FCA-powers-perimeter-300118.pdf>.

<sup>115</sup> See [www.fca.org.uk/about](http://www.fca.org.uk/about).

In the superannuation area, the FCA regulates firms and individuals that establish and operate stakeholder pension schemes and personal pension schemes – these are contract-based pensions usually provided by banks, insurance companies or investment managers. State or employer pensions are separately regulated, by The Pensions Regulator (TPR) – this includes regulating the conduct of trustees of these types of pension schemes. TPR has and exercises enforcement powers under the Pensions Act 2004.<sup>116</sup> The division of responsibilities is explained by the FCA and TPR in these terms:

The FCA is responsible for regulating the areas where individuals access personal (contract-based) pensions, either directly or in the workplace. The FCA also has significant regulatory responsibilities for firms that provide supporting products and services for pensions, such as advice and asset management. TPR is accountable for DWP [Department for Work and Pensions] and is responsible for regulating employers' [automatic enrolment] duties and the areas where individuals access occupational (trust-based as well as statute-based public service) pensions via their employers. While DWP sets the rules in TPR's area of operation, TPR supplements these rules with codes of practice and guidance.<sup>117</sup>

### *The Netherlands*

The Dutch regulatory architecture is set by the Dutch Financial Supervision Act (Wet op het financieel toezicht), which came into force on 1 January 2007.

The ECB and Dutch Central Bank (De Nederlandsche Bank or DNB) are responsible for prudential supervision under the single supervisory mechanism (known as SSM).<sup>118</sup> For banks, the division of responsibility between the ECB and DNB for ongoing supervision is based on the distinction between significant banks and less significant banks. DNB is also the pensions regulator.

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<sup>116</sup> See <http://www.thepensionsregulator.gov.uk/doc-library/enforcement-activity.aspx>.

<sup>117</sup> FCA and TPR, *Regulating the pensions and retirement income sector: our joint regulatory strategy* (October 2018). Available at <https://www.fca.org.uk/publication/corporate/regulating-pensions-retirement-income-sector-our-joint-regulatory-strategy.pdf>.

<sup>118</sup> This refers to the system of banking supervision in Europe. It comprises the ECB and the national supervisory authorities of the participating countries.

The Dutch Authority for the Financial Markets (Autoriteit financiële markten or AFM) is responsible for business supervision (*gedragstoezicht*). The AFM's supervision focuses on ensuring:

- orderly and transparent financial market processes
- integrity in relations between market parties
- due care in the provision of services to clients.

Its regulatory remit includes banks, insurers, pension funds, investment funds, advisers, markets, auditors and consumers and it regulates over 9,000 entities.<sup>119</sup> DNB and the AFM co-operate under the provisions of the FSA and have concluded a covenant on the co-operation and co-ordination of supervision and other related tasks. It is responsible for consumer protection in relation to financial services, to the exclusion of the Authority for Consumers and Markets.<sup>120</sup>

### *New Zealand*

The New Zealand financial sector regulators are the FMA and the RBNZ. The FMA is the government agency responsible for enforcing securities, financial reporting and company law as they apply to financial services and securities markets. It also regulates securities exchanges, financial advisers and brokers, auditors, trustees and issuers - including issuers of KiwiSaver superannuation schemes. The RBNZ is the prudential regulator of banks, insurers and non-bank deposit takers (including finance companies that take deposits from the public, building societies and credit unions).

The regulatory arrangements for the New Zealand financial sector were recently explained by the RBNZ and the FMA as follows:

The FMA's purpose is to facilitate the development of fair, efficient and transparent financial markets, but it does not regulate all of New Zealand's financial market activities. Its core focus is to regulate the conduct of financial market participants specified under financial markets legislation, such as financial advisers, KiwiSaver providers, retail fund managers, supervisors, issuers of financial products, and

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<sup>119</sup> The Dutch Authority for the Financial Markets, *Annual Report 2017*.

<sup>120</sup> See <https://www.acm.nl/en/about-acm/collaboration/national-cooperation>. See the collaboration protocol between the two agencies dated 26 May 2014.

licensed market operators. The FMA regulates the conduct of banks in relation to specific products or services where the bank holds a Financial Markets Conduct Act 2013 (FMC Act) licence or other regulatory authorisation to undertake those activities, which include managing a retail investment fund, issuing derivatives or providing advice through a Qualifying Financial Entity. The FMA also enforces fair-dealing laws as they apply to banks, although these are limited to a prohibition on deceptive or misleading conduct in relation to financial products and services, as defined by the FMC Act. Lending and the provision of consumer credit are excluded from these provisions.

The RBNZ regulates banks, insurers and non-bank deposit takers to maintain a sound and efficient financial system. The RBNZ's focus on conduct and culture reflects this prudential mandate. It is concerned about the conduct and culture of banks to the extent that undesirable behaviours and attitudes towards risk-taking and risk management can impact the viability of a financial institution, which in turn may impact financial stability. Poor conduct in banks can also lead to significant inefficiency within the financial system or a loss of confidence in our banking system.

In addition, the Commerce Commission is responsible for enforcing the law relating to consumer credit and finance.<sup>121</sup>

### *The United States*

The regulatory framework in the US is fragmented, and a number of federal agencies and departments and state regulators have a role to play.

**Table 1. Federal Financial Regulators and Organizations**  
(acronyms and area of authority)

<b>Prudential Bank Regulators</b>	<b>Securities and Derivatives Regulators</b>	<b>Other Regulators of Financial Activities</b>	<b>Coordinating Forum</b>
Office of the Comptroller of the Currency (OCC)	Securities and Exchange Commission (SEC)	Federal Housing Finance Agency (FHFA)	Financial Stability Oversight Council (FSOC)
Federal Deposit Insurance Corporation (FDIC)	Commodities Futures Trading Commission (CFTC)	Consumer Financial Protection Bureau (CFPB)	Federal Financial Institutions Examinations Council (FFIEC)
National Credit Union Administration (NCUA)			President's Working Group on Capital Markets (PWG)
Federal Reserve Board (FRB, or the Fed)			

**Source:** The Congressional Research Service (CRS).

<sup>121</sup> RBNZ and FMA, above n 2, 31.

Responsible agencies include:

- The Federal Reserve, which sets monetary policy and regulates banks and some other systemically important institutions<sup>122</sup>
- Office of the Comptroller of the Currency, which supervises all national banks and federal savings associations
- National Credit Union Administration, which regulates credit unions
- Federal Deposit Insurance Corp., which insures money deposited with banks
- SEC, which oversees publicly held companies and U.S. securities markets and administers (among other legislation) the Securities Act of 1933, the Securities Exchange Act of 1934 and the Investment Advisers Act of 1940
- Commodity Futures Trading Commission, which oversees the derivatives and futures markets
- Consumer Financial Protection Bureau (CFPB), which regulates consumer financial products and services
- Bureau of Consumer Protection of the Federal Trade Commission.<sup>123</sup>

Insurance is regulated by:

- Federal Insurance Office of the U.S. Treasury Department, and
- National Association of Insurance Commissioners representing the state insurance regulators.

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<sup>122</sup> The Federal Reserve is responsible for microprudential regulation and supervision of banks; holding companies and their affiliates; and other entities, including nonbank financial companies that the Financial Stability Oversight Council (FSOC) has determined should be supervised by the Board and subject to prudential standards. See generally, Federal Reserve, 'Supervising and Regulating Financial Institutions and Activities' available at

[https://www.federalreserve.gov/aboutthefed/files/pf\\_5.pdf](https://www.federalreserve.gov/aboutthefed/files/pf_5.pdf).

<sup>123</sup> See <https://www.ftc.gov/about-ftc/bureaus-offices/bureau-consumer-protection/our-divisions/division-financial-practices>. The Federal Trade Commission's (FTC) jurisdiction in the financial marketplace extends to financial products and services offered or provided to consumers by persons other than banks, thrifts, federal credit unions, bona fide non-profit organizations, and others exempt from the FTC's jurisdiction under the FTC Act: See Memorandum of Understanding Between the FTC and the CFPB dated 6 March 2015. Available at <https://www.ftc.gov/policy/cooperation-agreements/ftc-cfpb-interagency-cooperation-agreement>.

Private pensions are regulated by:

- Employee Benefits Security Administration (EBSA), part of the Department of Labor (DOL).<sup>124</sup>

Broker-dealers are regulated by:

- Financial Industry Regulatory Authority (FINRA), a non-government regulator.<sup>125</sup>

The main consumer protection regulator for the financial sector is the CFPB. The CFPB is an Obama-era creation that is a separate agency of the US government, within the Board of Governors of the Federal Reserve System. Its jurisdiction includes banks, credit unions, securities firms, payday lenders, mortgage-servicing operations, foreclosure relief services, debt collectors and other financial firms. It is established under Dodd-Frank Title X.<sup>126</sup>

Arrangements for the regulation of financial intermediaries in the US, including advisers, are also complex, but the regulatory architecture essentially divides into those intermediaries that are ‘investment advisers’ that must be registered with the SEC under the Investment Advisers Act of 1940,<sup>127</sup> and broker-dealers who are exempt from SEC registration and are regulated by FINRA. Generally, all registered broker-dealers that deal with the public must become members of FINRA, a registered national securities association, and may choose to become exchange members.<sup>128</sup> FINRA is the sole national securities association registered with the SEC under §15A of the Securities Exchange Act of

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<sup>124</sup> See generally, J. Mark Iwry, *Regulation and Supervision of Private Pensions in the United States – Paper Prepared for the Second OECD Conference on Private Pensions* (Brazil, May 2002).

<sup>125</sup> FINRA’s website says: ‘FINRA is not part of the government. We’re a not-for-profit organization authorized by Congress to protect America’s investors by making sure the broker-dealer industry operates fairly and honestly. We do this by: writing and enforcing rules governing the activities of all registered broker-dealer firms and registered brokers in the U.S.; examining firms for compliance with those rules; fostering market transparency; and educating investors’. See <https://www.finra.org/about>.

<sup>126</sup> Arnold and Porter LLP, *The Dodd-Frank Act Establishes the Consumer Financial Protection Bureau as the Primary Regulator of Consumer Financial Products and Services* (July 2010). Available at [https://files.arnoldporter.com/advisory--the\\_dodd-frank\\_act\\_establishes\\_the\\_consumer\\_financial\\_protection\\_bureau\\_071510.pdf](https://files.arnoldporter.com/advisory--the_dodd-frank_act_establishes_the_consumer_financial_protection_bureau_071510.pdf).

<sup>127</sup> See US Securities and Exchange Commission, *Regulation of Investment Advisers by the U.S. Securities and Exchange Commission* (March 2013). Available at [https://www.sec.gov/about/offices/oia/oia\\_investman/rplaze-042012.pdf](https://www.sec.gov/about/offices/oia/oia_investman/rplaze-042012.pdf).

<sup>128</sup> See Securities Exchange Act of 1934, s 15(b)(8) and Exchange Act Rule 15b9-1.

1934. The regulation of broker-dealers' interactions with retail clients in providing advice is contained primarily in FINRA's regulation, examination and enforcement arrangements with respect to member broker-dealers.

Many broker-dealers must be registered with the SEC. SEC registration is required of the advice-giving firm rather than particular advisers employed by the firm. There are important exclusions from the Act's coverage, including for US banks and hedge funds.<sup>129</sup> The SEC administers the general 'antifraud' provisions of the federal securities laws; these include sections 9(a), 10(b), and 15(c)(1) and (2) of the Securities Exchange Act of 1934. The antifraud provisions 'prohibit misstatements or misleading omissions of material facts, and fraudulent or manipulative acts and practices, in connection with the purchase or sale of securities. While these provisions are very broad, the Commission has adopted rules, issued interpretations, and brought enforcement actions that define some of the activities we consider manipulative, deceptive, fraudulent, or otherwise unlawful'.<sup>130</sup> It also administers the Investment Advisers Act of 1940, which regulates the conduct of IAs.<sup>131</sup>

In the area of superannuation, the main rules and structures are established by the Employee Retirement Income Security Act of 1974 (ERISA). However, not all retirement plans are covered by ERISA – for example, Federal, state, or local government plans are excluded. ERISA is administered and enforced by three bodies: EBSA, the Treasury Department's Internal Revenue Service, and the Pension Benefit Guaranty Corporation.

EBSA is the agency responsible for enforcing the provisions of ERISA that govern the conduct of plan fiduciaries, the investment and protection of plan assets, the reporting and disclosure of plan information, and participants' benefit rights and responsibilities. Its mission is 'to assure the security of the retirement, health and other workplace related benefits of America's workers and their families. We will accomplish this mission by developing effective regulations; assisting and educating workers, plan sponsors, fiduciaries and service providers; and vigorously enforcing the law'.<sup>132</sup> It enforces the law by

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<sup>129</sup> See footnote 79.

<sup>130</sup> For an overview of the conduct rules that apply to US broker-dealers, see <https://www.sec.gov/reportspubs/investor-publications/divisionsmarketregbdguidehtm.html#3> at Section V.

<sup>131</sup> For an overview of the conduct rules that apply to US IAs, see <https://www.sec.gov/divisions/investment/iaregulation/memoia.htm>.

<sup>132</sup> See <https://www.dol.gov/agencies/ebsa/about-ebsa/about-us/mission-statement>.

informally resolving benefit disputes, conducting investigations, and seeking correction of violations of the law, including taking enforcement action against pension fund operators.

## 6.2 Enforcement options

This section summarises the main forms of alternative resolution of regulatory matters available to the regulators for breach of the financial consumer protection laws. These are the actions open to the regulators that do not require the commencement of court proceedings.

It is worth noting that, in the US and the UK, deferred prosecution agreements (DPAs) are available to prosecutors as a means of resolving criminal matters involving corporations. These are court-based processes, and the terms of settlement must be approved by a court. The Serious Fraud Office in the UK describes the key features of DPAs as:

- They enable a corporate body to make full reparation for criminal behaviour without the collateral damage of a conviction (for example sanctions or reputational damage that could put the company out of business and destroy the jobs and investments of innocent people).
- They are concluded under the supervision of a judge, who must be convinced that the DPA is ‘in the interests of justice’ and that the terms are ‘fair, reasonable and proportionate’
- They avoid lengthy and costly trials
- They are transparent, public events.<sup>133</sup>

### *The United Kingdom*

The FCA’s Approach to Enforcement<sup>134</sup> consultation document states that:

We can take a number of routes to reach an appropriate outcome. The route taken will depend on whether we decide to take disciplinary

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<sup>133</sup> See <https://www.sfo.gov.uk/publications/guidance-policy-and-protocols/deferred-prosecution-agreements/>. For a very useful summary of the use of DPAs and NPAs by prosecutors in the US, see Clifford Chance, *Deferred Prosecution Agreements and U.S. Approaches to Resolving Criminal and Civil Enforcement Actions* (April 2012).

<sup>134</sup> Financial Conduct Authority, *Approach to Enforcement* (March 2018). Available at <https://www.fca.org.uk/publication/corporate/our-approach-enforcement.pdf>.

action, or criminal or civil proceedings through the courts. Our approach in making decisions is set out in our Decision Procedure and Penalties Manual (DEPP).

Misconduct may be addressed by the use of FCA powers under Part 4A of FSMA:

to vary permission, impose requirements or change individuals' approvals on our own initiative. These powers may be used to prevent or to stop harm from becoming serious. We can require firms to examine their conduct and address harm. In many cases, we will ask firms to voluntarily accept a variation of permission or the imposition of a requirement (VREQ). If firms refuse we may impose the variation or requirement under our own-initiative powers (OIREQ).

A person who is subject to a decision to take 'disciplinary action' can have the decision reviewed by the Regulatory Decisions Committee (RDC), which 'is part of the FCA, but is separate from our executive management structure. Apart from the Chairman, none of the members of the RDC is employed by the FCA and none of them will have been involved in the enforcement investigation'<sup>135</sup>.

The Approach to Enforcement document goes on to provide:

We aim to make sure the sanction is sufficient to deter the firm or individual from re-offending and deter others from offending. Where we take disciplinary action against a firm or an individual, we will consider all our sanctioning powers, including public censure, financial penalty, prohibition, suspension or restriction orders, as they may apply. We will also apply our penalties policy (DEPP). When we assess the nature of the sanction, we take into account all relevant circumstances. This includes what steps the firm or individual has taken to address the harm and to cooperate with us, including, where relevant, in cooperating with any variation of permission or with the imposition of a requirement under Part 4A of FSMA. ....

If appropriate steps have not been taken or more work is required to address the harm we will seek restitution orders or redress schemes. Redress is important for a number of reasons. Fines do not benefit the victims of wrongdoing, whereas redress directly compensates them. Redress can also deter misconduct by making the consequences of misconduct clear.

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<sup>135</sup> The case can also be referred directly to the Upper Tribunal (Tax and Chancery Chamber), or referred if the firm or individual disagrees with the RDC's decision. The Tribunal is entirely independent of the FCA and will consider the matter de novo.

The FCA publishes the results of its decisions in a Final Notice under ss 391 and 391A of FSMA. The Final Notice makes clear the basis for the findings, including the facts and its reasons for concluding there has been serious misconduct. This includes:

- whether the person responsible has acknowledged responsibility
- if voluntary redress, remediation or restorative steps have been taken in a timely and effective manner
- the extent of cooperation
- the extent to which any of the above have reduced the sanction.

### *The Netherlands*

The AFM website states:

The AFM conducts its supervision by means of inspections, enforcement and transfer of standards, and in so doing expressly monitors signals originating from the market and findings from its own control organisation. If the AFM identifies any breaches, it can impose sanctions. It may issue instructions or public warnings, place institutions under undisclosed custody, withdraw licences, cancel or refuse registrations or file reports with the Public Prosecution Service. The AFM is also authorised to impose fines and orders for periodic penalty payments.

It lists the following measures as available to it ‘in response to offences against the regulations’:

- instructive conversation on compliance with standards
- warning
- public warning
- notice
- order for incremental penalty payments
- administrative fine
- withdrawal or limitation of licence
- referral to the Public Prosecution Service
- submission of a disciplinary complaint (against an external auditor).

The AFM also provides detailed information about the use of ‘administrative fines’.<sup>136</sup> Its power to issue administrative fines arise under the legislation, including the Financial Supervision Act (Wet op het financieel toezicht, or Wft), the Pensions Act (Pensioenwet), the Consumer Protection (Enforcement) Act (Wet handhaving Consumentenbescherming), and the Audit Firms (Supervision) Act (Wet toezicht accountantsorganisaties). The AFM describes the process in the following terms:

When a supervisory division of the AFM detects an offence, it may decide to pass the case to the officer responsible for administrative fines at the AFM. This officer does not investigate the case himself. He advises the Executive Board of the AFM as to whether a fine should be imposed and the amount thereof.

Prior to giving this advice, the officer sends a notification to the offender, regarding the intention to impose a fine. In this notification of intention, the officer states the offence for which a fine may be imposed. The offender is thereby given the opportunity to state his views. After the offender’s views have been heard, the officer advises the Executive Board of the AFM as to whether a fine should be imposed or not, and also regarding the amount of the fine and its publication.

A decision to impose an administrative fine is reviewable by the courts.

There is a procedure for accelerated fines to deal with more technical and uncontested breaches which can be used when, among other things, ‘There is no public indignation involved’ and the case ‘does not involve any substantial and specific prejudice to consumers/clients. An example of prejudice would be the abuse of personal data obtained’.

### *New Zealand*

The FMA provides information about its enforcement approach, including its *Regulatory Response Guidelines* (August 2016).<sup>137</sup> This document lists a range of enforcement options available to the FMA that include the following (non-court) alternatives:<sup>138</sup>

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<sup>136</sup> See <https://www.afm.nl/en/over-afm/werkzaamheden/maatregelen/boete>.

<sup>137</sup> See <https://fma.govt.nz/assets/Policies/160824-Regulatory-response-guidelines-policy.pdf>.

<sup>138</sup> These are in addition to its powers to bring civil and criminal enforcement proceedings in court.

Warning letter	There has been or is likely to have been a contravention of the legislation and no greater sanction is justified. May be appropriate where participant has remedied breach and co-operated with the FMA.
Public warning	There has been, or is likely to have, a moderate or serious contravention of the legislation and censure and/or protection of the public is required.
Enforceable undertaking	There is a moderate or serious contravention of the legislation, and participant acknowledges the FMA's view and the need for to take remedial or other action.
Undertaking to make payment in lieu of penalty or compensation (s46A FMA Act)	There is moderate or serious contravention of the legislation and participant agrees to make payment.
Infringement notices	There is a contravention of an infringement offence and more than a warning is required. Usually first-time contravention or low level offence.
Administrative action (exercise of statutory / regulatory powers)	<p>There is a moderate or serious contravention of the legislation. This includes the ability to issue stop orders and direction orders, and to make these orders on an urgent basis.</p> <p>Available under FMCA (stop orders, direction orders, prohibition orders), Securities Act (suspend allotments, cancel offer documents), Auditor Regulation Act (issuing directions, suspending accreditation, censure), Financial Advisers Act (varying conditions or status of authorisation), Securities Trustees and Statutory Supervisors Act (varying a licence).</p>
Financial Advisers Disciplinary Committee	<p>There is a breach of the Code of Professional Conduct for authorised financial advisers which needs to be referred to the Financial Advisers Disciplinary Committee.</p> <p>Applicable to Financial Advisers Act (cancel or suspend authorisation, debar, censure, fine, order training or supervision). Can be pursued in addition to other enforcement action.</p>
Settlement	There is a serious contravention of the legislation, which the participant acknowledges and/or is prepared to compensate and/or implement a change that addresses the breach.
Conditioning licences	There is a moderate to serious contravention which justifies conditions being attached to licence that allows the participant to operate in the market.

Revoking licence or banning orders	There is a serious and persistent contravention and removal of participation from the market is justified to protect investors and the integrity of the market.
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### *The United States*

The complex nature of US financial regulation means that different agencies have responsibility for taking action in respect of misconduct by financial firms. This part explains the non-court based enforcement alternatives open to the CFPB, the SEC and FINRA.

#### **Consumer Financial Protection Bureau**

The CFPB's stated mission is 'to stand up for consumers and make sure they are treated fairly in the financial marketplace. One way we do this is by enforcing federal consumer financial laws and holding financial service providers accountable for their actions'. Its website indicates that 'enforcement proceedings are resolved by an enforcement action in federal court or through an administrative adjudication proceeding'. The CFPB acts 'only in the public interest and will not initiate an investigation or take other enforcement action when the alleged violation is merely a matter of private controversy and does not tend to affect adversely the public interest'.<sup>139</sup>

An administrative adjudication proceeding is 'conducted by an Administrative Law Judge, who holds hearings and issues a recommended decision'. Proceedings are conducted in accordance with the Rules of Practice for Adjudication Proceedings.<sup>140</sup>

The CFPB also uses 'warning letters' as a regulatory strategy. These 'advise recipients that certain actions may violate federal consumer financial law. These are not accusations of wrongdoing. Instead, they are meant to help recipients review certain practices and ensure that they comply with federal law'.<sup>141</sup>

<sup>139</sup> See <https://www.federalregister.gov/documents/2012/06/29/2012-14047/rules-relating-to-investigations#h-30>.

<sup>140</sup> See <https://www.consumerfinance.gov/policy-compliance/enforcement/actions/>.

<sup>141</sup> See <https://www.consumerfinance.gov/policy-compliance/enforcement/warning-letters/>.

## Securities and Exchange Commission

The SEC administers the federal securities laws, including those that regulate broker-dealers, IAs and mutual fund operators (among others).<sup>142</sup> The SEC may bring civil or administrative enforcement actions. Criminal prosecutions are handled by the Department of Justice (DOJ).

The SEC can seek a variety of sanctions through the administrative proceeding process:

Administrative proceedings differ from civil court actions in that they are heard by an administrative law judge (ALJ), who is independent of the Commission. The administrative law judge presides over a hearing and considers the evidence presented by the Division staff, as well as any evidence submitted by the subject of the proceeding. Following the hearing the ALJ issues an initial decision that includes findings of fact and legal conclusions. The initial decision also contains a recommended sanction. Both the Division staff and the defendant may appeal all or any portion of the initial decision to the Commission. The Commission may affirm the decision of the ALJ, reverse the decision, or remand it for additional hearings. Administrative sanctions include cease and desist orders, suspension or revocation of broker-dealer and investment advisor registrations, censures, bars from association with the securities industry, civil monetary penalties, and disgorgement.<sup>143</sup>

If a financial institution in the US contravenes the federal securities laws (including the Securities Exchange Act of 1934 or the Investment Advisers Act of 1940), then it may face enforcement action instigated by the SEC or the Department of Justice. The enforcement of federal financial laws is usefully summarised as:

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<sup>142</sup> For an explanation of the US securities laws, see <https://www.sec.gov/answers/about-lawsshtml.html>.

<sup>143</sup> See <https://www.sec.gov/enforce/how-investigations-work.html>. The SEC's Office of Administrative Law Judges 'consists of independent judicial officers who conduct hearings and rule on allegations of securities law violations in cases initiated by the Commission. When the Commission initiates a public administrative proceeding, it refers the cases to the Office, where it is assigned to an individual Administrative Law Judge (ALJ). The ALJ then conducts a public hearing that is similar to a non-jury trial in the federal courts. Just as a federal judge can do, an ALJ issues subpoenas, rules on motions, and rules on the admissibility of evidence. At the conclusion of the hearing, the parties submit proposed findings of fact and conclusions of law. The ALJ prepares an initial decision that includes factual findings and legal conclusions that are matters of public record. Parties may appeal an initial decision to the Commission, which can affirm, reverse, modify, set aside or remand for further proceedings. Appeals from Commission action are to a United States Court of Appeals.' See <https://www.sec.gov/Article/whatwedo.html#org>.

In the United States, responsibility for enforcement of criminal laws rests with the Department of Justice (DOJ), which at the direction of the Attorney General investigates criminal activity through the Federal Bureau of Investigation, among a myriad of other law enforcement agencies under DOJ's umbrella, and prosecutes criminal cases through 94 Offices of the United States Attorneys located in 50 states, the District of Columbia, Guam, the Mariana Islands, Puerto Rico, and the U.S. Virgin Islands. DOJ also occupies a prominent role in the civil enforcement landscape, most notably through its antitrust, civil, and tax divisions.

The Securities and Exchange Commission (SEC) is authorized to enforce U.S. securities laws through civil enforcement actions in federal court or before an administrative law judge. The SEC has become increasingly active in recent years, forming specialized investigative units in areas of asset management (hedge funds, investment advisers, and private equity), market abuse (large-scale insider trading and high-volume and computer-driven trading strategies), various derivative products, and Foreign Corrupt Practices Act violations, among other high-priority areas of enforcement. ... Another prominent U.S. regulator in the financial sector is the U.S. Commodity Futures Trading Commission (CFTC), which investigates and pursues civil actions relating to fraud, manipulation, and other abuses concerning commodity derivatives and swaps that threaten market integrity, market participants, and the general public. As an adjunct to their civil enforcement authority, the SEC, CFTC, and other regulators work closely with DOJ — and, indeed, law enforcement agencies around the globe — to bring criminal cases when appropriate.<sup>144</sup>

## **FINRA**

FINRA has the authority to fine, suspend or bar brokers and firms from the industry.

The FINRA website explains that FINRA 'can take disciplinary action through two separate procedures: a settlement or a formal complaint. With a settlement, a firm or broker can opt to settle with FINRA through a Letter of Acceptance, Waiver and Consent (AWC). A formal complaint is filed with and heard before FINRA's Office of Hearing Officers. The office assigns to the case a professional hearing officer who is responsible for ensuring the complaint is resolved fairly and expeditiously. The case is heard by a three-person panel made up of the hearing officer and two industry panelists.'<sup>145</sup>

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<sup>144</sup> Clifford Chance, above n 133 (footnotes omitted).

<sup>145</sup> See <http://www.finra.org/industry/enforcement>.

### 6.3 Oversight

This section explains the accountability arrangements for the main consumer financial regulator in each jurisdiction. It also includes a brief note of the accountability of prudential regulators.

It is notable that the FCA in the UK, the AFM in the Netherlands and the FMA in New Zealand are all autonomous agencies and all have independent boards. The SEC and the CFPB are federal agencies. FINRA is a self-regulatory organisation. There is a measure of Congressional oversight of the CFPB and the SEC.

#### *The United Kingdom*

On 1 April 2013, the FCA became responsible for the conduct supervision of all regulated financial firms and the prudential supervision of those not supervised by the PRA. Its overarching strategic objective is ensuring the relevant markets function well. To support this it has three operational objectives: to secure an appropriate degree of protection for consumers; to protect and enhance the integrity of the UK financial system; and to promote effective competition in the interests of consumers.

The priorities of the FCA are set out in its annual business plan.<sup>146</sup> The FCA is accountable to HM Treasury, which is responsible for the UK's financial system, and to Parliament. The FCA describes its accountability framework in the following terms:

Every year we report to the Treasury on our progress through our Annual Report. The Treasury then submits a report to Parliament that examines our performance against our statutory objectives, and how we have dealt with major regulatory cases.

We appear before Parliament's Treasury Select Committee (TSC) in a general accountability hearing twice a year to scrutinise all aspects of our work. We also regularly give evidence to the TSC and other Parliamentary committees.

As part of our accountability to Parliament we respond to requests for information from MPs and peers through letters, parliamentary questions and evidence to All Party Parliamentary Groups.

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<sup>146</sup> See <https://www.fca.org.uk/publication/business-plans/business-plan-2017-18.pdf>.

The Treasury appoints our Board, which manages and challenges our senior executives, helps hold us to account and helps set our direction as an organisation. The Board also ensures we achieve value for money and oversees senior appointments.<sup>147</sup>

The role of the Board in the governance of the FCA is important. Its members comprise: a Chair and a Chief Executive appointed by HM Treasury; the Bank of England Deputy Governor for prudential regulation; two non-executive members who are appointed jointly by the Secretary of State for Business, Innovation and Skills and the Treasury; and at least one other member appointed by the Treasury. The majority of the Board members are non-executive directors.

The FCA is required to hold an Annual Public Meeting (APM) every year. The APM must be held not later than three months after the Annual Report of the FCA has been submitted to the Treasury.<sup>148</sup>

### ***The Netherlands***

The AFM says of its strategic objectives that it:

promotes fairness and transparency within financial markets. We are the independent supervisory authority for the savings, lending, investment and insurance markets. We promote the fair and conscientious provision of financial services to consumers and private investors, as well as professional and semi-professional parties. We supervise the fair and efficient operation of the capital markets. Our aim is to improve consumers' and companies' confidence in the financial markets, both in the Netherlands and abroad'.<sup>149</sup>

The AFM is explicit about its accountability as a regulator. It is a signatory, with several other Dutch regulatory agencies, to a 2014 document entitled (in English) 'Criteria for good oversight'.<sup>150</sup> In translation, this document says:

This memo describes the joint vision of the Consultation Forum of Regulatory Bodies (MTB, in Dutch: Markttoezichthoudersberaad)

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<sup>147</sup> See [www.fca.org.au/about](http://www.fca.org.au/about).

<sup>148</sup> Financial Conduct Authority, *Corporate Governance of the Financial Conduct Authority Adopted by resolution of the Board on 1 April 2013* (September 2018).

<sup>149</sup> See <https://www.afm.nl/en/over-afm/werkzaamheden/strategische-doelstellingen>.

<sup>150</sup> See [https://www.acm.nl/sites/default/files/old\\_publication/publicaties/12624\\_mtb-criteria-for-good-oversight.pdf](https://www.acm.nl/sites/default/files/old_publication/publicaties/12624_mtb-criteria-for-good-oversight.pdf).

concerning the criteria for good oversight. By publishing this joint vision, a framework is offered for carrying out market oversight in an independent and targeted manner, as well as for critically evaluating oversight quality. In addition, the MTB believes it is important to have consensus between the ministries and the regulators regarding what constitutes 'good oversight'. While the MTB is aware that the question of what constitutes 'good oversight' is a multifaceted one, it hopes that this memo will provide some guidance.<sup>151</sup>

It goes on to observe that:

While the MTB is aware of the limitations of measuring oversight, the regulators in question feel responsible for ensuring adequate communication about their policies and results to both government and society, and for the resultant public support for their oversight ('licence to operate from stakeholders'). Creating a realistic pattern of expectations among politicians and the public, among other things, by communicating both what you do and what you do not do, is part of this.<sup>152</sup>

In terms of formal accountability structures, like many Dutch companies, the AFM has a two-tiered board structure. The Supervisory Board is appointed by the Minister of Finance. The Supervisor Board oversees the AFM Board, and must approve the annual plan, budget, financial statements and any major management decisions, such as a change in the structure of the organization.

The management Board of the AFM comprises four members. Board members each have a portfolio of focus areas for which they individually bear the strategic responsibility and the operational final responsibility. The AFM has a Chief Operating Officer who, under the responsibility of the Board, is responsible for the central management of the AFM's operations.

The AFM applies to itself the principles and best practices recommendation in the Dutch Corporate Governance Code.<sup>153</sup> The AFM operates as an independent agency under the political responsibility of the Dutch Minister of Finance.

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<sup>151</sup> Ibid, 1.

<sup>152</sup> Ibid, 6.

<sup>153</sup> See <https://www.afm.nl/nl-nl/over-afm/werkzaamheden/corporate-gov-code>. The Code is discussed in Part 2 above.

## *New Zealand*

The FMA is an independent Crown entity that operates under the Crown Entities Act 2004 (NZ). It was established in 2011 and performs regulatory functions previously undertaken by the Securities Commission and some of those of the Government Actuary and Companies Office.<sup>154</sup> The Crown entity legislation sets out the collective and individual duties of the FMA board and its members. These duties are owed to the Minister of Commerce.

The Minister provides the FMA with an annual letter of expectations.<sup>155</sup> This is a high-level document, but will include a number of particular expectations: in 2018/19 it includes nine specific expectations and three general expectations.<sup>156</sup> The FMA is required to prepare and provide to the House of Representatives an annual Statement of Performance Expectations (SPE) in accordance with Part 4 of the Crown Entities Act 2004. The FMA explains:

The [SPE] is one of two documents which set out how we measure our future performance and report on the progress of that performance against our performance targets. The other document is our SOI (Statement of Intent) which offers a medium term view of the progress made towards achieving our strategic priorities. The SPE covers one financial year. It describes how we intend to perform the services we receive funding for through our Government appropriation. The SPE covers an overarching measure which we call the Investor Confidence Index. It measures a number of factors we believe contribute to whether New Zealand's financial markets are fair, efficient and transparent.<sup>157</sup>

The FMA Board has a non-executive board comprised of between 5 and 9 members. The Governor-General, on the advice of the Minister, appoints all members of the Board and determines, on the recommendation of the Minister, who will be Chairperson and Deputy

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<sup>154</sup> The rationale for collecting these functions in a single agency is set out in <https://www.mbie.govt.nz/info-services/business/business-law/past-work-older-topics/documents-and-images/RIS-Financial%20Sector%20Regulatory%20Agencies.pdf>.

<sup>155</sup> See <https://fma.govt.nz/about-us/governance/minister/>.

<sup>156</sup> See <https://fma.govt.nz/assets/Reports/Annual-letter-of-Expectations-for-2018-19.pdf>.

<sup>157</sup> See <https://fma.govt.nz/assets/Reports/180613-FMA-2018-SPE.pdf>.

Chairperson. Members hold office for up to 5 years and may be reappointed. The role of the Board is set out in s 25 of the Crown Entities Act 2004:

(1) The board is the governing body of a statutory entity, with the authority, in the entity's name, to exercise the powers and perform the functions of the entity.

(2) All decisions relating to the operation of a statutory entity must be made by, or under the authority of, the board in accordance with this Act and the entity's Act.

### *The United States*

The CFPB is established by Dodd-Frank; it is headed by a Director who is required to establish the following four offices: (1) the Office of Fair Lending and Equal Opportunity; (2) the Office of Financial Education; (3) the Office of Service Member Affairs; and (4) the Office of Financial Protection for Older Americans. The Director is also required to establish a Consumer Advisory Board to advise the Bureau.

The CFPB has the authority to administer, enforce, and otherwise implement federal consumer financial laws, which includes the power to make rules, issue orders, and issue guidance. The Financial Stability Oversight Council (FSOC) has the power to set aside any of the Bureau's regulations if the FSOC decides that the regulation would endanger the safety of the banking system or the stability of the U.S. financial systems.

The basic accountability arrangements for the CFPB are set out in s 1016 of Dodd-Frank, which deals with appearances before and reports to Congress. It provides that:

(a) APPEARANCES BEFORE CONGRESS.—The Director of the Bureau shall appear before the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services and the Committee on Energy and Commerce of the House of Representatives at semi-annual hearings regarding the reports required under subsection (b).

(b) REPORTS REQUIRED.—The Bureau shall, concurrent with each semi-annual hearing referred to in subsection (a), prepare and submit to the President and to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services and the Committee on Energy and Commerce of the House of

Representatives, a report, beginning with the session following the designated transfer date.

The Bureau may also submit such report to the Committee on Commerce, Science, and Transportation of the Senate.

The report provided by the Director must comply with the content requirements in s 1016(c).<sup>158</sup> In the report issued April 2018, the CFPB's acting Director expressed the view that:

the Bureau is far too powerful, and with precious little oversight of its activities. Per the statute, in the normal course the Bureau's Director simultaneously serves in three roles: as a one-man legislature empowered to write rules to bind parties in new ways; as an executive officer subject to limited control by the President; and as an appellate judge presiding over the Bureau's in-house court-like adjudications.<sup>159</sup>

The acting Director recommended four legislative changes to approve accountability: fund the Bureau through Congressional appropriations; require legislative approval of major Bureau rules; ensure that the Director answers to the President in the exercise of executive authority; and create an independent Inspector General for the Bureau.<sup>160</sup>

The SEC is an independent federal agency, established pursuant to the Securities Exchange Act of 1934, headed by a five-member Commission. The Commissioners are appointed by the President and confirmed by the Senate. The President designates one of the

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<sup>158</sup> It must include: (1) a discussion of the significant problems faced by consumers in shopping for or obtaining consumer financial products or services; (2) a justification of the budget request of the previous year; (3) a list of the significant rules and orders adopted by the Bureau, as well as other significant initiatives conducted by the Bureau, during the preceding year and the plan of the Bureau for rules, orders, or other initiatives to be undertaken during the upcoming period; (4) an analysis of complaints about consumer financial products or services that the Bureau has received and collected in its central database on complaints during the preceding year; (5) a list, with a brief statement of the issues, of the public supervisory and enforcement actions to which the Bureau was a party during the preceding year; (6) the actions taken regarding rules, orders, and supervisory actions with respect to covered persons which are not credit unions or depository institutions; (7) an assessment of significant actions by State attorneys general or State regulators relating to Federal consumer financial law; (8) an analysis of the efforts of the Bureau to fulfill the fair lending mission of the Bureau; and (9) an analysis of the efforts of the Bureau to increase workforce and contracting diversity consistent with the procedures established by the Office of Minority and Women Inclusion.

<sup>159</sup> Acting Director Mick Mulvaney, Consumer Financial Protection Bureau, *Semi-annual report of the Bureau of Consumer Financial Protection* (2 April 2018). Available at [https://files.consumerfinance.gov/f/documents/cfpb\\_semi-annual-report\\_spring-2018.pdf](https://files.consumerfinance.gov/f/documents/cfpb_semi-annual-report_spring-2018.pdf).

<sup>160</sup> *Ibid.*

Commissioners as the Chairman.<sup>161</sup> By law, no more than three of the Commissioners may belong to the same political party, ensuring non-partisanship. Its responsibilities include overseeing ‘the activities of over 26,000 registered market participants, including investment advisers, mutual funds, exchange-traded funds, broker-dealers, municipal advisors, and transfer agents, who employ at least 940,000 individuals in the United States’; and overseeing ‘21 national securities exchanges, 10 credit rating agencies, 7 active registered clearing agencies, the Public Company Accounting Oversight Board (PCAOB), the Financial Industry Regulatory Authority (FINRA), the Municipal Securities Rulemaking Board (MSRB), the Securities Investor Protection Corporation (SIPC), and the Financial Accounting Standards Board (FASB)’.<sup>162</sup>

The SEC’s performance is subject to independent audits, including by the Government Accountability Office<sup>163</sup> and the SEC’s Office of Inspector General.<sup>164</sup> It operates under Congressional oversight, by the House Financial Services Committee,<sup>165</sup> and the Committee on Banking, Housing and Urban Development among others.<sup>166</sup>

FINRA is a self-regulatory organization overseen by the SEC. Section 964 of Dodd-Frank includes a provision for GAO to review and report triennially on aspects of SEC’s oversight of FINRA. The purpose of the report is to determine if SEC’s oversight of FINRA included the 10 areas specified in s 964 of Dodd-Frank, and to evaluate the extent to which selected SEC internal guidance for examinations of FINRA follow generally accepted government auditing standards and the extent to which SEC’s examinations of FINRA’s governance practices followed SEC internal guidance.<sup>167</sup>

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<sup>161</sup> See [https://www.sec.gov/files/SEC\\_Strategic\\_Plan\\_FY18-FY22\\_FINAL\\_0.pdf](https://www.sec.gov/files/SEC_Strategic_Plan_FY18-FY22_FINAL_0.pdf).

<sup>162</sup> Ibid.

<sup>163</sup> The U.S. Government Accountability Office (GAO) is ‘an independent, nonpartisan agency that works for Congress. Often called the “congressional watchdog,” GAO examines how taxpayer dollars are spent and provides Congress and federal agencies with objective, reliable information to help the government save money and work more efficiently’. See <https://www.gao.gov/about/>.

<sup>164</sup> The Office conducts internal audits and investigations of SEC programs and operations. Through these audits and investigations, the Inspector General seeks to identify and mitigate operational risks, enhance government integrity, and improve the efficiency and effectiveness of SEC programs. See for example, *The Inspector General’s Statement on the SEC’s Management and Performance Challenges* (October 2018) available at <https://www.sec.gov/files/Inspector-Generals-Statement-on-the-SECs-Mgt-and-Performance-Challenges-Oct-2018.pdf>.

<sup>165</sup> See <https://financialservices.house.gov/about/>.

<sup>166</sup> For a record of testimony given SEC staff to Congress, see <https://www.sec.gov/news/testimony>.

<sup>167</sup> See <https://www.gao.gov/products/GAO-18-522>.

### *Oversight of prudential regulators*

For completeness, it is worth noting the oversight arrangements for prudential regulators.

In the UK, the PRA is the prudential regulator of approximately 1,500 banks, building societies, credit unions, insurers and major investment firms. (Other firms are prudentially regulated by the FCA.) The PRA is part of the Bank of England. The Bank is overseen by a board of directors, known as the Court of Directors, appointed by the Queen on the recommendation of the Prime Minister and the Chancellor. The Court of Directors is responsible for setting and monitoring the Bank's strategy and making key decisions on spending and appointments. The Government selects one of the non-executive, or external, members to chair the Court of Directors. The Bank's Internal Audit Division evaluates the effectiveness of its internal controls, risk management and governance processes. The Bank of England's website says:

Although we are independent, we have to explain how and why we arrive at our decisions. We demonstrate our accountability to Parliament through the House of Commons Treasury Committee. Our Governors, Executive Directors and external Monetary Policy Committee and Financial Policy Committee members regularly appear before the committee after the Inflation Report, Financial Stability Report and Prudential Regulation Authority Annual Report are published.<sup>168</sup>

TPR is the UK regulator of workplace pension schemes; its Board is made up of the Chair, non-executive members, the Chief Executive and executive directors. Board members are appointed by the Secretary of State for Work and Pensions. Its responsibilities are:

- overseeing TPR's strategic direction and making key decisions on policy
- ensuring TPR is properly run as a public body and has effective internal controls
- ensuring that statutory and administrative requirements for the use of public funds are complied with.<sup>169</sup>

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<sup>168</sup> See <https://www.bankofengland.co.uk/about/governance-and-funding>.

<sup>169</sup> See <https://www.thepensionsregulator.gov.uk/en/about-us/the-board>.

Prudential regulation in the Netherlands is the responsibility of the DNB. Its governance and oversight arrangements are explained in the following terms:

DNB is managed by its Governing Board, which is responsible for the adequate fulfilment of DNB's duties. In its annual report and financial statements, the Governing Board provides an overview of the developments, decisions and results of the year under review. The Governing Board is accountable to the General Meeting. For its supervision, resolution and DGS tasks, the Board is accountable to the ministers of Finance and Social Affairs and Employment and documents the results in the annual independent public body report.

Many decisions are taken in the European context, with DNB as one of the decision-making partners.

- The ECB's Governing Council decides on monetary policy.
- The ECB's Supervisory Board prepares decisions regarding banking supervision.
- The Single Resolution Board decides on the orderly resolution of failing banks.

Further information on DNB's Governing Board and its division of duties.

### **Supervisory Board**

The Supervisory Board (SB) advises the Governing Board and supervises: DNB's operational management and Board effectiveness; and the Governing Board's policies with respect to its national tasks.

European decision-making on monetary matters and European payment systems are outside the scope of the SB's supervision. The SB's chief powers include: authorisation of far-reaching Board decisions, for example on significant investments; and adoption of DNB's budget and annual financial statements.

The SB comprises seven to ten members, including one government-appointed member. SB members are appointed by the shareholder for four years. They can be reappointed. The current SB members are listed in the overview.

### **General Meeting**

DNB has one single shareholder: the Dutch State, which is represented by the Minister of Finance in the General Meeting. The Governing

Board renders account to the General Meeting by presenting its annual report and financial statements over the past financial year. The General Meeting's chief powers include: adoption of the annual financial statements; discharge of Governing Board and Supervisory Board members; appointment of SB members; and appointment of the external auditor.

### **Bank Council**

The Bank Council acts as a sounding board for the Governing Board. The President discusses DNB's policies in the Bank Council. It comprises eleven to thirteen members. The current Bank Council members are listed in the overview.

### **Dutch Corporate Governance Code**

DNB attaches great importance to sound corporate governance. Although the Dutch Corporate governance code only applies to listed corporations, DNB voluntarily complies with its provisions insofar relevant to its organisational structure.<sup>170</sup>

In the US, the Federal Reserve is subject to oversight by Congress. The GAO has broad authority to review and audit Federal Reserve activities, subject to statutory limits on its access to the Federal Reserve System. The GAO conducts reviews and audits at the direction of the Congress and also under its own authority, which cover a wide variety of Federal Reserve activities. Consistent with the Inspector General Act of 1978, the Board of Governors' Office of Inspector General conducts and supervises independent and objective audits, investigations, and other reviews of Board programs and operations to promote economy, efficiency, and effectiveness, and to prevent and detect fraud, waste, and abuse.<sup>171</sup>

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<sup>170</sup> See <https://www.dnb.nl/en/about-dnb/organisation/governance/index.jsp>.

<sup>171</sup> See [https://www.federalreserve.gov/monetarypolicy/bst\\_oversight.htm](https://www.federalreserve.gov/monetarypolicy/bst_oversight.htm).

## **APPENDIX A: EU Banking and Financial Services Law**

### Financial supervision and risk management

- Financial conglomerates - Directive (2002/87/EC)
- Banking prudential requirements - Directive 2013/36/EU
- Banking prudential requirements - Regulation (EU) No 575/2013
- Bank recovery and resolution - Directive 2014/59/EU
- Deposit guarantee schemes - Directive 2014/49/EU
- Credit rating agencies - Regulation (EC) No 1060/2009

### Banking union

- Single resolution mechanism - Regulation (EU) No 806/2014
- Single supervisory mechanism – Council Regulation (EU) No 1024/2013

### Consumer financial services

- Mortgage credit directive 2014/17/EU
- Payment accounts - Directive 2014/92/EU
- Key information documents for packaged retail and insurance-based investment products (PRIIPs) - Regulation (EU) No 1286/2014

### Payment services

- Payment services (PSD1) - Directive 2007/64/EC
- Payment services (PSD2) - Directive (EU) 2015/2366
- Single euro payments area (SEPA) - Regulation (EU) 260/2012
- Cross-border payments - Regulation (EC) No 924/2009
- E-money - Directive 2009/110/EC

### Securities markets

- Markets in financial instruments (MiFID) - Directive 2004/39/EC
- Markets in financial instruments (MiFID 2) - Directive 2014/65/EU

- Markets in financial instruments (MiFIR) - Regulation (EU) No 600/2014
- Short selling - Regulation (EU) No 236/2012
- Prospectus - Directive 2003/71/EC
- Prospectus - Regulation (EU) 2017/1129
- Market abuse - Regulation (EU) 596/2014
- Market abuse - Directive 2014/57/EU
- Benchmark - Regulation (EU) 2016/2011

#### Investment funds

- Undertakings for the collective investment in transferable securities (UCITS) - Directive 2009/65/EC
- Alternative investment fund managers (AIFM) - Directive 2011/61/EU
- European venture capital funds (EuVECA) - Regulation (EU) No 345/2013
- European social entrepreneurship funds - Regulation (EU) No 346/2013
- European long-term investment funds (ELTIFs) - Regulation (EU) 2015/760
- Money market funds - Regulation (EU) 2017/1131

#### Post-trade services

- Derivatives (EMIR) - Regulation (EU) No 648/2012
- Central securities depositories - Regulation (EU) No 909/2014
- Settlement finality - Directive 98/26/EC
- Financial collateral - Directive 2002/47/EC

#### Insurance and pensions

- Risk management and supervision of insurance companies (Solvency 2) - Directive 2009/138/EC
- Insurance distribution - Directive 2016/97/EU
- Institutions for occupational retirement provision (IORP) - Directive 2003/41/EC
- Motor insurance - Directive 2009/103/EC

Company reporting and auditing

- Accounting rules – Directive 2013/34/EU
- International accounting standards – Regulation (EC) No 1606/2002
- Transparency requirements for listed companies – Directive 2004/109/EC
- Audit directive 2006/43/EC