

In Confidence

Office of the Minister of Commerce and Consumer Affairs

Chair, Cabinet Economic Development Committee

Regulation of Financial Advice: Disclosure and Multiple Providers

Proposal

- 1 This paper seeks Cabinet agreement to make regulations that will set disclosure requirements that will apply in the new financial advice regime, and policy approval for one matter to be contained in a supplementary order paper (SOP) to the Bill introducing the new financial advice regime.

Executive Summary

- 2 The Financial Services Legislation Amendment Bill (the Bill) introduces a new regime for the regulation of financial advice. The Bill aims to improve the quality of financial advice by introducing new duties that will apply to any individual or business who gives regulated financial advice to retail clients in New Zealand.
- 3 The Bill will ensure that consumers are able to access quality financial advice from providers who are required to give priority to a client's interests, to comply with a code of conduct, and to disclose information to clients. The new regulatory regime is a priority of mine and is important for responding to some of the issues recently identified by the Financial Markets Authority and the Reserve Bank of New Zealand in their conduct and culture reviews.
- 4 Many New Zealand consumers rely on financial advice to help make important financial decisions, such as obtaining a mortgage or saving for their retirement. However, they often have limited information about those giving financial advice, which can prevent them from making confident and informed decisions. To address this, I propose that regulations require people who give financial advice to provide retail clients with information regarding:
 - 4.1 the licence they are operating under, and the conduct and client care duties they are subject to;
 - 4.2 the types of financial advice that they can provide, and whether they can only advise on a limited suite of products;
 - 4.3 any commissions, incentives or conflicts of interest that could be perceived by a client to materially impact the advice;
 - 4.4 any fees or other costs associated with the advice;
 - 4.5 recent enforcement action, including action taken by Financial Advice Disciplinary Committee (FADC) which have been publicly notified, relevant

civil liability findings, relevant criminal convictions, and whether they have been subject to recent bankruptcy proceedings;

4.6 the complaints handling and dispute resolution arrangements.

- 5 Rather than including all of this information in a single template given up-front to the client, which is the current approach and is ineffective, I propose that different pieces of information be given as it becomes relevant to the client at certain points in the advice process. For example, if a client requires relatively straight-forward advice on a KiwiSaver fund, they may not benefit from receiving detailed disclosures on other types of advice or financial products offered by the provider.
- 6 Recognising the range of different types of financial advice that will be covered by the regime, I also propose that the regulations provide some flexibility in terms of precisely how this disclosure is provided. This will ensure that clients are able to receive effective disclosure, regardless of how they choose to access financial advice.
- 7 I also propose that an SOP to the Bill includes a provision allowing regulations or licence conditions to specify circumstances in which an individual financial adviser cannot give advice on behalf of more than one financial advice provider. I propose this change in order to protect against the risk of consumer confusion and barriers to effective redress.

Background

- 8 The Bill is currently before Parliament and is awaiting the Committee of the whole House stage and third reading. The Bill introduces a new regulatory regime for financial advice that will improve access to, and the quality of, financial advice. The Bill will repeal the Financial Advisers Act 2008 (FA Act) and move the regulation of financial advice into the Financial Markets Conduct Act 2013 (FMC Act).
- 9 The Ministry of Business, Innovation and Employment (MBIE) has been working on an SOP to the Bill to improve clarity and workability. The SOP contains generally minor or technical matters. I am seeking additional policy approvals for one matter that will be addressed in an SOP.

Regulations are required to set the new regime's disclosure requirements

- 10 The Bill enables regulations to be made to set out the information that individuals and business who give regulated financial advice need to disclose to their clients. Disclosure helps consumers choose where to obtain financial advice by providing information about the person giving financial advice and the services they provide, and can improve transparency of conflicts of interest and other factors that have the potential to influence the advice that consumers receive. Disclosing information to clients is one of several tools in the new regime that aims to ensure consumers are treated fairly by those giving advice and that they can make informed decisions.
- 11 Under the FA Act, financial advisers are required to provide prescribed disclosure statements that vary for different types of advisers. Some consumers receive long and complicated disclosure statements that are difficult to interpret, while others

receive insufficient information about financial advisers that prevents them from making informed decisions. This can result in consumers making incorrect assumptions based on the information provided.

Disclosure helps consumers make informed decisions about those giving financial advice

- 12 The new regulatory regime covers a large range of activities, including one-off simple advice, holistic investment planning, and automated digital-advice offerings. The Bill establishes a level playing field of regulation and introduces universal conduct and client care duties. This includes a requirement to give priority to a client's interests, and to comply with a code of conduct. This approach ensures that consumers have the same level of protections, regardless of how they choose to access financial advice.
- 13 On top of the new conduct obligations, the disclosure requirements will enable consumers to make better informed decisions when choosing where to receive financial advice and when making financial decisions.

Objectives

- 14 My proposals aim to achieve five objectives:
 - 14.1 provide consumers with the key information they need;
 - 14.2 provide consumers with the right information at the right time;
 - 14.3 provide information in a way that is accessible for consumers;
 - 14.4 provide consumers with effective disclosure, regardless of the channel used;
and
 - 14.5 not impose unnecessary compliance costs on the industry.

Proposed disclosure requirements

I propose that disclosure information be provided when it is relevant to the consumer

- 15 Under the FA Act, consumers receive information about the financial adviser at the start of the financial advice process or immediately before receiving financial advice. I am concerned that this approach reduces the effectiveness of the disclosure. Large volumes of information can be difficult for consumers to interpret, while providing information that is not relevant to their circumstances or is provided too early, or too late, in the process.
- 16 I therefore propose that the requirements in the new regime focus on providing information to consumers as it becomes relevant to them at prescribed points in the process of giving regulated financial advice. In order to help consumers:
 - 16.1 find financial advice that meets their needs, I propose that financial advice providers be required to provide certain information on a website if they have one, or make it available on the request of a retail client;

- 16.2 decide whether to proceed with the firm or individual, I propose that those giving advice to retail clients be required to provide certain information about the person giving financial advice and the specific service the client will receive by the point at which the nature and scope of the financial advice is known; and
- 16.3 decide whether to follow the advice they have been given, I propose that those giving financial advice to retail clients be required to provide any new or additional information before (or at the time of) giving financial advice (e.g. when making a recommendation to acquire a financial advice product).
- 17 This approach is intended to ensure that consumers receive the right information when they need it, and reduce the likelihood of information being ignored, forgotten or discounted.

Information to be disclosed

Licensing

- 18 The Bill requires anyone who advises retail clients to operate under a financial advice provider licence granted by the Financial Markets Authority (FMA). The FMA may impose conditions on a licence that may limit what the provider can do.
- 19 I propose that consumers be provided with information regarding the licence, the licensing authority and any relevant conditions on the licence. This will help consumers to choose a financial advice provider and improve their confidence by providing assurances that the financial advice they receive is subject to regulatory oversight.

Conduct and client care duties

- 20 The Bill imposes duties on anyone who gives financial advice, including duties of competence, care and skill, a requirement to give priority to a client's interests in the event of a conflict and to comply with the code of conduct. I propose that clients be made aware of certain duties in order to promote confidence and help a client decide whether to follow advice they have been given.

Complaints handling process and dispute resolution membership

- 21 All financial service providers who provide services to retail clients are required to belong to an approved dispute resolution scheme. These schemes handle disputes between providers and consumers, and require providers to have internal complaints handling processes. However, there is a lack of awareness among consumers of their right to access redress through these schemes. In order to promote confidence in the sector and ensure that consumers are aware of their rights in the event of a dispute, it is vital that consumers are informed of their ability to access redress.
- 22 I propose that those giving financial advice be required to make information regarding both their internal complaints handling process and their dispute resolution scheme membership available on a website, and to provide this information to consumers when receiving a complaint.

Nature and scope of advice

- 23 Financial advice covers a range of different services and may be limited in terms of the type of advice that can be given (e.g. investment planning), the types of products that can be dealt with (e.g. insurance or investments), or the product providers whose products they can give advice on (e.g. their own product, or products from a range of providers). Further, some advisers are incentivised or obliged to send a certain amount of business to a particular product provider (e.g. through a contractual arrangement with a product provider), despite being able to deal with multiple product providers.
- 24 To help consumers decide whether to seek or follow advice from a particular person, I propose that consumers receive information about the nature and scope of the advice, including information about these limitations.

Costs of the financial advice

- 25 It is important that consumers are aware of any fees that will be incurred for the advice they receive and any other expenses that might be charged by the financial advice provider.
- 26 I propose that consumers receive information about these costs, including the basis on which they are charged, when they will be charged, and any additional amounts that the provider might seek to recover from the client. This will help consumers decide whether to seek advice from a particular provider and whether to follow the advice given to them.

Commissions and incentives

- 27 Many firms and individuals who give financial advice receive commissions or are otherwise incentivised to give financial advice. These incentives can give rise to conflicts of interests between the client and the person giving financial advice.
- 28 As announced on 29 January 2019, we will be regulating to remove incentives in the insurance sector that are driving behaviour that is not in the interests of consumers. Officials are developing options and we will pay particular attention to those incentives that have been shown to drive bad behaviour (e.g. loaded up-front commissions).
- 29 Beyond that direct regulation, I believe it is still important that consumers get information about the commissions or other incentives that have the potential to influence the advice as it will help consumers decide whether to seek or follow advice from a particular person.
- 30 I propose that anyone who gives regulated financial advice to retail clients disclose the incentives they may receive as a result of their relationship with the consumer. This disclosure will be limited to commissions and incentives that a client might perceive as having potential to materially influence the financial advice they receive. This will ensure that the information disclosed to consumers is not overly complex.

31 This, along with the duty to put the client's interests first, should help to address some of issues recently identified by the FMA and the Reserve Bank of New Zealand as they relate to the financial advice sector. I note that issues from across the broader financial services sector will need to be addressed through a separate vehicle. The scope of the Bill is limited to financial advice, so any further changes here would fail to capture non-advised sales of financial products.

Other conflicts of interest and affiliations

32 In addition to potential conflicts of interest caused by commissions and other incentives, it is important that consumers are aware of potential conflicts of interests caused by relationships or affiliations that could influence the advice. To help consumers decide whether to seek or follow advice from a particular person, I propose that any relevant conflicts of interests, such as interests, relationships and associations that a client might perceive as having potential to materially influence the financial advice they receive, be disclosed.

Disciplinary history, relevant criminal convictions and recent bankruptcy history

33 I also propose that those who give financial advice should be required to disclose certain recent disciplinary history, criminal history, or civil liability findings, and whether they have been subject to recent bankruptcy proceedings. This information will help consumers to determine how much confidence to put in the advice provided by the individual, which will help when deciding whether to seek advice from a particular person.

34 As discussed in paragraph 20, the Bill imposes duties on those who give financial advice to retail clients. A contravention of these duties can result in disciplinary action for financial advisers (via FADC) or civil liability for financial advice providers.

35 I propose that those who give financial advice should be required to disclose details of relevant enforcement action taken against them, including disciplinary action by FADC within the past five years, where FADC publicly notified the action. Similarly, I propose that they should be required to disclose the following matters that would be perceived as relevant to the client's ability to rely on the advice, within, at most, the past five years:

35.1 certain adverse civil liability findings; and

35.2 certain criminal convictions or adverse findings from a court or other tribunal (e.g. crimes involving dishonesty).

36 I propose that individual financial advisers should be required to disclose whether they have been adjudicated bankrupt or admitted to the no asset procedure, within four years of the date of discharge. Nominated representatives are required to be tightly controlled by the financial advice provider on whose behalf they give advice, and whether they have been subject to recent bankruptcy proceedings is of less relevance to a consumer. I therefore propose that the requirement to disclose recent bankruptcy proceedings should not apply to nominated representatives.

Form of disclosure

Flexibility in how disclosure information is provided

- 37 The Bill provides for financial advice to be given by a range of different businesses in a range of different scenarios, and allows consumers to access financial advice in a range of different ways. I therefore propose that disclosure move away from the prescriptive approach of the FA Act. Rather, the regulations should specify what information needs to be disclosed at certain points in the financial advice process, but provide flexibility in terms of precisely how this information is provided.
- 38 A prescriptive approach would give certainty to the industry and create documents where consumers could compare similar services. However, I am concerned that it would not work in many circumstances and could lead to a tick-box approach to disclosure. This would reduce its effectiveness for consumers, ultimately resulting in undue compliance costs. My proposal will allow businesses to determine the best delivery method for them and their clients, whether it is in writing, verbally or potentially through an interactive online tool.

Regulations to set clear standards of what is required

- 39 While it is desirable to provide some flexibility to businesses, I propose that the regulations include additional requirements to ensure that the regulations meet the objectives. In particular:
- 39.1 Many consumers like to receive written disclosure that they can review. I propose that anyone who gives financial advice should be required to provide written disclosure on the request of a retail client;
- 39.2 To avoid the information provided being overly complex, I propose that any disclosure provided to retail clients must be clear, concise and effective, and in plain language so that it can be readily understood;
- 39.3 To ensure clients know who has provided the disclosure, and who is accountable for the advice, any written disclosure should be easily identifiable and contain the professional contact details of the financial advice provider, financial adviser or nominated representative.

Different requirements when advice is given to existing clients

- 40 I recognise that many financial advisers have an ongoing relationship with their clients and that providing repetitive disclosure could add unnecessary compliance costs for them, particularly if the service provided remains the same. I therefore propose that anyone who gives advice to an existing retail client will only need to provide disclosure when making a recommendation if:
- 40.1 there has been a material change in the information previously disclosed;
- 40.2 there has been a material change in the nature and scope of the financial advice service provided (e.g. advice relating to different financial products); or
- 40.3 more than a year has passed since the original disclosure was provided.

- 41 This does not allow a business that provides a range of financial services, such as a bank, to give financial advice to its clients without disclosure if the service differs from what was previously provided to that client.

Disclosure not to be required when advising wholesale clients

- 42 The Bill distinguishes between everyday retail clients, and wholesale clients who are generally deemed to be large or sophisticated. Wholesale clients typically do not benefit from the same level of protections or have the same information needs as retail clients. In addition, the threshold for being deemed ‘wholesale’ for financial advice has significantly increased in the Bill. This reduces the risk of consumers being deemed wholesale when they would benefit from these valuable protections.
- 43 I therefore propose that those who give financial advice to wholesale clients will not be required to provide information in accordance with these regulations.

Individual advisers giving advice on behalf of multiple financial advice providers

- 44 MBIE has recently been working with the FMA to identify changes that should be made to the Bill by SOP. Almost all of the changes proposed in the SOP are purely minor or technical matters. However, I am seeking Cabinet policy approval on one matter.
- 45 MBIE, the FMA, and I have heard of financial advice providers considering engaging individual financial advisers who are also engaged to give advice on behalf of other financial advice providers.¹
- 46 This type of “multiple provider arrangement” may be legitimate in some scenarios (e.g. an individual adviser working two distinct part-time jobs). However, some forms of multiple provider arrangements could be concerning, particularly where individual advisers act on behalf of multiple providers in one advice conversation with one client. Such arrangements could lead to a lack of clarity around which provider would be liable if something went wrong, and which dispute resolution scheme a consumer should complain to. These arrangements could also be concerning if they resulted in confusion for consumers about who the adviser is working for.
- 47 To address this concern, I propose the SOP include a provision allowing regulations or licence conditions to specify scenarios where providers cannot engage advisers also engaged by other providers. It is important to retain the flexibility for how advisers and providers structure themselves in the proposed regime. This power would provide a safeguard to balance that flexibility in the event that problems arose.
- 48 MBIE and FMA would then engage further with providers considering multiple provider arrangements and analyse whether regulations or licence conditions are necessary to protect against the risk of consumer confusion, poor advice or ineffective redress for poor advice.

¹ In other words, some in the industry are considering an arrangement whereby a licensed financial advice firm would give advice through an individual that is also engaged to give advice on behalf of another licensed financial advice firm. This is different from what is expected to be the more common arrangement whereby different product providers (e.g. multiple insurers) might have an arrangement with an independent licensed financial advice provider to distribute their products.

Consultation

- 49 The following Government agencies have been consulted: the Financial Markets Authority, the Treasury, Ministry of Justice, the Office of the Privacy Commissioner and the Commission for Financial Capability.
- 50 MBIE has completed extensive consultation in the development of the disclosure proposals set out in this paper, including two rounds of consumer testing and a series of workshops with practicing financial advisers. On 3 April 2018 Cabinet agreed to the release of a discussion document that sought feedback on proposed disclosure requirements [DEV-18-SUB-0034 refers]. 70 submissions were received from financial advisers, industry associations, financial product providers and consumer advocates. Submissions were broadly in favour of the proposals and the feedback received has been used to inform the final proposals contained in this paper.
- 51 Some submitters did not agree with the proposal to require disclosure to be given at different points during the advice process, favouring a similar approach to the FA Act where disclosure is given upfront to the client. Others favoured the proposal as this was consistent with their current practices. Consumer testing found that providing information to consumers when it is relevant to them removes the risk of them forgetting or disregarding information, and removes the need to cover all information in a single document at the outset of the process.
- 52 Subject to Cabinet's agreement, I intend to complete further consultation on draft regulations to ensure that they are fit for purpose.
- 53 While there has not been public consultation in relation to the multiple provider arrangements, further consultation will be carried out before any types of arrangements are prohibited by regulations or licence condition.

Financial Implications

- 54 The Financial Markets Authority is responsible for the ongoing operation and enforcement of the new regulatory regime. They have been consulted throughout the development of the preferred option and are supportive of it.
- 55 The proposals in this paper are part of the new regulatory regime for financial advice and will pose additional costs on the FMA. As previously noted by Cabinet [CAB-16-MIN-0336 refers], the FMA may require additional funding in the future to effectively regulate financial advice in the new regime. The FMA's funding arrangements will be reviewed once more information about the costs of the new regulatory regime are known. In the meantime, the FMA has sufficient cash reserves to oversee the initial implementation of the new regime..

Legislative Implications

- 56 The disclosure proposals in this paper will require the making of regulations under the Financial Market Conduct Act 2013, as amended by the Financial Services Legislation Amendment Bill.

- 57 The proposal in relation to multiple provider arrangements will be included in an SOP to the Bill.

Impact Analysis

- 58 The regulatory impact analysis requirements apply to the disclosure proposals recommended in this paper. A Regulatory Impact Summary has been prepared and is attached to this paper.

Quality of the Impact Summary

- 59 A Quality Assurance Panel with representatives from the Treasury Regulatory Quality Team and the Ministry of Business, Innovation and Employment (MBIE) has reviewed the “Impact Summary: Financial Advice Disclosure Regulations” produced by MBIE and dated February 2019. The review panel considers that it meets the Quality Assurance criteria.
- 60 The analysis is commensurate with the scale of the issue, with the preferred option identified and described well, and assessed against consistent criteria. There is limited information available on the quantum of the costs and benefits of the impacts on the financial advice sector. The review panel acknowledges that it is difficult to accurately estimate the marginal costs (in monetary terms) given that the proposed regime covers such a wide range of activities provided by vastly different businesses, each currently subject to differing requirements.

Human Rights

- 61 The proposals outlined in this paper are consistent with the New Zealand Bill of Rights Act 1990 and the Human Rights Act 1993. There are no gender or disability perspective implications from the proposals in this paper.

Publicity

- 62 Subject to Cabinet’s agreement to the recommendations in this paper, I intend to issue a press release announcing Cabinet’s decisions.

Proactive Release

- 63 I intend to release the paper proactively in whole within 30 days. The Ministry of Business, Innovation and Employment will publish a copy of this paper on its website.

Recommendations

The Minister of Commerce and Consumer Affairs recommends that the Committee:

1. **note** that the Financial Services Legislation Amendment Bill (Bill) will introduce a new regulatory regime for financial advice and provide for regulations to set out the disclosure requirements for persons who give regulated financial advice.

Disclosure regulations

2. **note** that, if the Bill is enacted as anticipated in March 2019, the disclosure regulations should come into effect when the new regime comes into force around May 2020.
3. **note** that on 29 March 2018 the Cabinet Economic Development Committee (DEV) agreed to the release of a discussion document on proposed disclosure requirements and that the proposals in this paper take into account feedback from this consultation.
4. **agree** that retail clients who receive regulated financial advice should be provided with information on the following matters by financial advice providers and/or individuals that give advice:
 - 4.1. the licence held by the financial advice provider and whether there are any relevant conditions on the licence;
 - 4.2. information about certain duties that the person giving advice is subject to;
 - 4.3. the financial advice service that can be provided, the financial advice products and product providers that can be advised on, and other limitations on the advice;
 - 4.4. the applicable fees and costs relating to the financial advice, including the basis on which they are charged;
 - 4.5. the commissions or incentives that may be received by the financial advice provider and the individual giving advice, or any other conflicts of interest, that a client might perceive as having potential to materially influence the financial advice;
 - 4.6. the complaints handling and dispute resolution arrangements;
 - 4.7. information about Financial Adviser Disciplinary Committee proceedings within the past five years, where the disciplinary committee publicly notified the action;
 - 4.8. information about certain criminal convictions, civil liability findings, or adverse findings from a court or other tribunal within, at most, the last five years, if these would be perceived as relevant to a client's ability to rely on the advice;
 - 4.9. in the case of financial advisers, any instances of being adjudicated bankrupt, or admitted to the no asset procedure, within four years of the date of discharge.
5. **agree** that, to enable clients to receive information as it becomes relevant to them:
 - 5.1. general information relating to the provider's licence, dispute resolution arrangements, scope of advice, fees, potential commissions and conflicts of interest (as referred to in recommendations 4.1, 4.3-4.6 above) must be made

available on financial advice providers' websites if they have one, and on request;

- 5.2. details relating to the licence, the scope of the financial advice (including the range of products that will be advised on), estimated fees, commissions, incentives, and conflicts of interest, disciplinary and bankruptcy history (as referred to in recommendations 4.1, 4.3-4.5, 4.7-4.9 above) must be provided to the client by the point at which the nature and scope of the financial advice service to be provided is known, or soon after;
 - 5.3. any material change to the information disclosed in recommendation 5.2, along with confirmation of any actual fees, commissions, incentives and conflicts of interests, information about certain duties that the person giving advice is subject to, and information about the dispute resolution arrangements (as referred to in recommendations 4.2, 4.4-4.6), must be provided to the client at the point financial advice is given;
 - 5.4. details of the dispute resolution arrangements must be provided when a financial advice provider, financial adviser or nominated representative receives a complaint from a retail client.
6. **agree** that information disclosed in accordance with paragraphs 5.2 and 5.3 to an existing client, does not need to be disclosed again to the same client, within a one year period, unless there has been a material change to the information provided or to the nature and scope of the advice service which will be provided.
 7. **agree** that any disclosure provided to a retail client should be clear, concise, effective, and use plain language.
 8. **agree** that disclosure information must be provided to a retail client in writing if requested by the client.
 9. **agree** that any written disclosure provided to a retail client should be clearly identifiable and contain the professional contact details of the person giving financial advice.
 10. **agree** that anyone who gives financial advice should not be required to disclose any information under the regulations when the financial advice service is given to a wholesale client.
 11. **authorise** the Minister of Commerce and Consumer Affairs to issue drafting instructions to Parliamentary Counsel Office to give effect to the above recommendations.
 12. **authorise** the Minister of Commerce and Consumer Affairs to approve and release an exposure draft of the regulations and related commentary for public consultation.
 13. **agree** to delegate to the Minister of Commerce and Consumer Affairs the power to make decisions consistent with the policy proposals in this paper on minor issues that arise during the drafting process.

Multiple provider arrangements

14. **note** that officials are preparing a supplementary order paper proposing changes to improve the clarity and workability of the Bill, and that the Financial Services Legislation Amendment Bill is expected to be enacted in March 2019.
15. **agree** to make a change to the Bill by supplementary order paper allowing regulations or licence conditions to specify circumstances in which an individual financial adviser cannot give advice on behalf of more than one financial advice provider.

Authorised for lodgement

Hon Kris Faafoi

Minister of Commerce and Consumer Affairs