MINISTRY OF BUSINESS, INNOVATION & EMPLOYMENT
HIKINA WHAKATUTUKI

Regulatory Impact Statement

Review of the Financial Advisers Act 2008

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Agency disclosure statement

This regulatory impact statement (**RIS**) has been prepared by the Ministry of Business, Innovation and Employment (**MBIE**).

The purpose of this RIS is to support a Cabinet paper proposing amendments to the Financial Advisers Act 2008 (**FA Act**) as a result of a 5 year review, required under section 161 of the FA Act.

The FA Act governs those who may give financial advice, the types of advice that can be provided, the format advice should be given in and the requirements on those financial advisers.

The RIS is detailed as it deals with a large number of options for potential amendments to the current regime. We believe the current regime does not fully meet its objectives and propose a suite of amendments to improve on the status quo.

The analysis is based largely on:

- impacts identified in submissions received in responses to two consultation documents - a May 2015 Issues Paper and a November 2015 Options Paper - and extensive consultation with other government agencies (particularly the Financial Markets Authority (**FMA**)), adviser and consumer representatives and members of the public through workshops, focus groups and meetings undertaken over the past 16 months;
- desk-based research including of behavioural economics and other academic papers, international trends and experiences; and
- FMA reports relevant to the financial advice market.

There are some limitations on the analysis undertaken:

- The analysis is based partly on impacts identified in submissions. In some instances these submissions included anecdotal evidence but did not include quantitative evidence of the problems identified. They also included qualitative descriptions of the costs and benefits of the options rather than quantitative estimates.
- MBIE is undertaking further consideration of compliance and enforcement tools and transitional arrangements, with regulatory impact analysis of these elements to follow. The enforcement tools and transitional arrangements will impact on the effectiveness, costs and risks of some of the options in this RIS.
- Some of the proposals will have implications for the FMA's funding requirements (e.g. by increasing the population of advisers who are actively monitored by the FMA). These costs have been identified throughout the RIS and may require subsequent adjustments to fees and levies which will be determined through a subsequent policy process.

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Contents

List of Acronyms

ABS	Adviser Business Statement
AFA	Authorised Financial Adviser
CPD	Continued Professional Development
DIMS	Discretionary Investment Management Services
FA Act	Financial Advisers Act 2008
FADC	Financial Advisers Disciplinary Council
FMA	Financial Markets Authority
FMC Act	Financial Markets Conduct Act 2013
FSP Act	Financial Service Providers (Registration and Dispute Resolution) Act 2008
FSPR	Financial Service Providers Register
MBIE	Ministry of Business, Innovation and Employment
QFE	Qualifying Financial Entity
RFA	Registered Financial Adviser

Executive summary

MBIE has been reviewing the operation of the FA Act and Part 2 of the Financial Service Providers (Registration and Dispute Resolution) Act 2008 (**FSP Act**) over the past 16 months. A number of problems with the Acts have been identified through the review.

This RIS contains the analysis of options intended to address the problems with the FA Act. Table 1 below summarises the problems and, for each, sets out the options that have been considered (with the preferred option shaded). Analysis of options to address the problems with the FSP Act is contained in a separate RIS.

Table 1 Summary of problems and the options to address them

Problem	Options to address the identified problem (please see relevant page for analysis of the option)						
Advice cannot be provided through online channels	Enable robo-advice with licensing (p 16)	Hybrid robo-advice model (p 17)					
Regulatory perimeter not always capturing the right practices	Provide greater clarity as to what is not financial advice (p 20)	Redefine financial advice (p 21)	Ability to designate activities as advice (p 21)				
Complexity, perverse incentives, and disproportionate regulatory requirements	Remove the class/personal-ised advice distinction (p 27)	Remove the current distinction between Category 1 and 2 products (p 28)	Define a new set of high-risk or complex services (p 29)	Distinguish between salespeople and advisers (p 29)			
Conflicts of interest may be resulting in poor outcomes for consumers	Universal conduct obligation to put the consumer's interest first (p36)	Universal replacement rule (p 38)	Code of Conduct to provide minimum standards of conduct and client care (p 38)	Improve the disclosure by advisers of conflicted remuneration (p 39)	Require product providers to disclose soft commissions paid (p 41)	Ban or restrict conflicted remuneration (p 41)	Restriction on soft-commissions (p 43)
Accountability for advice does not always sit with the appropriate party	All advisers are individually accountable for their advice (p 47)	Ability for firms to take on all accountab-ility for advice (p 48)	Obligation for firms to not incentivise their representatives in such a way that does not put the consumer first (p 49)	Dual-accountability between firm and adviser (p 50)			
Disclosure requirements do not help a consumer choose an adviser	Require all advisers to complete full disclosure documents (p 55)	Introduce a simplified disclosure document (p 55)	Principles based approach to disclosure (p 56)				
Consumers are unaware of the limitations of the advice they receive	Introduce a mandatory Statement of Advice(p 58)	All advisers to ensure consumers are aware of the	Require consumers to 'opt-in' to being deemed a wholesale client				

		limitations of the advice (p 59)	(p 60)				
Competency requirements are not always proportionate to advice complexity	Introduce a broad competency obligation for all advisers (p 62)	All advisers to meet common standards of competence, knowledge and skill (p 63)	Competency, knowledge and skill standards specific to certain parts of the industry (p 64)	Require new advisers to have a degree level qualification prior to joining the profession (p 65)	Require all advisers to meet CPD standards (p 66)	Enable flexibility in how advisers demonstrate compliance with standards (p 67)	
Some advisers operating with limited regulatory oversight	Require a subset of advisers to be individually licensed (p 71)	Require all financial advice firms to be licensed (p 72)	Require all financial advisers to be licensed individually or as a firm (p 73)				
Consumers struggle to know where to find quality financial advice	Develop a portal for consumers seeking financial advice (p 76)	Amend the FSPR to make it a more consumer friendly tool (p 76)	Promote the sources of information available from different parties (p 77)				

1 Context, status quo and problem definition

Context

Section 161 of the FA Act requires MBIE to review the operation of the FA Act no more than 5 years after its commencement. Section 45 of the FSP Act requires a similar 5 year review of the registration provisions (Part 2) of that Act. MBIE is required to report to the Minister of Commerce and Consumer Affairs with any recommendations for amendments by July 2016.

Feedback from financial advisers, financial service providers, consumers and regulators indicate the Acts have created some unintended consequences that are limiting, rather than enabling, access to high quality financial advice.

This **RIS** considers potential changes to the FA Act. A separate RIS considers potential changes to the FSP Act and can be read in conjunction with this RIS.

A further RIS will be completed analysing options in relation to the compliance and enforcement tools within the regime, as well as transitional provisions and some more detail on the roles and responsibilities of various bodies within the regime.

Status Quo

The FA Act regulates providers of financial advice in the investment, insurance, mortgage and banking industries. It aims to promote the sound and efficient delivery of financial adviser and broking services, and to encourage public confidence in the professionalism and integrity of financial advisers. It seeks to do this by imposing regulatory requirements on advisers which vary, depending on how complex the product is, how personalised the advice is, and whether the client is a retail or wholesale client.

The FSP Act requires financial service providers to be registered and, if they provide advice to retail clients, to belong to a dispute resolution scheme. These requirements seek to promote confident and informed participation of businesses, investors, and consumers in fair, efficient and transparent financial markets.

Key features of the regime

The key elements of the regime are:

- Types of financial advice – financial adviser services can be more or less tailored to the client. Personalised advice takes into account the client's particular situation or goals and class advice is more generic advice about what is usually suitable for people with similar circumstances (or in the same class).
- Categories of financial products – financial products are categorised by complexity. Category 1 products are generally more complex and include securities (including bonds, shares and

KiwiSaver) and futures contracts. Category 2 products are generally less complex and include term deposits and insurance policies.

- Types of advisers – there are three types of advisers which can all provide class advice, have different regulatory requirements and restrictions on the personalised advice they can provide.
  - Registered financial advisers (**RFAs**) which are typically mortgage and insurance brokers and can provide personalised advice on Category 2 products – there are approximately 6,200 RFAs.
  - Qualifying financial entity (**QFE**) advisers which are representatives of QFEs (mostly large bank and insurance companies) and can provide personalised advice on Category 1 products issued by the QFE – there are approximately 23,000 QFE advisers and 56 QFEs.
  - Authorised financial advisers (**AFAs**) which are investment advisers and financial planners who may also provide mortgage or insurance advice can provide personalised advice on all products – there are approximately 1,800 AFAs.
- Regulation of brokers and custodians – the FA Act also regulates the provision of broking and custodial services. Brokers and custodians are individuals or entities who receive, hold, pay or transfer client money or property, or hold these assets on behalf of the beneficial owner - there are currently around 1,100 registered brokers.
- Types of clients – clients are either deemed to be retail or wholesale clients. There are a number of factors which determine whether a client is a wholesale client and these are intended to capture more experienced investors (including institutional investors) who need lesser protections.
- Conduct and competency – advisers have different conduct and competency requirements. All financial advisers are required to exercise care, diligence and skill and not engage in misleading or deceptive conduct. There are no additional requirements for RFAs but there are for both QFE advisers and AFAs. QFE advisers are held to a higher ethical obligation in respect to personalised advice on Category 1 products, and QFEs are required to ensure that QFE advisers are supported to achieve and maintain the right level of knowledge, skill and competence. AFAs are subject to a Code of Professional Conduct which imposes further ethical, client care and competence standards and includes a requirement to attain the relevant Level 5 National Certificate unit standards.
- Registration and licensing – advisers have different registration and licensing requirements. RFAs need to be registered on the Financial Service Providers Register (**FSPR**) while AFAs need to be registered and authorised. To be authorised AFAs must meet additional entry requirements and comply with a number of ongoing reporting obligations. QFEs must be registered and meet additional entry requirements and ongoing reporting obligations (QFE advisers do not need to be individually registered or authorised).
- Disclosure – advisers have different disclosure requirements. All financial advisers are required to disclose certain information about the nature of services they provide prior to providing personalised advice to a retail client. In addition AFAs are required to disclose more detailed information on the nature of services they provide, show how many provider’s products they can consider and detail of conflicted remuneration and all conflicts of interest.
- Dispute resolution – all those providing advice to retail clients must belong to an approved dispute resolution scheme.

Since the advent of the FA and FSP Acts, further legislation has been introduced in the financial markets area with a much stronger focus on increasing the transparency for consumers. This has created a new operating environment for financial advisers and financial service providers. For example, the Financial Markets Conduct Act 2013 introduced a licensing regime for financial products, clarified expected conduct and procedures on those dealing with financial products and communicating risk to clients.

Institutional Settings

The following institutional settings support the FA and FSP Acts.

The Financial Markets Authority

The FMA is responsible for the monitoring and enforcement of the FA Act. In addition to authorising AFAs and approving QFEs, it monitors all financial advisers' ongoing compliance with the FA Act's provisions and has both formal and informal tools through which to respond to non-compliance. The FMA has extensive enforcement powers under the FA Act, the FMC Act and the Financial Markets Authority Act 2011, including the ability to require information, to direct a financial adviser to take steps to comply with the Act and ultimately to withdraw the authorisation/approval of AFAs and QFEs.

The FMA's enforcement policy states that it focusses its enforcement resources on conduct that harms or presents the greatest likelihood of harm to the function of open, transparent and efficient capital markets. The FMA therefore targets its activities on a risk assessed basis, informed by its surveillance and intelligence activities.

The FMA also periodically releases guidance documents, outlining providers' regulatory responsibilities and how to comply with relevant legislation, and information and fact sheets on issues relevant to the industry.

Code Committee

The Code Committee was appointed in 2009 to prepare and periodically review the Code of Professional Conduct. Members of the Code Committee are appointed by the FMA. Under the FA Act, the Committee may be comprised of between 7 and 11 members from industry and the consumer affairs sector as follows:

- one member with knowledge, experience and competence in consumer affairs, appointed for three years; and
- other persons who, in FMA's opinion, are qualified for appointment by virtue of their individual knowledge of, and experience and competency in relation to, the financial adviser industry.

Professional associations / Industry bodies

There are a range of professional bodies in New Zealand that specifically focus on representing, advocating for, and providing services to financial advisers. The associations do not hold a formal regulatory role under the current regime, though many provide assistance to their members and some set their own standards that members must meet (over and above those set in law). Membership of a professional body is voluntary.

Financial Advisory Disciplinary Committee

The FADC is an independent body established under the FA Act. The FA Act sets out the functions of FADC and authorises it to determine its own procedures in order to meet its responsibilities and obligations. These functions are:

- to conduct disciplinary proceedings arising out of complaints about AFAs in relation to breaches of the Code of Professional Conduct which are referred by the FMA; and
- to consider and impose appropriate penalties that may range from recommending that the FMA cancel an AFA's authorisation, to imposing a fine of up to $10,000 as a result of disciplinary proceedings.

The FADC cannot consider complaints against RFAs or QFE advisers. As of March 2015, the FADC had only considered cases against 7 AFAs.

Dispute Resolution Schemes

Under the FSP Act, all financial service providers who provide services to retail clients are required to be a member of one of the four approved dispute resolution schemes.

The purpose of the schemes is to provide an avenue for consumers who have a dispute with their financial service provider to seek redress in a quick, efficient and cost-effective manner. Without dispute resolution, consumers' primary recourse for redress would be through the courts. The particular procedures and jurisdiction of each scheme are set out in their individual scheme rules, which are approved by the Minister of Commerce and Consumer Affairs.

The Minister can also recommend that Regulations be made that prescribe provisions to be implied into the scheme rules.

High level description of the policy problem

Public consultation has raised a number of problems with the current regime that the review seeks to address. Most relate to improving and enabling the availability of quality advice for consumers, reducing unnecessary compliance costs and removing undue regulatory barriers that are inhibiting the provision of advice.

Access to financial advice

Certain types of advice are not being provided

Very few consumers are getting advice that takes into account their particular situation or goals. For example, the FMA's 2015 review of *Sales and advice* which found that for every 1,000 KiwiSaver sales or transfers, only three were recorded as being sold with personalised advice.

The boundary between personalised and class advice is inhibiting access to advice, and higher regulatory requirements and unclear documentation standards for personalised advice are incentivising this behaviour. Most advisers are operating at extreme ends of the advice spectrum where regulation and guidance is clearest – providing either very comprehensive personalised advice or generic class advice.

The legislative requirement for personalised advice to be provided by a natural person is a barrier to the provision of robo-advice. Internationally robo-advice has a rapidly growing market share and is increasing the accessibility of advice for technologically savvy investors who may otherwise struggle to access advice due to the smaller size of their investments and the costs of person to person advice.

Quality of financial advice

Conduct of advisers

Commissions and remuneration structures are incentivising advisers to push particular products which may not be appropriate for the consumer. The FMA's 2015 review of *Sales and advice* found that KiwiSaver providers are paying direct sales incentives or setting sales targets in staff performance plans but were unable to show how they recognise and manage these incentives (or conflicts) against consumers' interests. Another review by the FMA into life insurance replacement business (where a policyholder moves their policy from one provider to another following financial advice) found correlations between replacement business and incentives.

Although not widespread, this strongly suggests that some advisers' practices may be resulting in poor advice and consumer outcomes. For example switching from one life insurance policy to another can carry significant risks of losing cover, as evidenced in case studies published by dispute resolution schemes.

Competence of advisers

RFAs are not held to any competence standards, while QFE advisers and AFAs are held to standards which may not be fit for purpose. We are concerned that this might be driving the provision of suboptimal financial advice and damaging consumer confidence and investment.

Oversight of advisers

RFAs are not subject to any active regulatory oversight despite providing some of the exact same services as QFE advisers and AFAs. This is confusing to consumers and means that unless the FMA receives a complaint about the activities of an RFA and investigates, they are not monitored or supervised.

Consumer understanding

Consumers don't always understand the limitations of different types of advice they receive and these are not always transparent

The current distinction between Category 1 and Category 2 products, with different regulatory requirements applying to each, does not necessarily reflect the true risk or complexity they can carry. For example, advice on some Category 2 products can be complex and have a significant impact on consumers' financial outcomes.

Feedback from consumers is that terminology is causing confusion and can often be misleading. For example, adviser designations do not provide an indication of the kind of advice consumers can expect to receive or the quality of the adviser – in particular the term 'registered' suggests some level of qualification, oversight or monitoring (as it does with other professions like nursing) and superiority over 'authorised' financial advisers. The legislation has introduced other definitions which are difficult for advisers to communicate and consumers to understand. For example, consumers do not often understand the limitations of class advice and expect and assume all advice to be personalised.

Disclosure documents are long and overly complex and are not providing consumers with the key information they need to make good financial decisions. Anecdotal evidence suggests they are rarely read and when read the differing disclosure requirements might mean that consumers make incorrect assumptions about the advice they have received.

Cost of compliance

Compliance requirements are bringing limited benefit to regulators, advisers & consumers

The current regime is designed in a way which misses opportunities for efficient compliance. QFEs are approved at a business level with an upfront fee of $4,886 while AFAs are required to be individually authorised which is imposing an upfront fee of $1,145 per adviser. This means that a small-medium sized advisory firm with ten advisers is required to spend almost $11,500 in direct fees compared to $4,886 for a large QFE with potentially hundreds of advisers.

The scale of this disparity means that AFAs are imposed with significantly greater direct compliance costs. Many advisers claim this is preventing them from remaining viable and competitive, and forcing them to be selective about the type of clients they take on.

How to navigate the RIS

This RIS considers different elements of the regulatory regime in turn. Within each element of the regime, this RIS provides more detailed descriptions of the status quo and problems and sets out options to address the problems.

The table below outlines how the four high-level policy problems discussed above are addressed throughout this document

Table 2: Relevant sections for specific policy problems

High-level policy problem	More detailed or specific policy problem	Discussed in section
Access to financial advice	Advice cannot be provided through online channels	3.1: What is financial advice and who can provide financial advice
	The distinction between class and personalised advice is creating perverse incentives which are limiting access to advice	3.2: Tiers of advisers and advice
Quality of financial advice	Regulatory perimeter not always capturing the right practices	3.1: What is financial advice and who can provide financial advice
	The Category 1 versus Category 2 distinction is not reflective of risk or complexity	3.2: Tiers of advisers and advice
	Conflicts of interest may be resulting in poor outcomes for consumers	3.3. Conduct and conflicts of interest
	Concerns about the lack of individual accountability and ability to incentivise good conduct within a QFE	3.3. Conduct and conflicts of interest
	Current competency requirements are not always proportionate to the services advisers can offer	3.5: Competency
	Varying licensing and reporting requirements result in some advisers operating with limited regulatory oversight	3.6: Licensing and oversight

Consumer understanding	The tiers of advice and associated tiers of consumer protection are difficult for consumers to understand and respond accordingly	3.2: Tiers of advisers and advice
	Current disclosure of conflicted remuneration is inadequate	3.3. Conduct and conflicts of interest
	Current disclosure requirements do not help a consumer choose an adviser	3.4: Disclosure and client care
	Consumers are unaware of the limitations of the advice they have received	3.4: Disclosure and client care
	Consumers struggle to know where to find good quality financial advice	3.7: Finding an adviser
Cost of compliance	Current regime does not reflect a firm's ability to influence consumer outcomes	3.3. Conduct and conflicts of interest
	Inefficiencies in the licensing and reporting requirements	3.6: Licensing and oversight

2 Objectives

The long-term outcome we want the regime to work towards is more confident and informed participation of consumers in financial markets. This is aligned with the purpose of the FMC Act. To achieve this, we have set the following three primary objectives for the review of the FA Act.

Consumers can access the advice they need

All consumers should be able to access the right kind of advice to meet their needs and wants. For advice to be accessible it must be offered through different channels, easy to understand and available in a variety of ways (e.g. from simple targeted advice to more detailed comprehensive financial plans).

Advice makes consumers better off

When consumers receive advice, it should be good quality. We want advisers to have the right skills, competencies and ethics to provide advice that enables consumers to make financial decisions that will make them better off. In turn, consumers should have high levels of satisfaction from their dealings with financial advisers and have confidence that advisers are held to certain standards. This requires consumers to be able to determine the interests and incentives of advisers and their ethical and competency requirements, so they can place the right amount of trust in their adviser. It also requires a regime that is easy to navigate so consumers are able to judge where to go for financial advice.

Regulation is enabling with no undue compliance costs, complexity, or barriers to innovation

The regulatory regime should enable advice to be provided in a cost-effective way. This requires the removal of any undue barriers to innovation so advisers and firms can provide the advice that consumers want. This also requires regulatory requirements that are proportionate to the risks they are mitigating so that they do not unduly limit the provision of advice. It also requires a regime that is easy to navigate so consumers are able to judge where to go for financial advice.

Note that the objectives of addressing the misuse of the FSPR and ensuring consumers have access to effective redress are discussed in the separate RIS on the operation of the FSP Act.

To achieve these objectives, MBIE considers the following regulatory design characteristics to be desirable. The options considered in this RIS are analysed against these design characteristics, using the status quo as a baseline:

- Increase consumer understanding of what they are getting and how best to respond
- Improve the availability of advice
- Improve the quality of advice
- Reduce undue compliance costs or barriers to innovation
- Contribute to the achievement of best practice regulatory design principles[1]
- Result in a positive net assessment of costs, benefits and risks

[1] Growth compatible; proportional; flexible, durable; certain, predictable; transparent, accountable; and capable regulators (page 80 http://www.treasury.govt.nz/regulation/bpr/bpregpa-feb15.pdf)

3 Options and impact analysis

3.1 What is financial advice and who can provide financial advice

Status Quo

A financial adviser service is currently defined as the provision of:

- *financial advice*: a recommendation or opinion in relation to acquiring or disposing of a financial product;
- an *investment planning service*: designing or offering to design a plan that is based on an analysis of an individual's current and future overall financial situation and identifies their investment goals and includes recommendations or opinions on how to realise those goals; or
- a *discretionary investment management service*: any service in which the provider decides which financial products to acquire or dispose of on behalf of and authorised by their client.

The FA Act clarifies that providing information about a financial product or giving advice about a class of financial product is not financial advice.

Personalised advice (defined as advice that takes into account a client's particular financial situation or goals) can only be provided by a natural person.

Exemptions to be discussed in a later RIS. There are a number of exemptions in the FA Act. This includes an exemption for incidental services, where a service is an incidental part of another business that is not otherwise a financial service. The FA Act also exempts a number of occupations, including teachers, journalists, lawyers, accountants, and real estate agents when providing a financial advice service in the ordinary course of their business. We are currently considering whether there is sufficient ability for the FMA to monitor whether exempt occupations are operating within the terms of the exemption. This will be discussed further in a later RIS.

Problem: Advice cannot be provided through online channels

As above, the FA Act explicitly restricts the provision of personalised advice to a natural person. This requirement was intended to ensure an individual is responsible for advice that meets the required standards.

Since the FA Act came into force, there have been considerable advances in technology relevant to financial advice. Automated technologies are being increasingly relied upon globally such that financial advice is not crafted by a human adviser but instead designed by an algorithm that determines the client's needs and makes a recommendation. It is known as digital advice, automated advice, or robo-advice (hereafter referred to as robo-advice).

The current prohibition against robo-advice is a significant barrier to the provision of advice. By limiting the provision of personalised advice to natural persons, New Zealand financial service providers have been unable to fully develop online advice channels. This has resulted in reduced choice for consumers and reduced access to quality advice (potentially at a lower cost). While the prohibition was intended as a consumer-protection mechanism, advances in technology are such that robo-advice can be high-quality and overseas experience demonstrates that controls can be put in place to ensure consumer protection without a blanket prohibition. While the prohibition may have been sensible a decade ago, it is now an undue barrier to advice.

Option 1: Enable robo-advice (with licensing and with broadly the same obligations as apply to traditional advice)

This option involves removing the requirement that personalised advice can only be provided by a natural person and applying broadly the same obligations as apply to traditional advice (i.e. advice provided by a natural person). For example, if financial advisers were required to put the consumer's interest first, then the same requirements would apply to robo-advice platforms.

All firms wishing to provide robo-advice would need to be licensed. The licensing requirements for providing robo-advice should be comparable to requirements for person-to-person advice (refer to section 3.6). This would require prospective robo-advice licensees to demonstrate to the FMA that their robo-advice platform will meet conduct and client care obligations, and the standards in a Code of Conduct. This would include, for example, processes to ensure the ongoing robustness of the algorithms underpinning their platform showing how they put the consumer's interests first, that they have the appropriate expertise to deliver advice via an electronic platform, and how they are disclosing things like conflicts of interest.

The intent of this option is that robo-advice would be required to meet the same standard as advice provided by a natural person. Note, however, that the means of demonstrating the standard may differ for some standards. For example, while a financial adviser may demonstrate quality through having passed a qualification, a robo-advice platform may demonstrate equivalent quality through algorithm and scenario testing.

Related topic: refer to section 3.6 for analysis of options relating to licensing more generally.

	Impact	Incidence	Magnitude
Costs	• Would impose costs on the FMA for developing expertise, guidance and requirements for licensing robo-advice platforms.	FMA	Moderate
	• Costs and uncertainty for firms wishing to provide robo-advice, especially in the short-term while guidance is being developed and the FMA's approach to licensing and monitoring robo-advice platforms beds-in.	Firms	Moderate
Benefits	• The main benefit of allowing robo-advice is that consumers will have increased access to financial advice, potentially at lower cost. In particular: o A wide range of consumers will have access to advice through automated tools	Consumers	High

	○ Consumers can obtain financial advice in a faster, easier, less-intimidating, and non-time consuming way. ○ Consumers can access advice at lower costs than traditional financial advice. • Licensing and other obligations would enhance consumer protection given the risks of unregulated robo-advice.		
	• Ability for providers to reach a greater number of customers. • Greater ability to provide a consistent consumer experience. • Greater ability to consistently comply with regulatory requirements (less dependent on individual's behaviour).	Providers (most likely to be banks and other large financial institutions in the first instance)	High
Risks	• Consumers could make unsuitable decisions as a result of a lack of information, limitations or assumptions within the tool, and reduced opportunity to seek clarification (vis a vis traditional advice). This risk would be mitigated by introducing clear disclosure obligations which would aim to clarify the limitations of advice as discussed in section 3.4. • Consumers could suffer detriment if the financial advice tool is hacked and the underlying algorithm is manipulated or any error or bias within the algorithm could cause widespread consumer detriment due to the same algorithm being used for multiple consumers. This would be mitigated through the testing, licensing and ongoing enforcement of robo-advice platforms. Consumers would also have access to redress through dispute resolution schemes as with other forms of financial advice.		
Net impact	Overall this option is likely to bring significant benefits, particularly through increasing access to lower cost advice. There are some risks associated with robo-advice. These can largely be mitigated through ensuring sufficient controls and testing of algorithms and through disclosure requirements to ensure consumers understand the limitations of any robo-advice service.		

Option 2: Hybrid robo-advice model with mandated option to speak to a financial adviser

Under this option, robo-advice providers would be required to offer consumers the option of speaking to a human financial adviser throughout the advice process (e.g. if the consumer does not know how to answer a question or does not understand the portfolio recommended by the robo-advice platform).

	Impact	**Incidence**	**Magnitude**
Costs	• May increase the costs of providing robo-advice services.	Providers	Unknown – may be low to moderate
	• There would be additional costs for the FMA who would be required to develop additional capability for associated licensing and monitoring of robo-advice platforms.	FMA	Unknown – likely to be high
Benefits	• Ensures consumers have access to the assistance they need when using robo-advice and minimise the risk of consumers choosing an option without fully understanding its consequences.	Consumers	Unknown – depends on other means available to ensure consumers can access assistance they need
Risks	There is a risk that this option may limit access to advice by acting as a barrier to the development of robo-advice platforms.		

Net impact	Overall the net benefit of this option is unclear. The requirement to provide the option for consumers to speak to an adviser is likely to improve the likelihood that consumers have the assistance they need when using robo-advice, but it may be an overly prescriptive response to potential risks of robo-advice that can be mitigated through other means.

Assessment of options against criteria (relative to the status quo) and summary of cost/benefit/risk analysis

	Increases consumer understanding of what they're getting and how best to respond	Improves the availability of advice	Improves the quality of advice	Reduces undue compliance costs or barriers to innovation	Contributes to the achievement of best practice regulatory design principles	Net assessment of costs, benefits and risks
Option 1: Enable robo-advice (with licensing and with broadly the same controls as apply to traditional advice)	~	Significant potential to improve access to advice – especially for those with lower sums to invest ✓✓	While the controls should ensure quality, it is not an improvement on the status quo since robo-advice is currently prevented ~	The current prohibition of robo-advice has become an undue barrier in light of technological advances ✓✓	Significant improvement of status quo in relation to flexibility and durability (enables regulated entities to adopt least cost and innovative approaches) ✓✓	Significant net benefit. Some risks which can be mitigated through testing and monitoring and other controls.
Option 2: Hybrid robo-advice model with mandated option to speak to a financial adviser	~	Improvement on status quo but this option may limit access relative to option 1 ✓	While the controls should ensure quality, it is not an improvement on the status quo since robo-advice is currently prevented ~	Improvement on status quo but this option adds (possibly undue) compliance requirements ✓	Improvement on status quo but less ability than option 1 for regulated entities to adopt least cost approaches. ✓	Net benefit relative to status quo but likely an overly prescriptive response to potential risks of robo-advice that can be mitigated through other means.

Our preferred option is to enable robo-advice with broadly the same controls as apply to traditional advice. This recommendation should be considered in conjunction with the other recommendations throughout this RIS (e.g. that all advice should be subject to a 'consumer first' obligation and with clearer disclosure). These obligations would therefore apply under Option 1. Both options would require the FMA to develop additional capability to license and monitor robo-advice platforms.

Key
✓✓ Significant improvement on the status quo
✓ Improvement on the status quo
× Inferior to the status quo
~ No impact relative to the status quo
☐ Shaded row = preferred option

Problem: Regulatory perimeter not always capturing the right practices

The 'reach' of the FA Act is determined by the definition of a financial adviser service. We have heard two contrasting concerns relating to the definition of financial advice:

- Firstly there is a concern that the current regulatory perimeter may be unintentionally capturing activities that are not intended to fall within the regulatory perimeter. An example we have heard in submissions is that some providers lack clarity as to whether execution or transaction-only services (whereby a consumer has requested to buy or sell a specific financial product and does not wish to receive advice) are captured. Some providers are electing not to respond to the consumer's request without going through a rigorous advice process when this is not what the consumer wants or needs. A similar concern relates to the provision of factual information about a financial product (e.g. the cost or terms and conditions).

- Secondly there is a concern that the current regulatory perimeter may be allowing some conduct – which is intended to be captured – to go unregulated by providers using the strict 'letter of the law' definition. That is, the form of the activity is not strictly financial advice but in substance the activity is financial advice (i.e. the current perimeter allows form over substance).

  An example we have heard through submissions and the FMA's review of *Sales and advice* is the cross-selling of financial products, whereby a consumer who intends to purchase a financial product is sold an additional product. For example:

  > *"We are aware of cases where customers have been sold a product such as life insurance or KiwiSaver, when their original intention had been to organise a different product, such as a credit card or home loan. In some cases there has been little, if any, awareness by the customer that the agreement to acquire the secondary product has been finalised"—FMA, Sales and advice, November 2015*

  While it is reasonable to expect a consumer to have done their homework on the product they originally asked for, there is no basis for assuming the same level of knowledge when they are sold an additional product on the spot. Therefore there is greater possibility of harm to a consumer if these practices are not covered by the financial advice conduct obligations.

Option 1: Provide greater clarity as to what is not financial advice

This option would involve clarification (on top of the existing definition of a financial advice service) that the following does not constitute financial advice:

- an execution-only or transaction-only service (whereby a consumer has requested a specific product and does not wish to receive advice), e.g. *I would like to purchase 5,000 Mighty River Power shares.*
- the provision of factual information about a financial product, whether or not it is in response to a request by a consumer (such as the cost or rate of return of a financial product) e.g. *Can you please give me information about your basic car insurance – how much would the premium be, what would the excess be?*

	Impact	Incidence	Magnitude
Benefits	• Likely to ensure consumers can access information-only and execution-only services without advice when this is not wanted or needed. • May improve the provision of information and execution only services by providers.	Consumers	Moderate
Net impact	Overall, this option would provide greater clarity as to what is not captured and would result in improved outcomes for consumers.		

Option 2: Redefine financial advice so that it captures substance over form

The option would involve amending (or adding to) the current definition of financial advice so that it clearly captures the substance of the activity rather than the form. For example, the definition could include a statement that financial advice includes any practices that are intended to influence an individual consumer in making a decision about a financial product.

This definition would capture (but would not be limited to) the provision of information about a financial product that a consumer has not requested (e.g. in a cross-selling scenario) with the information being provided in such a way that it is clearly intended to influence the consumer to buy the additional financial product.

	Impact	Incidence	Magnitude
Costs	• Could result in costs to firms that may need to adjust their processes and systems to ensure compliance with any changes to the regulatory perimeter.	Firms	Moderate
Benefits	• Likely to lessen the possibility of consumers being sold products without consideration of their needs, since providers would not be able to operate a 'sales' model by purposefully avoiding the regulatory perimeter (as detailed in the FMA's *Sales and advice* report).	Consumers	Moderate
Risks	• There is a risk that this option would inadvertently disincentivise activities like information provision, since providers may fear it would be captured as financial advice. Further consideration would be needed of specific formulations of a definition that might address this risk. • The principles-based nature of this rule may create additional uncertainty for advisers about what is captured by the regime. Possibility that some of this risk may be mitigated through FMA and Code guidance.		
Net impact	Risk of perverse outcomes (such as disincentivising any information provision) may outweigh the potential benefits to consumers.		

Option 3: Ability to designate activities as advice on basis of substance over form

This option would involve a mechanism to allow an activity to be regulated as a financial advice service having regard to a set of guiding principles. MBIE would explore the possible mechanisms further but it could, for example, be a designation making power granted to the FMA (similar to the power that the FMA has under the FMC Act to designate financial products) or a regulation making power for the Minister of Commerce and Consumer Affairs. Guiding principles could include:

- The overarching purposes of the Act, and
- Whether the activity is likely to have the same effect as a financial advice service (for example, whether the activity is likely to have the same effect as a recommendation to buy a financial product), and
- Whether the activity is undertaken in such a way that a reasonable consumer would likely think they had received a financial advice service (for example, whether information is provided in such a way that a consumer would likely believe that they had received advice).

	Impact	**Incidence**	**Magnitude**
Costs	• Costs to FMA of monitoring perimeter conduct and responding with designations.	FMA	Low[2]
Benefits	• Likely to lessen the possibility of consumers being sold products without consideration of their needs, since providers would not be able to operate a 'sales' model by purposefully avoiding the regulatory perimeter through activities that are advice in substance but not form.	Consumers	Moderate
	• Greater certainty for advisers (especially relative to Option 2) about activities that will be treated as financial advice by the FMA.	Advisers	Moderate
Net impact	Subject to further exploration of this option, including with the FMA and Parliamentary Counsel Office (PCO), MBIE considers it could provide better outcomes for consumers by allowing specific activities to be designated as advice (and hence subject to the associated protections).		

[2] Cost is low recognising that the FMA's ongoing monitoring and surveillance activities (such as the FMA's 2015 review of *Sales and advice*) are expected to provide the information the FMA would need to identify activities that should be captured – therefore the marginal cost of the option is expected to be low.

Assessment of options against criteria (relative to the status quo) and summary of cost/benefit/risk analysis

	Increases consumer understanding of what they're getting and how best to respond	Improves the availability of advice	Improves the quality of advice	Reduces undue compliance costs or barriers to innovation	Contributes to the achievement of best practice regulatory design principles	Net assessment of costs, benefits and risks
Option 1: Provide greater clarity as to what is not financial advice	~	~	~	Reduces undue barriers to execution-only services that are not intended to be captured ✓	Provides greater certainty to advisers. ✓	Overall, this option would provide greater clarity as to what is not captured with improved outcomes for consumers. ✓
Option 2: Redefine financial advice so that it captures substance over form	Removes the concern that consumers may think they are receiving advice (and subject to associated protections), meanwhile the provider is avoiding the obligations ✓	Improves the likelihood of consumers receiving advice, with providers less able to operate a 'sales' model by purposefully avoiding the regulatory perimeter (as detailed in the FMA's *Sales and advice* report). ✓	Likely to improve advice outcomes for consumers since advisers would not be able to operate a 'sales' model by purposefully avoiding the regulatory perimeter (as detailed in the FMA's *Sales and advice* report). ✓	Depending on formulation of definition, may present an undue barrier to information provision which is not intended to be captured ×	May be a disproportionate response and create regulatory uncertainty about what activities will be considered to be advice by the FMA ×	Depending on formulation of definition, risk of perverse outcomes (such as disincentivising any information provision) may outweigh the potential benefits to consumers. ×
Option 3: Ability to designate activities as advice on basis of substance over form	Removes the concern that consumers may think they are receiving advice (and subject to associated protections), meanwhile the provider is avoiding the obligations ✓	Improves the likelihood of consumers receiving advice, with providers less able to operate a 'sales' model by purposefully avoiding the regulatory perimeter (as detailed in the FMA's *Sales and advice* report). ✓	Likely to improve advice outcomes for consumers since advisers would not be able to operate a 'sales' model by purposefully avoiding the regulatory perimeter (as detailed in the FMA's *Sales and advice* report). ✓	~	Provides certainty as to what activities will be treated as financial advice (once designated) and flexibility as new activities emerge. ✓✓	Overall, this option would provide better outcomes for consumers by allowing specific activities to be designated as advice (and hence subject to the associated protections). ✓

Our preferred options are to provide greater clarity in legislation as to what does not constitute advice and to further explore, with PCO and the FMA, the feasibility of a mechanism to ensure the regulatory perimeter is capturing activities that should be captured. The mechanism could, for example, be a power granted to the FMA under which the FMA could designate activities as advice subject to a set of guiding principles. These options aim to provide clarity to advisers about what is not captured and prevent providers purposefully avoiding being regulated.

Key
✓✓ Significant improvement on the status quo
✓ Improvement on the status quo
× Inferior to the status quo
~ No impact relative to the status quo
☐ Shaded row = preferred option

3.2 Tiers of advisers and advice

Status Quo

The FA Act distinguishes between different advice services and between products based on their complexity. These distinctions are then used to determine who can provide what advice and what processes and obligations apply when giving advice.

Distinction between advice services

The FA Act divides advice into class advice and personalised advice (i.e. advice that takes into account a client's particular financial situation or goals). The original rationale for distinguishing between class and personalised advice was to allow entities to produce generic publications. There was a concern that, because only a natural person (and not an entity) was permitted to give advice, an entity would be breaching the law when producing generic publications in the name of the entity. In light of this intended purpose there are fewer obligations and less rigour required when giving class advice. There are also no restrictions on which advisers can provide class advice (refer to Table 3 below).

Distinction between Category 1 and Category 2 products

The FA Act divides financial products into Category 1 and Category 2 products. Category 1 products have been assessed as being higher risk or more complex, and therefore advice on these products is subject to higher regulatory requirements and restricted to certain advisers (refer to Table 3 below). Category 1 includes investment products such as equity securities and KiwiSaver funds. Category 2 includes most insurance products, credit contracts and many savings products.

Resulting tiers of advisers

The FA Act creates three different types of financial advisers and utilises the class/personalised and Category 1/Category 2 distinctions to determine what services they can each provide:

- Authorised Financial Advisers who can provide personalised advice on any product
- Registered Financial Advisers who can only provide personalised advice on Category 2 products
- QFE Advisers who can provide personalised advice on Category 2 products or on their own Category 1 products.

These distinctions are illustrated in the table below. Each type of adviser has different conduct and competency obligations and different means of gaining approval and being supervised.

Related topic: refer to sections 3.3, 3.5, and 3.6 for analysis of options relating directly to conduct, competency, and licensing and oversight. This section does not consider what these obligations should be (e.g. what conduct obligations should be in place); rather it examines issues with the tiers of advice/advisers and options to change the tiers.

Table 3: Who can provide different types of financial advice?

	Authorised Financial Advisers (AFA) Individuals who are registered and authorised by the FMA	**Qualifying Financial Entity (QFE) advisers** Representatives of entities approved by the FMA as Qualifying Financial Entities	**Registered Financial Advisers (RFA)** Individuals registered to provide financial advice	**Registered financial adviser entities** Entities registered to provide financial advice
Class advice	✓	✓	✓	✓
Personalised advice on category 2 products	✓	✓	✓	×
Personalised advice on category 1 products	✓	✓ in respect of category 1 products issued by the QFE	×	×

Problems: Complexity, perverse incentives, and disproportionate regulatory requirements

The tiers of advice and associated tiers of consumer protection are difficult for consumers to understand and respond accordingly

The tiered set of regulatory requirements has unintentionally resulted in a complicated framework that is difficult for industry to communicate and consumers to understand. This complexity makes it difficult for consumers to know where to go for advice and, when getting advice, to understand the limitations of the service they are receiving. Many submitters to the Options Paper noted that the current distinction between class and personalised advice in particular is confusing to consumers. For example:

> *"The current distinction inhibits a proper conversation. We still need to ask personal questions to ensure that whatever product is being sold is suitable, so by default we are personalising the discussion. The current lack of consumer understanding about this distinction adds confusion as customers don't understand why we can't explain elements in a way that is meaningful or 'personal' to the customer"* – Cigna Life Insurance, submission on Options Paper, February 2016

The distinctions between adviser types are also causing consumer confusion and can be misleading. This is evidenced by findings from focus groups[3] and responses to the Issues Paper Consumer Questionnaire. Some consumers said that the distinctions do not provide any indication of the tier of advice they receive while others think the term registered financial adviser suggests more

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[3] Comlar Brunton for MBIE, FA Act and FSP Act Review: Consumer Groups *Exploring the value, experiences and impact of obtaining financial advice in New Zealand*, June 20015, http://www.mbie.govt.nz/info-services/business/business-law/financial-advisers/review-of-financial-advisers-act-2008/resolveuid/44d41931b6a4463ea084fa920557391c

qualification than an authorised financial adviser and/or some level of oversight or monitoring. 84 per cent of respondents to the Issues Paper Consumer Questionnaire think that people who want advice don't know how to find the right type of adviser for them.

The distinction between class and personalised advice is creating perverse incentives which are limiting access to simple but personalised advice

The different obligations, particularly between class and personalised advice, are creating perverse incentives and leading to gaps in the provision of advice.

In light of the intended purpose of class advice (i.e. for things like generic publications), the lower levels of rigour and consumer protection seem sensible. However, in practice the distinction is relied upon for a much wider range of services that the intended "generic publications and online planning services". Instead, the lower level of rigour has created a perverse incentive for providers to limit their services to class advice. This has created an advice gap for limited personalised advice, i.e. advice on relatively discrete matters that nonetheless involves a degree of personalisation (e.g. *what KiwiSaver fund is right for me?*). We heard through submissions that this is the kind of advice that we heard most New Zealanders want but which they are not getting.

For example, the FMA found that, for every 1,000 KiwiSaver sales or transfers, only three were recorded as having been sold with personalised advice.[4] Moreover, many respondents to the Options Paper noted that the distinction has led to a very conservative compliance approach, with QFEs in particular directing their frontline staff to avoid giving personalised advice. For example:

> *"In ANZ's view, the current distinction between class and personalised financial advice in the FAA is arbitrary and has led to an overly conservative approach by QFEs."* – ANZ, submission on Options Paper, February 2016

The Category 1 versus Category 2 distinction is not reflective of risk or complexity, and this is resulting in regulatory requirements that are not proportionate to risk

The current distinction between Category 1 (complex) and Category 2 (simple) products is not reflective of risk or complexity. For example, many submitters to the Options Paper noted that advice on life insurance or mortgages, for example, can be complex and can have a significant impact on consumers' financial wellbeing. The distinction between complex and simple products has, in turn, resulted in regulatory requirements that are not proportionate to risk. For example, there is significant potential risk to consumers from poor insurance advice; meanwhile there are very limited conduct and competency obligations applying to advisers who give this advice. For example:

> *"The sale of complex commercial general insurance or income protection is much riskier to a customer than a personalised KiwiSaver sale, yet under the current regime the latter is considered Category 1 and needing much higher levels of adviser education/status. Such absurd anomalies should be a priority for changes to the FAA regime."* – AMP, submission on Options Paper, February 2016

> *"The current two tier categorisation of financial products is flawed. For example the complexity and risks associated with KiwiSaver (a category 1 product) can vary significantly –*

[4] FMA, *Sales and advice 1 July 2014 – 30 June 2015,* November 2015, https://fma.govt.nz/assets/Reports/151117-Sales-and-advice-report.pdf.

from relatively simple in the case of a young person entering the workforce for the first time but could be complex for someone with a number of assets and who is reaching the point of decumulation. In addition, the current categorisation of insurance products as category 2 creates a perception that such products are 'low risk' and not complex. However, the financial consequences of being under insured in the event of a claim can easily be as adversely material to a client's financial situation as the consequences of receiving poor investment advice." – MAS, submission on Options Paper, February 2016

"Financial advisers should only provide financial adviser services that they are competent to provide. Maintaining an artificial list of "risky" products fails to recognise that the risk of a product depends primarily on the consumer – not the type of product. Whether a service is high risk (or low-risk) depends on the consumer's circumstances, for example their income, investments, insurance products, risk tolerance, age, gender, short and long term goals. The current legislative framework for distinguishing between categories of products should be removed." – Fidelity Life, submission on Options Paper, February 2016

Option 1: Remove the class/personalised advice distinction

This option would involve removing the regulatory distinction between class and personalised advice. This would not require all advice to be fully comprehensive and personalised advice. Rather, the aim would be to remove the current perverse incentive to limit the degree of personalisation where this is not in the interests of the consumer. To this end, the legislation would clarify that the scope of advice can be limited by factors such as the service the consumer wants and the service the adviser is competent to provide. For example, an adviser need only consider a client's KiwiSaver fund if that is all the consumer wants advice on.

Related topics: Refer to section 3.4 on client care and the scope of service for a discussion of options to provide clarity to consumers in relation to the limitations in the scope of service provided. Refer to section 3.3 on conduct for a discussion of an option of a Code of Conduct, including minimum standards of client care.

	Impact	Incidence	Magnitude
Costs	• Would result in costs to firms that currently provide class advice and would need to develop new processes and systems	Advisers and QFEs	High
Benefits	• Clarity that advice services can vary along a spectrum from class advice to fully comprehensive advice (and therefore greater ability to provide customised services). • Simpler advice processes because determining whether the service was class or personalised would not be required.[5]	Advisers	Moderate
	• Removes the current perverse incentive for advisers to limit their service to class advice. We heard that this incentive is the main factor underpinning the current advice gap for personalised advice. • Likely to improve advice outcomes for consumers since advisers would not be able to operate a 'sales' model utilising the limited obligations that apply to class advice (as	Consumers	High

[5] "Removing the distinction between class and personalised services, coupled with a principles based relaxation of who can provide advice, will improve the confidence of financial advisers to provide advice. We say this because: advisers will have certainty as to the regulatory treatment of the advice they are providing; and advisers will not have to concern themselves with subtle distinctions between class and personalised advice, and importantly will not have to monitor or moderate their behaviour to address the risk that they stray from class into personalised advice (as happens at present)." – Chapman Tripp, Submission on Options Paper, February 2016

	detailed in the FMA's *Sales and advice* report).		
Risks	• Could limit access to any advice – worsening the current advice gap – by removing the current "safe-harbour" provided by class advice and leading providers to limit their services to information only. This could be mitigated by the option in section 3.1 on the regulatory perimeter aimed at preventing providers purposefully avoiding being regulated. • Could increase the cost of advice, particularly if providers take a risk-averse approach to compliance and consider the removal of the distinction means they need to always provide a comprehensive advice service and cannot limit the scope of the service. This should be mitigated through clarity in legislation that advice scope can vary and through clear guidance for advisers and clear standards of client care (e.g. in a Code of Conduct).		
Net impact	This option is expected to bring significant benefits to consumers by improving access to limited personalised advice. The main risks (that it will lead providers to provide information only or that advisers will take a risk-averse approach) can be mitigated through guidance around limited advice scope discussed in section 3.4 and a possible mechanism to prevent providers purposefully avoiding being regulated as discussed in section 3.1.		

Option 2: Remove the current distinction between Category 1 and 2 products – all financial products treated equally

This option would involve removing the current distinction between Category 1 and Category 2 products resulting in the regulation of all financial advice in the same way (regardless of which financial products an adviser recommends). It would aim to overcome concerns that the current distinction between Category 1 and Category 2 products has resulted in regulatory requirements that are not proportionate to risk.

An effect of this option would be to remove the current distinction between AFAs and RFAs (since the ability to provide advice on Category 1 and/or 2 products is what distinguishes the two types of advisers under the current regime).

Related topic: refer to sections, 3.3 and 3.5 on conduct and competency for options for the standards that all advice would be held to if this distinction was removed. Note that the costs to advisers of meeting these standards is outlined in sections 3.3 and 3.5 on conduct and competency (we have therefore not included specific costs in the table below (beyond noting that we expect RFAs in particular to face increased compliance costs if this distinction is removed).

	Impact	Incidence	Magnitude
Costs	• Costs of meeting conduct and competence standards that do not currently apply to those only giving advice on Category 2 products (as above, refer to sections 3.3 and 3.5 for more detailed discussion on impact).	RFAs	Depends on standards and transitional arrangements – refer to sections 3.3 and 3.5.
Benefits	• Overcomes the risks to consumers of receiving poor advice on products that have been classified as Category 2 (but with significant ability to impact their financial wellbeing). • Creates a simpler regime for consumers to navigate, with the same protections irrespective of the product being advised on.	Consumers	High
Risks	• Could limit access to any advice if the resulting standards that RFAs would need to meet are not set at a sensible level or if there is not sufficient time for RFAs to transition to new standards. This risk can be mitigated through transitional arrangements (this will be discussed in a later RIS) and ensuring the competency requirements are flexible and appropriate for those giving advice on (what are currently defined as) Category 2 products (refer section 3.5).		

	• Could lower the quality of advice as a wider group of people will potentially be able to provide advice on category 1 products. This risk would be mitigated by options in Chapter 3.5 requiring all advisers to prove competence in the areas they provide advice in.
Net impact	This option is expected to bring significant benefits to consumers by ensuring robust advice regardless of the financial product being advised on.

Option 3: Define a new set of high-risk or complex services that can only be provided by a particular type of adviser (e.g. Expert Financial Adviser)

Under this option, a set of financial advice services would be designated as complex or high-risk and could only be provided by a subset of advisers who are clearly labelled as being more competent (e.g. Expert Financial Advisers). The services that would fall into this category could be set in Regulations or designated by the FMA.

	Impact	Incidence	Magnitude
Costs	• Would retain a layer of complexity whereby consumers would need to know what type of adviser to see for a particular service.	Consumers	Low
Benefits	• Could provide advisers with a higher status to aim for and could increase professionalism of the advice industry.	Advisers	Low
Risks	• Risk of creating an advice gap for the restricted services if the costs associated with demonstrating competence to provide the services are too high.		
Net impact	The net impact is unclear – this option may perpetuate consumer confusion though may provide advisers with a higher standard to aim for.		

Option 4: Distinguish between salespeople and advisers (with fewer regulatory obligations applying to salespeople)

Under this option, there would be fewer regulatory obligations applying to people who are clearly identified as salespeople. The philosophy underpinning this option is that consumers may need less protections if they are aware they are being sold something (i.e. a buyer-beware philosophy). We considered two sub-options for distinguishing between salespeople and advisers:

1. On the basis of the degree of independence. Under this option, the title 'adviser' (and the associated obligations) would be limited to those with the freedom to make a recommendation about a range of financial products. Those making a recommendation or giving an opinion about a very limited range of financial product, or only their own financial products, would be deemed salespeople.

2. On the basis of who has the conduct obligation to put the consumer's interests first. Under this option, the title 'adviser' (and associated obligations) would be limited to those who elected to meet the adviser regulatory obligations, including the consumer first obligation.

Related topic: refer to section 3.4 on disclosure for a discussion of options to ensure consumers understand whether they are receiving independent advice or a recommendation on a limited range of products. This option relates to whether salespeople should have fewer regulatory obligations, rather than disclosure of independence.

	Impact	Incidence	Magnitude
Costs	• Would likely limit access to advice, where many choose to act as salespeople rather than provide advice. In turn, this is likely to lead to worse outcomes for consumers .	Consumers	Moderate

	• Likely to lead to lower confidence in the industry.	Advisers	Medium
Benefits	• Relative to the status quo, consumers would be more aware of when they were effectively being sold something – would therefore have greater ability to place the right amount of trust in advice. However, this assumes that consumers understand the implications of this carve out. If they do not, they could continue to make uninformed decisions.	Consumers	Low
	• Lower compliance costs for advisers who wish to operate a sales model.	Advisers	Moderate – high
Risks	• Risk of consumers not knowing what the term 'salesperson' means in terms of how it limits their protections. This could be mitigated to an extent by requiring salespeople to provide a clear notification to the consumer that these lesser obligations apply.		
Net impact	• This option will deliver a net cost to consumers. While there are some potential benefits to consumers in distinguishing sales from advice, it is difficult to draw a clear line for consumers as to when they are in an 'advice' situation or when they are in a 'sales' situation. It would exacerbate the current consumer confusion and barriers thrown up when trying to navigate 'authorised', 'registered' and 'QFE advisers', and 'class' and personalised' advice. It presents other risks which could have significant adverse effects (eg. relying on something as financial advice when it is purely a sale and being sold multiple products).		

Assessment of options against criteria (relative to the status quo) and summary of cost/benefit/risk analysis

	Increases consumer understanding of what they're getting and how best to respond	Improves the availability of advice	Improves the quality of advice	Reduces undue compliance costs or barriers to innovation	Contributes to the achievement of best practice regulatory design principles	Net assessment of costs, benefits and risks
Option 1: Remove the class/personalised advice distinction	Would remove an element that is confusing to consumers about the service they are receiving ✓	Significant potential to improve access to advice – especially limited personalised advice ✓✓	Likely to improve advice outcomes for consumers since advisers would not be able to operate a 'sales' model utilising the limited obligations that apply to class advice. ✓	Potential to simplify advice processes because determining whether the service was class or personalised would not be required. ✓	~	Significant net benefit. Some risks which can be mitigated through clear guidance to advisers and consumers about the scope of service. ✓✓
Option 2: Remove the current distinction between category 1 and 2 products – all financial products treated equally	Would remove consumer confusion about different types of advisers and who can do what ✓	Risks to access to advice (e.g. by having a significant impact on costs faced by RFAs) can be mitigated. ~	Likely to mitigate the risks to consumers of receiving poor advice on products that are currently classified as Category 2 ✓✓	~	Overcomes a concern that the Category 1/ Category 2 distinction means that the standards and enforcement are not proportional to the risk. ✓✓	Expected to bring significant benefits to consumers by ensuring robust advice regardless of the financial product being advised on. ✓
Option 3: Define a new set of high-risk or complex services that can only be provided by a particular type of adviser	May perpetuate current consumer confusion ~	Not likely to be inferior to the status quo, but risk of creating an advice gap for the restricted services ~	May improve the quality of advice in relation to high-risk or complex services ✓	~	Demarcating certain services likely to limit flexibility and durability (similar to status quo) ~	The net cost/benefit is unclear ~

Key
✓✓ Significant improvement on the status quo
✓ Improvement on the status quo
× Inferior to the status quo
~ No impact relative to the status quo
☐ Shaded row = preferred option

	Increases consumer understanding of what they're getting and how best to respond	Improves the availability of advice	Improves the quality of advice	Reduces undue compliance costs or barriers to innovation	Contributes to the achievement of best practice regulatory design principles	Net assessment of costs, benefits and risks
Option 4: Distinguish between salespeople and advisers (with fewer regulatory obligations applying to salespeople)	Likely clearer to consumers than status quo, but this assumes that consumers understand the implications of the sales carve out. ✓	Would likely limit access to advice, where many choose to operate a sales model (although as this appears to be happening under the status quo, it may not be inferior to the status quo). ~	Would likely limit quality advice, where many choose to operate a sales model (although as this appears to be happening under the status quo, it may not be inferior to the status quo). ~	~	Difficulties in drawing a clear distinction between salespeople and advisers likely to result in uncertainty and complexity ×	This option will deliver a net cost. It presents risks to the quality and availability of advice which could have significant adverse effects on consumers. ×

Our preferred options are to remove the class/personalised and Category 1/Category 2 distinctions. In combination this will result in a net benefit of a much simpler regime for consumers and ensure robust advice regardless of the degree of personalisation or the product being advised on. An effect of this is to remove the distinction between AFAs and RFAs. It will also avoid the boundary and consumer confusion issues that may result in introducing 'salesperson' category.

Key
✓✓ Significant improvement on the status quo
✓ Improvement on the status quo
× Inferior to the status quo
~ No impact relative to the status quo
☐ Shaded row = preferred option

3.3 Conduct and conflicts of interest

Status Quo

A large number of financial advisers receive conflicted remuneration, including in the form of commission payments and other incentives paid by providers. There is no restriction on conflicted remuneration or other conflicts. In order to deal with these, some advisers have conduct obligations to put the consumer first, manage conflicts of interest and to disclose these conflicts to consumers. However, these obligations are not common to all advisers. In particular:

- All advisers are required to meet the conduct obligations in the FA Act to exercise care, diligence, and skill and must not engage in misleading or deceptive conduct.

- In addition to this, AFAs are also required to meet minimum standards of ethical behaviour and client care, which are set out in the Code of Professional Conduct. This includes requirements to place the interests of the client first and to manage any conflicts of interest so that the interests of the client are placed first. AFAs must also disclose commissions and any other conflicts of interest.

- RFAs are not required to put the consumer's interest first. QFE Advisers only have this obligation in when giving personalised advice on Category 1 products.

AFAs and RFAs are ultimately accountable for the advice they provide while a QFE holds sole responsibility for any advice provided by QFE advisers. When an AFA is employed by a QFE and provides a personalised service, they hold joint responsibility with the firm.

Problem: Conflicts of interest may be resulting in poor outcomes for consumers

Evidence that commissions and sales targets are incentivising advice and sales that may not be in the consumer's interests

The FMA's 2015 *Sales and advice* report found KiwiSaver providers paying direct sales incentives to staff, or having KiwiSaver sales targets as part of staff performance plans, with little evidence of supporting policies to ensure conflicts of interest were recognised and managed.[6]

In addition, the FMA's recently released report on insurance replacement business[7] shows a strong link between high upfront commissions and the likelihood of an insurance policy being replaced. The FMA review also found that the quality of a product was only a minor factor in whether a policy was replaced. This suggests that some advisers are not acting in the consumers' best interest.

Based on data from April 2011 to March 2015, the FMA's review found:

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[6] *Sales and advice*, FMA

[7] *Replacing life insurance – who benefits?*, FMA, June 2016 - https://fma.govt.nz/assets/Reports/160322-Insurance-churn-2016.pdf. Note: that over 80 per cent of the policies analysed were on trail commissions under 10 per cent.

- High rates of replacement business[8]. For example, the overall number of life insurance policies grew by less than 2 per cent each year, while life insurers described 11 to 13 per cent of their policies each year as 'new'. This suggests that many 'new' policies were more likely to be replacement policies.

- Of 1,100 high-volume advisers (defined as those with over 100 active life insurance policies), 200 had high estimated replacement business[9]. 45 high-volume advisers replaced more than 20 per cent of their life insurance policies in a single year, while nine replaced more than 30 per cent of their policies.

- Policies sold through advisers were much more likely to be replaced after the end of the clawback period (the period in which an adviser must repay a portion of their upfront commission if the policy is cancelled).

- Correlations between replacement business and incentives. For example, policies no longer subject to clawback were 2.2 times more likely to be replaced if overseas trips[10] were offered as an incentive. Even new policies subject to clawbacks were 8 per cent more likely to be replaced.

- Evidence that high replacement business is slightly more prevalent amongst RFAs than AFAs. About two thirds of the high volume advisers, and 85 per cent of the high-replacement advisers, were RFAs.

Advice that is not motivated by the consumer's interests has the potential to cause significant harm to consumers

The impact of a financial product that is not 'right' for the consumer can be very significant. For example, the compounding impact of being in an overly conservative KiwiSaver fund for many years could significantly impact a consumer in terms of foregone income. Alternatively, a consumer being switched to a replacement health insurance product, which fails to cover them for a pre-existing medical condition, can be devastating to a consumer's financial position. Further, poor advice practice can cause detriment to the wider economy if a large number of consumers are impacted.

A key trigger for occupational regulation is whether there is a possibility that incompetent, negligent, or fraudulent service by members of the profession could result in harm to consumers or a third party . In the case of financial advice, this potential was highlighted following the numerous finance company collapses in New Zealand over the last decade. Between May 2006 and October 2011, 45 finance companies in New Zealand failed, putting at risk around $6 billion of investors' deposits. Through its inquiry into finance company failures report, the Commerce Committee identified lack of adviser competence as one

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[8] 'Replacement business' is when a policyholder moves their policies from one provider to another following advice from their financial adviser.

[9] A high rate of replacement business was defined as when:

- At least 12 per cent of an advisers' policies lapsed, and the adviser writes at least 12 per cent of policies as new businesses within one year; or
- At least 40 of an advisers policies lapsed in a single month and an adviser writes at least 40 new policies in the same month.

[10] Insurance providers who sell through AFAs and RFAs offer overseas trips as sales incentives. Destinations during the FMA review period included Shanghai, Prague, Las Vegas, Hollywood, Rome and Rio de Janeiro.

factor that contributed to the failures, which saw individuals receive poor advice about the riskiness of investment. Advisers often did not recommend adequate diversification of investment to minimise these risks. Investors were also often unaware of advisers' interests in promoting certain products. The report stated that the Commerce Committee was also aware of instances in which finance companies exploited the lack of investor understanding. At the time of the inquiry, it was estimated that between 150,000 and 200,000 deposit holders had been affected and losses to date sat at $3 billion. The Crown faced losses of around $2 billion as a result of claims under the retail deposit guarantee scheme for liabilities of failed finance companies.

Serious problems internationally following the Global Financial Crisis (**GFC**) demonstrated that this was not a New Zealand-specific problem and that regulatory interventions in other countries have not always successfully prevented such problems.

However, information asymmetries and behavioural biases mean consumers need to rely on advice

Notwithstanding the risks that can arise from poor advice, many consumers need to rely on the information given to them by the financial firm or adviser selling it. This is because the nature of financial products means there is information asymmetry between the consumer and the adviser. For example, consumers infrequently purchase financial products and services and therefore often do not have good knowledge of them. Further, when decisions are made infrequently, the ability of consumers to learn over time and adjust their behaviour accordingly is reduced.[11] Moreover, it is usually difficult to detect poor advice at the time of purchase, with risks and consequences often not emerging for many years.

In addition, the features of financial products may make consumer decisions particularly prone to biases and errors (behavioural biases). These biases mean that financial capability and/or disclosure of conflicts of interest may not be sufficient (by themselves) to overcome the potential harm to consumers arising from poor or conflicted advice.

For example, financial decisions require making trade-offs between the present and the future, and many financial decisions are emotional. Emotions such as stress, anxiety and fear of losses and regret can drive decisions rather than the costs and benefits. Good advice is important to help correct these biases. It can also help to reduce people's inertia, the behavioural economic bias which suggests people have a tendency to choose inaction, and stick with the status quo. This is particularly important to overcome in terms of investment and savings products, such as KiwiSaver.

Current disclosure of conflicted remuneration is inadequate

The current situation, where retail clients receive different information from different advisers, can be misleading for consumers. Of particular concern is the fact that RFAs are not required to disclose details of their remuneration, or whether they have any conflicts of interest, and the treatment of 'soft-commissions'[12].

It is important that conflicted remuneration is disclosed in such a way that it can be readily understood by consumers. For example 88 per cent of respondents to the Issues Paper

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[11] Chater, Huck & Inderst. 2010. Consumer Decision-Making in Retail Investment Services: A Behavioural Economics Perspective. Final Report.

[12] Soft-commissions are non-monetary incentives paid to financial advisers from providers, such as overseas trips that are generally paid on an incentive basis. AFAs are required to disclose if they receive "non-financial benefits from other organisations" in their primary disclose statement.

Consumer Questionnaire thought that disclosure of commission payments is useful, however only 55% per cent thought they would know how to interpret disclosure of these payments[13].

The options discussed below relate to both the provision of financial advice through advisers and robo-advice platforms where applicable.

Option 1: Universal conduct obligation to put the consumer's interest first

Under this option, there would be a legislative conduct obligation applying to all financial advisers to put the consumer's interest first. This option creates a principles-based obligation on an adviser to act in the interests of the consumer. When a conflict of interest arises, the obligation makes it clear that the interest of the consumer must be prioritised.

Recognising that all advice is limited in some respects – e.g. some advisers can only recommend one or two providers' products, some consumers only want limited advice on one kind of financial product – the conduct obligation would not require all advisers to consider the full range of products from across the market. Rather, it requires the adviser to put the consumer's interests first in light of what the adviser does and the scope of service being provided.

Related topic: Please see section 3.4 for a discussion of options aimed at ensuring the consumer understands the scope of service they are receiving – e.g. how many products and providers the adviser is considering and other conflicts of interest that have been managed by the adviser.

In order to be effective, this option would be supported by monitoring and enforcement by the FMA such that breaches of the obligation are identified and penalised. As part of this option, the FMA would undertake information gathering and surveillance activities (as it can under its current powers), for example, through setting continuous and periodic reporting requirements for advisers. This could include (for example) mandatory reporting of complaints, replacement and new business data and details of any commissions including soft-commissions received. This will allow the FMA to identify advice that may be a breach of the consumer first standard and investigate further, e.g. with site-visits and audits of individual advisers' files.

Note that options to ensure that the enforcement regime is fit for purpose, including disciplinary proceedings and penalties for offences, will be analysed in a separate RIS.

Related topics: This option would also be more effective if supported by up-front checks that advisers have the right training, systems and procedures to put the consumer's interest first. Refer to sections 3.5 and 3.6 on competency requirements and licensing respectively for analysis of options relating to training and up-front checks of systems and procedures.

	Impact	Incidence	Magnitude
Costs	• Would impose some costs on some advisers and QFEs to meet / demonstrate compliance	RFAs and QFEs	Low – Moderate[14]

[13] http://www.mbie.govt.nz/info-services/business/business-law/financial-advisers/review-of-financial-advisers-act-2008/pdf-document-library/Summary%20of%20Consumer%20Brochure%20responses.pdf

[14] Impact will vary depending on the current degree of compliance: many advisers are likely to have strong processes in place to manage conflicts of interest etc. The impact will be greater on those who do not currently have these processes in place.

	with new ethical obligations (AFAs are already subject to this standard).		
	• Would require monitoring and surveillance by the FMA of a greater number of advisers against the consumer first standard, which may end up being borne by consumers in full or in part (currently this standard only applies to AFAs (and QFEs in a small number of instances)).	FMA[15]	Moderate
Benefits	• Would improve financial outcomes for consumers, by increasing the likelihood that advice puts their interests first and decreasing the likelihood of conflicted remuneration driving advice. The impact will be greatest where conduct does not currently apply (e.g. RFAs providing advice on life-insurance and QFEs providing advice on KiwiSaver under class advice definition). For example, the FMA's review of life insurance replacement business has found that RFAs had higher rates of replacement business than AFAs (only AFAs are currently required to put the consumer's interest first).[16] • Would create a simpler regime for consumers to navigate (since all advisers would need to put the consumer first). Currently consumers cannot judge which advisers are subject to the consumer first obligation and 94 per cent of respondents to the Options Paper consumer questionnaire thought that all advisers should be subject to this obligation[17].	Consumers	High
	• Creating a more level-playing field (all advice subject to same conduct obligation) allows more flexible risk-based monitoring and enforcement (rather than having to focus on limited areas where obligations currently apply).	FMA	Moderate
Risks	• Could reduce access to more limited forms of advice (as opposed to fully comprehensive advice services) if advisers perceive the ethical obligation as a requirement to know everything about the consumer and/or know about all products from across the market. This could be mitigated by clarifying in the law that advice scope can vary (see section 3.2). • Alternatively, could lead to harm to consumers who do not understand that the duty is bound by certain limitations. This would be mitigated by requiring this obligation to be accompanied by disclosure that includes any advice limitations as discussed in section 3.4.		
Net impact	This option is expected to provide a net benefit. It will go some way in addressing one of the core problems with the status quo – that conflicts of interest maybe leading to		

[15] Any change in funding requirement for the FMA may be wholly or partially funded through the FMA levy of market participants.

[16] "On average, RFAs had higher rates of replacement business than AFAs. About two-thirds of the high-volume advisers, and 86 per cent of the high-replacement advisers, were RFAs. Some RFAs replaced more than 35 per cent of their life policies in one year" – FMA, *Replacing life insurance – who benefits,* June 2016

[17] http://www.mbie.govt.nz/info-services/business/business-law/financial-advisers/review-of-financial-advisers-act-2008/pdf-document-library/Consumer-Questionnaire-Summary.pdf

	suboptimal outcomes for consumers. This option would be supported by monitoring and enforcement by the FMA such that breaches of the obligation are identified and penalised – the FMA has the ability to gather data and other information to monitor this area and identify practices requiring further investigation.

Option 2: Universal replacement rule - adviser must ensure replacement is in the consumer's interest

Under this option, an adviser (or advice platform) would only be allowed to recommend that a consumer replace a financial product with another product if they had taken into account the risks of switching and, having taken those risks into account, considered replacement was in the consumer's interest. The impact of this requirement would be highest in relation to products like life or health insurance where product replacement carries a risk of losing cover due to factors like non-disclosure or pre-existing medical conditions.

The replacement obligation is an extension of putting the consumer's interests first (Option 1 above). However, whereas the consumer first obligation can be limited by the scope of the adviser's service (e.g. a bank adviser must put the consumer first within the limits of only providing advice on one provider's products) the replacement obligation requires additional client care and skill in the case of product replacement.

A consumer could still request a product replacement in an execution-only type scenario without the adviser being required to perform a comparison (i.e. this would still fall within the definition of execution-only and would be beyond the scope of the regime).

	Impact	Incidence	Magnitude
Costs	• Would impose some costs on RFAs and QFEs to demonstrate replacement is in the consumer's interests (AFAs are already held to a similar standard through the Code of Conduct).	RFAs and QFEs	Moderate
Benefits	• Would improve financial outcomes for consumers, by increasing the likelihood that replacement is in their interests and decreasing the likelihood of conflicted remuneration driving advice.	Consumers	High
Risks	• Significant risk that a specific replacement rule may set too high a standard for product replacement (and act as a barrier for any product replacement advice). This could be mitigated by limiting the replacement rule to certain replacement advice, e.g. life insurance product replacement. However, this mitigation then risks additional complexity and rigidity.		
Net impact	Net impact is unclear. This option may result in a net benefit to consumers by increasing the likelihood that replacement is in their interests. However, there is a real risk that this option may act as a barrier to any replacement advice, thereby limiting access to replacement advice.		

Option 3: Code of Conduct to provide minimum standards of conduct and client care for all financial advice

Under this option, a Code of Conduct, produced by a Code Committee, would prescribe minimum standards of conduct and client care that all financial advisers/advice must adhere to. It would provide greater specificity on the behaviours, processes and practices expected when providing financial advice. For example, relevant standards might include how to effectively manage conflicts of interest and ensure there is an appropriate internal process in place for resolving client complaints.

The detail on how the Code Committee would be appointed and process for establishing and changing the Code of Conduct is yet to be determined and will be included in a separate RIS.

	Impact	Incidence	Magnitude
Costs	• Would impose costs on RFAs and QFE advisers who would need to meet (and demonstrate compliance with) the Code of Conduct.	RFAs and QFE advisers	Moderate
	• Cost of producing a new Code (would not simply be an expansion of the current AFA Code, recognising it would cover a much wider range of advisers/advice).	FMA (if funded as per current arrangements, but this is yet to be determined)	Low
Benefits	• Improved quality of advice and in turn improved outcomes for consumers through all advisers being subject to clear standards of conduct and client care.	Consumers	High
	• Certainty for advisers about how to comply with the legislative obligations (especially in combination with Option 1). • Improved consumer confidence in the professionalism of advisers. • Ability to amend as needed/respond to new challenges/respond to things not working well.	Advisers	Moderate
Risks	While there is a risk of the Code of Conduct becoming overly prescriptive and acting as a barrier to advice, the content of the Code would be guided by the purposes of the Act.		
Net impact	Overall this option is expected to bring net benefits, by providing greater certainty to advisers and improving outcomes for consumers.		

Option 4A: Improve the disclosure of conflicted remuneration by advisers

This option would require all financial advisers to disclose the same information regarding conflicts of interest and conflicted remuneration at prescribed times and in prescribed formats. For example, it could require:

- disclosure of percentage ranges of commissions received from different providers in an adviser's up-front disclosure statement, and
- a dollar figure of expected commission at the time of a specific recommendation and details of any soft commissions the adviser expects to receive.

Related topics

- Refer to section 3.4 for a discussion of options relating to disclosure more generally.
- Submitters noted that QFE advisers may be incentivised to sell particular products (through bonus payments, sales targets and non-quantifiable incentives such as performance management). These incentives were identified as a concern in the FMA's

2015 review of *Sales and advice.* Options aimed at reducing the impact that the incentives and other conflicts of interest have on the advice provided by QFE staff and options intended to improve the quality of disclosure documents are discussed later in this section and in section 3.4 respectively.

Academic literature supports the view that people are naïve about how conflicts of interest affect the quality of advice[18]. Recognising these behavioural biases, disclosure alone will not prevent the potential harm to consumers created by conflicts of interest and other incentives. It is therefore recommended that this option be implemented with options 1, 3 and 4B in order to be successful.

	Impact	Incidence	Magnitude
Costs	• Would require advisers to calculate the extent of commissions they expect to receive and amend disclosure documents to include this information.	Advisers, especially RFAs who do not currently have to disclose details of conflicts of interest	Moderate
	• Could result in delays at the time an adviser makes a recommendation (for those advisers who are not currently required to disclose details of conflicted remuneration). • Could increase the cost of providing advice which may result in a reduction of access to financial advice or for firms to favour a fee based and /or an in-house distribution model).	Consumers	Low to Moderate (as some advisers are already required to disclose this information)
Benefits	• Would significantly increase transparency by giving consumers more information about conflicted remuneration (88 per cent of respondents to the Issues Paper consumer questionnaire thought that disclosure of commission payments is useful). Most submitters agreed that conflicted remuneration should be disclosed, but there were divergent views on how this could best be achieved (for example: in dollar terms, as a range etc).	Consumers	High
Risks	• There is a risk that disclosure documents could become complicated due to the nature of incentive structures (which can vary significantly between products types and providers, and are frequently volume-based) if too much detail is included. For example, life insurance policies frequently contain up-front and trail commissions, and are subject to claw-back periods. This information can be difficult to present in a way that maximises the chance of consumers responding appropriately. • To mitigate these risks MBIE will work with industry and consumer groups to develop and test the most effective format for disclosing conflicted remuneration (and to ensure effective disclosure through different advice channels).		
Net	This option is expected to provide a net benefit. While imposing costs on those advisers that don't currently disclose details of conflicted remuneration, this option would		

[18] European Commission (2010) *Consumer Decision-Making in Retail Investment Services: A Behavioural Economics Perspective - Final Report*.

impact	significantly benefit consumers by ensuring they are aware when an adviser receives conflicted remuneration.

Option 4B: Require providers to disclose soft-commissions paid

Under this option, all providers would be required to maintain annual registers of the extent of soft commissions paid to financial advisers. For example, they could be required to state that they took X amount of advisers to Prague at a cost of Y per head. Soft-commissions can be difficult to attribute to any one sale (and therefore disclose) as they are generally a volume-based incentive. Rather than relying on disclosure by advisers alone as a means of highlighting the impact of soft-commissions, this option aims to address this issue by improving the level of transparency and consumer awareness more generally. This option would be complemented by the FMA's work to help consumers make better-informed decisions when buying financial products.[19]

	Impact	Incidence	Magnitude
Costs	• Would result in additional costs for providers that will need to develop and maintain the registers of soft commissions.	Providers that pay soft commissions	Unknown – expected to be low as this should require maintenance on an annual basis.
	• Would result in additional costs for the FMA who would be required to monitor and audit the registers to ensure their accuracy. This would be facilitated in part by the monitoring and enforcement functions discussed in Option 1.	FMA	Moderate
Benefits	• Would significantly increase the transparency of soft commissions that are not currently disclosed by RFAs and are only disclosed by AFAs at a high level.	Consumers	High
Risks	There is a risk that the public may not be aware of the existence of the registers. This could be mitigated through the FMA's work to help consumers make better-informed decisions when buying financial products.		
Net impact	This option is expected to result in a net benefit. It would lead to greater transparency and should result in increased levels of consumer awareness of soft commissions and the impact that these may have on the quality of financial advice.		

Option 5: Ban or restrict conflicted remuneration

Under this option, financial advisers would be banned or restricted from receiving certain conflicted remuneration for the sale of financial products. This could include, for example, limits on the amount an adviser can earn in an upfront commission or a total ban on commissions. A total ban would require a move to a fee based model and/or to an in-house

[19] For example, further to its review *Replacing life insurance – who benefits?,* the FMA has developed further resources for consumers to help them to make better-informed decisions when buying or replacing life insurance.

distribution model (i.e. where providers sell directly and there is no adviser-channel). Alternatively, this option could include a ban on any volume-based incentive such as sales targets or commissions that are associated with the volume of a product sold.

	Impact	Incidence	Magnitude
Costs	• A ban or significant restriction could limit access to advice for consumers, especially those with lower sums to invest, and those who are not willing to, or cannot afford to, pay upfront for advice. For example, in the UK the Financial Conduct Authority (**FCA**) has found that while the move to fee-based advice on retail investment products has improved transparency and ended conflicts caused by a mainly commission driven model, advice is expensive and is not always cost-effective for consumers particularly those seeking help in relation to smaller amounts of money or with simpler needs[20] • This option fails to recognise that the revenue from commissions is used to fund the distribution costs of the adviser channel (just as a product provider faces distribution costs like salaries and overheads for direct sales) and it would likely remove access to this channel for some consumers. . In the case of investment products, the impact is likely to be greatest for investors with small amounts to invest • In relation to insurance and mortgage products, a ban or restriction could limit the provision of mortgage and insurance broking services (whereby the adviser shops around, e.g. to get the best mortgage interest rate) and this, in turn, may lead to less competitive pressure with consumers less likely to shop around themselves (and it is less efficient for individual consumers to need to shop around vis a vis an intermediary performing this function for multiple consumers).	Consumers	Unknown – potentially high
	• Large number of firms in the industry would have to restructure their business models (and move to a fee based model and/or to an in-house distribution model (i.e. where providers sell directly and there is no adviser-channel)). • May be a disproportionate response to the conduct concern e.g. concerns about some advisers selling life insurance (i.e. it does not target the poor conduct but would have more far-reaching consequences). In relation to the review of life insurance replacement business, the FMA has stated that the majority of advisers do not have high levels of replacement business, regardless of	Industry	Likely high

[20] See https://www.fca.org.uk/static/fca/documents/famr-final-report.pdf. The FCA banned commissions in the UK as part of the Retail Distribution Review in 2013. Despite the benefits of removing 'commission bias', the FCA has noted that the move from paying for advice via commission to paying adviser fees has contributed to many people not being able to get the advice they need at a level they are willing to pay. A survey of 250 financial advisers conducted by NMG Consulting also found that 47 per cent had turned away clients on the basis that the cost of their service had become disproportionately high for some clients' needs.

	the way they are paid for their service.		
Benefits	• Would significantly lessen the possibility for advice to be motivated by conflicted means. For example, in the UK, the removal of commission has led to the reduction of product bias in adviser recommendations, resulting in the enhancement in quality of advice for at least some consumers.[21] However, it only addresses conflicts where advice is through an third-party channel – it does not address conflicts through in-house distribution channels (such as bonuses and other incentives linked to sales targets – which the FMA identified as a concern in its 2015 review of Sales and Advice). Moreover, it exacerbates concerns around such incentives since it drives advice to in-house channels. • Mis-selling and therefore investor losses could be reduced. Aligning incentives also has the effect of ensuring financial capital is priced and allocated more efficiently in the economy.	Consumers	Moderate
	• By aligning the incentives of regulated advisers and consumers, theory (and evidence from UK) suggests that the costs of regulation and compliance could be reduced.	FMA and Advisers	Moderate
Risks	• Relative to a broad conduct obligation could be difficult to design without creating the perverse incentives for providers to incentivise advisers by other means. This could be mitigated in part through clear guidance and supervision by the FMA. • It could also be difficult to put in place restrictions and monitor them where product provider sells direct to consumers. This could be mitigated in part by the options described later in this section. • A potential risk that consumers could misinterpret any ban or restriction by assuming that there are no longer any conflicts of interest. This would be mitigated through clear disclosure as described in Option 4 of this section, and section 3.4.		
Net impact	Overall, this option offers benefits by directly reducing the possibility of advice being motivated by conflicted means when advice is offered via the adviser channel. However, there are risks that this option limits access to advice and exacerbates problems with conflicted incentives within in-house delivery channels that may partially or fully offset these benefits. This risk of reducing access to advice counters one of the main objectives of the review.		

Option 6: Restriction on soft-commissions

An alternative option to address the impact of conflicts of interest is by imposing a restriction on the payment of soft-commissions (non-monetary incentives attached to the sale of a certain product). Under this option, there would be restrictions around the soft-commission incentive structures that financial product providers could operate. For example, any non-monetary incentives that were likely to create a conflict could be prohibited. This option would likely include guidelines around the type of non-monetary benefit which may be allowed i.e. benefits that do not impact the ability of the adviser to put the consumer's interest first and that enhance the quality of service to the client. This

[21] https://www.fca.org.uk/static/documents/research/rdr-post-implementation-review-europe-economics.pdf

option would also likely include a ban on any volume-based non-monetary incentives[22], such as overseas trips which are associated with the volume of a product sold.

The nature of soft commissions and the psychological impacts associated with them suggests that there may be rationale to treat soft commissions differently from regular commissions. Academic literature across a range of disciplines explores the use of non-monetary benefits as a source of motivation. Some of these principles may help to understand why soft commissions can have a particularly strong influence on the selling behaviour of financial advisers.[23] The nature of non-monetary incentives being difficult to monetise also mean they are easier to hide from consumers (as they do not directly affect pricing) and more difficult to disclose in a meaningful way.

	Impact	**Incidence**	**Magnitude**
Costs	• Would create uncertainty for providers in assessing what is in or out of the ban	Industry	Unknown – potentially high
	• Could increase the cost of advice and, in turn, reduce the availability of advice for consumers who are unable or unwilling to pay for it.	Consumers	Unknown – potentially high
Benefits	• Would significantly lessen the possibility for advice to be motivated by conflicted incentives	Consumers	Unknown – potentially high
Risks	• There is a risk that firms increase the use or value of monetary commission structures, or introduce other means of incentivising advisers. • May restrict provision of good incentives, such as training, if providers take a risk averse interpretation to the restriction		
Net impact	Overall, expected net cost. Benefits may not be fully realised if monetary commission structures intensify. Also, whether or not there would be added benefit is dependent on conduct obligation changes (i.e. conduct obligations may address the problem). There is also a real risk of limiting the provision of good incentives, like training.		

[22] Australian Securities and Investment Commission guidance notes on conflicted remuneration presume that volume-based benefits are conflicted remuneration.

[23] Principles of social and cognitive psychology suggest that non-monetary incentives may be perceived as more valuable than the retail of that award in cash. Certain dynamics can extend this value, such as acknowledgement from others, or the fact that attributing a monetary value to the reward is often difficult, so the person's affective (or emotional) reaction contributes to its perceived value. Tangible, non-monetary incentives can increase motivation because they are earned rather than purchased. Many non-monetary rewards are viewed as luxuries, such as travel, so attaining the benefit by exhibiting certain behaviour removes the need to justify its purchase.

Assessment of options against criteria (relative to the status quo) and summary of cost/benefit/risk analysis

	Increases consumer understanding of what they're getting and how best to respond	Improves the availability of advice	Improves the quality of advice	Reduces undue compliance costs or barriers to innovation	Contributes to the achievement of best practice regulatory design principles	Net assessment of costs, benefits and risks
Option 1: Universal conduct obligation to put the consumer's interest first	Creates a simpler regime for consumers to navigate (since all advisers need to put the consumer first). ✓	Risk that this option could reduce access to limited advice can be mitigated by clarity that the obligation does not require an assessment of all products/circumstances. ~	Likely to improve quality of advice by increasing likelihood that advice puts consumer's interests first. ✓✓	~	A principles-based rule is durable. Moreover, increasing consistency of this obligation (relative to the status quo's inconsistent application) contributes to proportionality. ✓	Expected to provide a net benefit. It will go some way in addressing a core problem with the status quo – that conflicts of interest maybe leading to suboptimal outcomes. ✓
Option 2: Universal replacement rule - adviser must ensure replacement is in the consumer's interest	~	Risk that a specific replacement rule may set too high a standard for product replacement (and act as a barrier for any product replacement advice). ×	Increases the likelihood that replacement is in their interests and decreasing the likelihood of conflicted remuneration driving advice. ✓✓	Risk that this option may impose undue costs on replacement advice. ×	Depends on design, though could be inferior to the status quo by limiting flexibility. ~	Net impact is unclear. May result in a net benefit to consumers by increasing the likelihood that replacement is in their interests. However, real risk that it may act as a barrier to any replacement advice. ~
Option 3: Code of Conduct to provide minimum standards of conduct and client care for all financial advice	~	~	Improved quality of advice and improved outcomes for consumers through all advisers being subject to clear standards of conduct and client care. ✓✓	~	Certainty for advisers about how to comply with the legislative obligations (especially in combination with Option 1) ✓	Overall this option is expected to bring net benefits, by providing greater certainty to advisers and improving outcomes for consumers. ✓
Option 4A: Improve the disclosure of conflicted remuneration by advisers	Significant improvement on the status quo as all advisers will be required to disclose conflicted remuneration. ✓✓	~	~	Will increase the level of consistency of disclosure obligations and improve the relevance of current disclosure documentation. ✓	Option is proportional and flexible. ✓	While imposing additional costs on some advisers, this option would provide greater transparency to consumers. ✓

	Increases consumer understanding of what they're getting and how best to respond	Improves the availability of advice	Improves the quality of advice	Reduces undue compliance costs or barriers to innovation	Contributes to the achievement of best practice regulatory design principles	Net assessment of costs, benefits and risks
Option 4B: Require product providers to disclose soft commissions paid	Will increase the level of transparency of the existence and potential impact of soft commissions ✓	~	Should improve the quality of advice by reducing the impact of volume-based incentives ✓	Potential for undue compliance costs for providers if consumers do not become aware of the registers. ×	~	Expected to provide a net benefit to consumers due to the increased transparency ✓
Option 5: Ban or restrict conflicted remuneration	Slight improvement, consumers don't need to respond to information on conflicted remuneration because it is banned (but doesn't address the issue of conflicted remuneration via in-house distribution). ✓	Risk that this option reduces access by moving towards a fee based models and in-house distribution direct by product providers ×	Lower possibility for advice to be motivated by conflicted means, but does not address non-commission forms of conflict ✓	Does not require active monitoring by FMA of how commission-based conflicts are managed (since commissions are banned) ✓	Greater alignment of incentives between financial advisers and consumers, but option not proportional to the problem. ~	Overall the risk of reducing access to advice outweighs the benefits as it counters one of the review objectives ×
Option 6: Restriction on soft-commissions	May create confusion for consumers around what is or isn't allowed in terms of remuneration. ~	~	Lower possibility for advice to be motivated by conflicted means, although this does not address monetary commission structures ✓	May add undue compliance cost depending on conduct obligations introduced and their actual impact ×	~	Expected to provide a net cost. Issue of monetary commission not addressed and may result in a redundant compliance exercise. ×

Our preferred options are to introduce a universal conduct obligation to put the consumer's interests first, a universal Code of Conduct to prescribe minimum standards of conduct and client care, and to require the disclosure of conflicted remuneration (with further work to follow on the best format to ensure this disclosure is meaningful). This option would be supported by monitoring and enforcement by the FMA such that breaches of the consumer first obligation are identified and penalised (we note that the FMA has the ability to gather data and other information to monitor this area and identify practices requiring further investigation. In addition, we are separately considering options to ensure the enforcement regime is fit for purpose, including disciplinary proceedings and penalties for offences). Together these options should provide a net benefit over the other proposals in improving the conduct of advisers and making different forms of conflicted remuneration more transparent to consumers. In the first instance, these options are preferred over 'blunter' options to ban or restrict conflicted remuneration, which could have significant unintended consequences and do not address all conflicts (e.g. in-house sales targets). However, MBIE and FMA would closely monitor conduct and the impact of the preferred options to ensure they are sufficient.

Key
✓✓ Significant improvement on the status quo
✓ Improvement on the status quo
× Inferior to the status quo
~ No impact relative to the status quo
☐ Shaded row = preferred option

Problem: Accountability for advice does not always sit with the appropriate party

Concerns about the lack of individual accountability and ability to incentivise good conduct by advisers within a QFE

Through consultation, concerns were raised about the QFE model and in particular the lack of incentive on QFE advisers to adhere to conduct and client care standards. We heard from submitters the issue arises because QFE advisers are not individually accountable to legislative standards combined with the fact that they may be incentivised by the QFE to sell products without due consideration as to whether it is in the consumer's interests. Note that this is a sub-set of the broader conflict of interest problem discussed above; we have separated this issue out because the options below respond directly to this particular concern.

There is some evidence that these concerns may be valid. For example, the FMA's Sales and advice report found KiwiSaver providers paying direct sales incentives to staff, or having KiwiSaver sales targets as part of staff performance plans, with little evidence of supporting policies to ensure conflicts of interest were recognised and managed. It is unclear whether the problem arises from the different accountability arrangements applying to QFEs (alternatively, it could arise because QFEs are not subject to the consumer first obligation in most situations, in which case this problem would be addressed by extending the consumer first obligation as discussed in the previous section). This limitation has been considered during the below analysis.

Current regime does not reflect a firm's ability to influence consumer outcomes

A firm that provides financial advice through AFAs or RFAs will generally put systems and processes in place that have the potential to impact the quality of financial advice provided. However, in these instances the individual financial adviser holds sole accountability for the advice provided.

Consumers may not be aware whether a firm or an individual is accountable for the advice they provide

Consumers may be unaware whether an individual adviser is accountable for the advice that they provide. This confusion can be exacerbated in part by the term 'QFE adviser' which may not differentiate representatives of a provider sufficiently from other financial advisers. The current terminology does not provide clarity for consumers of how the services offered by a QFE adviser differ from the services offered by other financial advisers.

Further work is to be undertaken on enforcement tools including whether a banning order is necessary and feasible for QFE advisers who have breached the conduct obligations. Discussion on this option will be included in a separate RIS.

Related topic: refer to section 3.4 on Disclosure and Client Care for a discussion of the options to provide clarity to consumers of the limitations of the advice provided.

Option 1: All advisers are individually accountable for their advice

Under this option, the current ability for firms (i.e. QFEs) to take responsibility for compliance on behalf of their representatives would be removed. Anyone providing a financial advice service would be individually accountable for their advice and for complying with the associated regulatory obligations (such as conduct and client care obligations).

	Impact	Incidence	Magnitude
Costs	• This option could significantly limit the availability of advice provided by QFEs. In particular, QFEs may choose not to provide advice in this scenario and/or QFE advisers may choose to exit the industry.	Consumers	Unknown – possibly high
	• This option would significantly increase the compliance costs for individuals that would now need to comply with regulatory obligations and implement systems to ensure compliance.	Advisers within a QFE	High
	• This option would significantly increase monitoring and enforcement costs for the FMA which would no-longer be able to monitor compliance at the firm level.	FMA	Unknown – possibly high
Benefits	• Stronger incentive on those within a QFE to adhere to the consumer first obligation and hence greater likelihood that the consumers' interests will be prioritised.	Consumers	High
Risks	This option does not reflect the business models operated by some providers, particularly those which provide detailed advice processes and rules for their representatives to follow (including templates, checklists, questions to ask the consumer, products to recommend) with limited discretion available to the representative. Accountability would therefore be placed on a party with limited ability to manage processes or risks.		
Net impact	Overall, this option may limit the availability of advice and would not place accountability with the party best able to manage risks.		

Option 2A: Ability for firms to take on all accountability for advice

Rather than requiring all advisers to be individually accountable for their advice, a firm could assume responsibility for complying with legislative obligations (akin to the current QFE model). This option recognises that some firms may set strict controls around the advice process for some of their representatives such that the representative's exercise limited individual discretion. In these situations it is predominantly the firm's controls that determine consumer outcomes and compliance with legislative obligations.

Unlike the status quo, under this option these representatives would be labelled 'agents' to distinguish them from other financial advisers. This reflects their limited discretion and clearly links them to the firm to help the consumer understand the connection to the firm, which is accountable for the advice. For example, agents working for ANZ bank would need to disclose that they are agents for ANZ and could not call themselves financial advisers. 'Financial adviser' would become a term restricted to those who are individually accountable for the advice they provide.

	Impact	Incidence	Magnitude
Costs	• There will be some costs for QFEs	QFEs	Unknown

	which will need to change their marketing material, disclosure statements and information they provide to consumers.		
Benefits	• The use of 'agent' should provide clarity to consumers that these representatives are following the firm's processes and that their advice is limited accordingly.	Consumers	Unknown
	• Will retain the efficiencies gained by holding firms accountable for the advice processes they set and allowing the FMA to monitor compliance at the firm level.	QFEs and FMA	Unknown – possibly high
Risks	• There is a risk that, without individual accountability, some advisers may remain incentivised to sell products that are not necessarily putting a consumer's interests first. This could be mitigated by the additional obligation detailed in Option 2B.		
Net impact	• While the magnitude of costs and benefits are somewhat unknown, there is expected to be a net benefit. This option will retain the efficiencies of the current QFE model by enabling firms to assume accountability where they set advice processes for its staff to follow. It will also improve the level of consumer understanding by clearly differentiating between 'advisers' and 'agents'.		

Option 2B: Obligation for firms to ensure they do not incentivise their representatives to sell a product in a way that does not put the consumer first

Under this option, firms that were accountable for the advice of their representatives (i.e. this option works in combination with Option 2A) would be subject to an additional legislative obligation to ensure they are not incentivising their representatives to sell products without regard to the consumer's interests. This would require a firm to recognise potential conflicts of interest – such as the role of incentives in sales and advice – and develop plans to effectively manage such conflicts of interest.

This option aims to address concerns about firms incentivising their staff to sell financial products without sufficient regard to whether it is in the consumer's interest. Unlike the options aimed specifically at conflicted remuneration, this option addresses other incentive arrangements, like direct sales incentives to staff or sales targets informally forming part of staff performance assessments.

	Impact	**Incidence**	**Magnitude**
Costs	Would impose some costs on QFEs to identify conflicts and ensure their sales and advice processes have sufficient regard to the consumer's interest.	QFEs	Low – moderate
Benefits	Would improve financial outcomes for consumers, by increasing the likelihood that advice puts their interests first and decreasing the likelihood of conflicted remuneration driving advice.	Consumers	High
Net impact	This option is expected to provide a net benefit. It will go some way to address the concerns under the current QFE model of QFEs incentivising their staff to sell financial products without sufficient regard to whether it is in the consumer's interest.		

Option 3 Dual accountability between the firm and the adviser

Under this option, a firm will be held accountable for ensuring that the processes and systems that it puts in place support their financial advisers to meet their legislative obligations. For example, a firm should ensure its advisers have the capacity a support to undertake relevant training and that processes are in place to enable compliance with the conduct obligations. Meanwhile, under this option, an individual adviser will be accountable for their individual advice.

This option recognises that both advisers and the firms are likely to influence the quality of advice.

	Impact	Incidence	Magnitude
Costs	Could result in additional costs for some firms that may need to update systems and processes to ensure compliance (some firms will already have such systems and processes in place).	Firms that hire AFAs and RFAs	Low to high (depending on the current business arrangements)
Benefits	Would improve the quality of advice to consumers by ensuring that all parties with an ability to control the quality of advice are accountable.	Consumers	High
	May provide benefits to financial advisers employed by multiple-adviser firms. These advisers may receive increased support to comply with their obligations.	AFAs and RFAs	Unknown – possible moderate
Net impact	While the costs of this option are unknown, we expect it to provide a net benefit to consumers. It will increase the likelihood of financial advice improving outcomes by ensuring that all parties with an ability to control quality are accountable.		

Assessment of options against criteria (relative to the status quo) and summary of cost/benefit/risk analysis

	Increases consumer understanding of what they're getting and how best to respond	Improves the availability of advice	Improves the quality of advice	Reduces undue compliance costs or barriers to innovation	Contributes to the achievement of best practice regulatory design principles	Net assessment of costs, benefits and risks
Option 1: All advisers are individually accountable for their advice	May increase consumer understanding by removing the current inconsistency. ✓	Could significantly limit the availability of advice provided by QFEs. ×	Stronger incentive on those within a QFE to adhere to the consumer first obligation and hence greater likelihood that the consumers' interests will be prioritised. ✓	May impose undue costs on QFE advisers. ×	Does not directly target party with ability to manage risks, therefore not proportionate. ×	Expected to deliver net cost to QFEs and limit the provision of advice overall. ×
Option 2A: Ability for firms to take on all accountability for advice	Renaming those individuals who are not accountable for the advice they provide 'agents' should improve consumer understanding. ✓	~	~	~	Proportional option - likely to cause minimal disruption to QFEs while providing clarity to consumers. ✓✓	Net benefit. Will go some way to addressing current problem where it is not always transparent to the consumer the where the accountability lies. ✓
Option 2B: Obligation for firms to ensure they do not incentivise their representatives to sell a product in a way that does not put the consumer first	~	~	Would increase the likelihood that advice put their interests first and decreases the likelihood of conflicted remuneration driving advice. ✓✓	~	Creates a more proportional response than both the status quo (which does not impose clear conduct obligations on a QFE) and Option 1 (which does not take account of different business models). ✓	Expected to provide a net benefit. It will go some way in addressing concerns of QFEs incentivising their staff to sell financial products without sufficient regard to whether it is in the consumer's interest. ✓

Key
✓✓ Significant improvement on the status quo
✓ Improvement on the status quo
× Inferior to the status quo
~ No impact relative to the status quo
☐ Shaded row = preferred option

	Increases consumer understanding of what they're getting and how best to respond	Improves the availability of advice	Improves the quality of advice	Reduces undue compliance costs or barriers to innovation	Contributes to the achievement of best practice regulatory design principles	Net assessment of costs, benefits and risks
Option 3: Dual accountability between the firm and the adviser	~	~	Would increase the likelihood that advice put their interests first by ensuring all of those able to impact the quality of advice are accountable. ✓	Could reduce compliance costs for some advisers who may receive increased support to comply with their obligations. ✓	Proportional option – will ensure that those who are able to influence the quality of advice are accountable while not requiring representatives who follow a process to be held accountable. ✓	Expected to provide a net benefit to consumers. It will increase the likelihood of financial advice improving outcomes by holding firms accountable for the systems and processes they impose on financial advisers. ✓

We support Options 2A, 2B and 3 in favour of Option 1 because we think it is reasonable to allow firms to continue to take on accountability on behalf of its representatives. This is appropriate for firms where representatives are largely required to follow the firm's processes with limited individual discretion. In this instance, it is the firm who manages risk through the setting of advice processes and incentives. However, we recommend an additional obligation should apply to firms who assume all accountability for the advice to ensure its representatives are not incentivised to sell products without regard to the consumer's interests. This would require a firm to recognise potential conflicts of interest.

Key
✓✓ Significant improvement on the status quo
✓ Improvement on the status quo
× Inferior to the status quo
~ No impact relative to the status quo
☐ Shaded row = preferred option

3.4 Disclosure and Client Care

Status Quo

Disclosure is an important tool for addressing the information asymmetry inherent in financial advice and ensures that consumers have sufficient information about their adviser before engaging their services.

The FA Act sets out disclosure obligations that relate to QFEs and financial advisers. All financial advisers and QFEs are required to disclose certain information about their firm and the nature of services they provide prior to providing a personalised service to a retail client.

AFAs are also required to disclose more detailed information on the nature of services they provide, signify how many provider's products they can consider, details of all other conflicts of interest and relevant information regarding competency and conduct.

RFA disclosure statements include a short statement detailing the type of advice they can provide but are not required to disclose details of any conflicts of interest or the number of providers that they are able to consider prior to giving financial advice.

Problem: Current disclosure requirements do not help a consumer choose an adviser

Consumers receive insufficient information about the services the financial adviser can provide

The different disclosure requirements can result in consumers making incorrect assumptions about the services an adviser can provide prior to engaging their services.

Advice can be limited by the types of advice that an adviser can provide (e.g. comprehensive financial planning or advice on life insurance only), the number of providers whose products they can consider and the extent to which the adviser considers a cleint's personal circumstances.

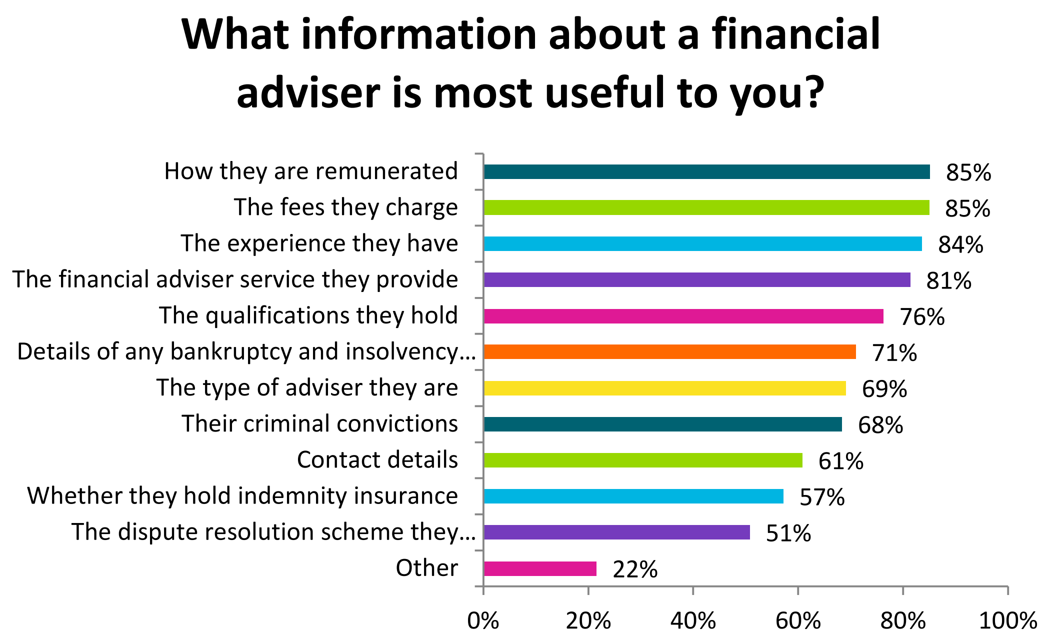
While a consumer receiving advice from a bank might reasonably expect that they will only be receiving advice on the bank's product, this is less apparent when a consumer meets an adviser not directly aligned to a product provider. RFAs are not required to disclose information on the number of providers whose products they consider which could result in consumers not being aware of these restrictions.

There is anecdotal evidence that some advisers tend to place the majority of their clients with one or two providers, despite being able to consider the products of multiple providers.

Consumers receive insufficient information about the financial adviser

AFAs are required to disclose numerous details regarding recent bankruptcy, insolvency or relevant disciplinary proceedings they have been subject to. QFEs and RFAs are not required to disclose these details. Respondents to the Consumer Questionnaire on the Options Paper showed that this information is important to consumers, as shown in the below table.

Table 4 - Response from Options Paper Consumer Survey, March 2016



Current disclosure documents are legalistic and overly complex

Submitters have expressed concerns at the length of the current disclosure documents which are frequently legalistic and overly complex.

> *"For more sophisticated customers the disclosure has meaning. BNZ is concerned however that retail customers view this as just part of the process and it is not perceived as providing significant value. Customers see it as a compliance process that the banker must complete rather than a value tool for the customer."* – BNZ, Submission on Issues Paper, July 2015

Any changes in disclosure requirements will need to ensure that these current concerns are not exacerbated. MBIE will work with consumer and industry bodies to ensure that an appropriate balance between sufficient levels of information and simplicity is achieved.

MBIE has considered options intended to address concerns that the terminology in the current regime is misleading to consumers. However, in most instances we found the root cause to be the tiers of requirements rather than simply the terminology. Therefore, options to re-name AFAs and RFAs are not included below.

Option 1: Require all advisers to complete full disclosure documents

Under this option, all those providing a financial advice service would be required to provide disclosure documents containing all information relating to the nature of the services they provide. This would include details of their competency, any relevant conduct issues, all conflicts of interest and conflicted remuneration in one document. The content, format and timing of the disclosure would be prescribed in regulations. The exact information contained would vary depending on the business model to ensure relevance for consumers.

	Impact	Incidence	Magnitude
Costs	• Would increase the cost of preparing and maintaining disclosure documents for some advisers which currently have limited disclosure requirements.	Advisers (mainly RFAs)	Moderate
	• Would lead to long documents which are difficult for consumers to understand. We have heard through submissions that the current AFA disclosure documents are generally not read nor understood by consumers.	Consumers	Moderate
Benefits	• Would lead to more consistency across the industry and increase transparency for consumers.	Consumers	Moderate
Risks	• Due to the wide ranges of services on offer from some advisers (and the complex remuneration structures as described in section 3.3) there is a risk that the disclosure documents would become long and cumbersome (as has occurred in some overseas jurisdictions). This would have a detrimental impact on consumer understanding. • There is also a risk that the information would be presented in such a way that it is not readily understood by consumers. • These risks could be mitigated by imposing size restrictions, and prescribing the layout of certain categories of information.		
Net impact	• While complete disclosure documents would improve the level of transparency, there is a significant risk that these documents would provide little real value to consumers (due to their length and complexity).		

Option 2: Introduce a simplified disclosure document

This option would introduce a more prescriptive format of disclosure where the most important information is contained in a standardised single page. The content, format and timing of disclosure will be determined through consultation with industry and consumer groups and will be prescribed in regulations. This could include clear and concise disclosure remuneration (refer to option 4A in section 3.3), the nature of the service the adviser can provide, an indication of the extent of the market they can consider and other relevant information regarding competency and conduct issues. More detailed information could sit behind this document should it be necessary.

	Impact	Incidence	Magnitude
Costs	• Would increase the cost of preparing and maintaining disclosure documents for some advisers (which currently have limited disclosure obligations). However, it is expected that the cost of maintaining	Advisers (mainly RFAs)	Moderate

	these simplified disclosure documents would be relatively low.		
Benefits	• Would increase transparency for consumers and aid comparability between different advisers.	Consumers	High
	• Would reduce the costs of producing and maintaining two disclosure documents.	AFAs	Low
Risks	• There is a risk that disclosing the extent of the market an adviser can consider may be misleading in instances where advisers may be able to consider the products of multiple providers but, in practice, place the majority of their clients with fewer providers. This would be mitigated through clear guidance to ensure consistency across advisers. • There is a risk that an overly prescriptive format may prevent meaningful disclosure through different channels (ie. through robo-advice or over the phone). Some flexibility would therefore be necessary. • There is also a risk that the information would be presented in such a way that it is not readily understood by consumers. MBIE would look to mitigate this by working with industry and consumer groups to design documents that are as effective as possible.		
Net impact	• The benefits to consumers, who would have more accurate information in a simplified format, would outweigh the cost of preparing and maintaining disclosure documents. This option is likely to have a net-benefit over time as it will reduce the current undue compliance costs of producing lengthy, complex documents which offer limited value to consumers.		

Option 3: Principles based approach to disclosure

This option would aim to provide greater flexibility to ensure that disclosure can be provided through different channels. It would specify the information that all advisers must disclose, but would not prescribe how this information is to be presented.

	Impact	**Incidence**	**Magnitude**
Costs	• Would increase the cost of preparing and maintaining disclosure documents for some advisers (which currently have limited disclosure requirements).	Advisers (mainly RFAs)	Low
	• This option could result in an increase in costs for the FMA as it would need to produce guidance and disclosure documents themselves may require approval.	FMA	Moderate
	• Could reduce the relevance comparability of disclosure documents due to the lack of consistency.	Consumers	Moderate
Benefits	• Would increase transparency for consumers and ensure that appropriate disclosure can be provided through different channels.	Consumers	High
Risks	• There is a risk that the information would be presented in such a way that it would prevent comparability and not be readily understood by consumers, exacerbating the current problems. This would be partially mitigated by the production of clear guidance but would also require increased monitoring by the FMA.		
Net impact	• Flexibility would ensure that disclosure can be tailored to the advice channel. However, given the risk of consumers not understanding the information, the costs to the industry and government would appear to outweigh the benefits to consumers under this option.		

Assessment of options against criteria (relative to the status quo) and summary of cost/benefit/risk analysis

	Increases consumer understanding of what they're getting and how best to respond	Improves the availability of advice	Improves the quality of advice	Reduces undue compliance costs or barriers to innovation	Contributes to the achievement of best practice regulatory design principles	Net assessment of costs, benefits and risks
Option 1: Require all advisers to complete full disclosure documents	Improvement to the status quo where some advisers provide limited disclosure. However it is likely to result in long, complicated disclosure documentation. ✓	~	~	The cost of producing disclosure documents would increase significantly on the majority of advisers. ×	Would limit flexibility and the scope would not be proportional to the benefits. ×	While complete disclosure documents would improve the level of transparency, these documents would provide little additional value to consumers. ~
Option 2: Introduce a universal, simplified disclosure document	Would be a significant improvement to the status quo. Consumers would have access to more information presented in a clear and concise form. ✓✓	~	~	Would be an increase in compliance costs for some advisers, however disclosure documents would become more meaningful to consumers ~	Would allow some flexibility and is proportional to the benefits. ✓	The benefits to consumers, who would have more accurate information, would outweigh the cost of preparing and maintaining disclosure documents. ✓
Option 3: Principles based approach to disclosure	Would increase the level of information available to consumers but may reduce their understanding and ability to compare documents. ✓	~	~	Would reduce costs/production of cumbersome disclosure documents *but* will impose costs on firms to develop documents and the FMA to approve them. ×	Flexible and proportional to the benefits but provides less certainty. ~	Given the risk of consumers not understanding the information, the costs to the industry and government would appear to outweigh the benefits to consumers under this option. ×

We favour Option 2 as it is the most likely option to result in consumers receiving useful disclosure documents that are readily understood. Submissions on the Options Paper generally favoured the idea of a common disclosure document for all advisers. MBIE will work with the industry and consumers to ensure that the information is disclosed in a meaningful way. Some flexibility would need to be incorporated to enable suitable disclosure when advice is provided through various channels (e.g. through a robo-advice platform).

Key
✓✓ Significant improvement on the status quo
✓ Improvement on the status quo
× Inferior to the status quo
~ No impact relative to the status quo
☐ Shaded row = preferred option

Problem: Consumers are unaware of the limitations of the advice they receive

Consumers may not be receiving sufficient information about the limitations of the advice they have received at the point of receiving a recommendation.

The Code of Professional Conduct sets out certain standards which are designed to ensure minimum standards of client care and consumer understanding. For example, AFAs must ensure that consumers understand the limitations of the advice they receive.

RFAs are not required to detail the scope of service provided. Similarly, consumers may be unaware of the limitations associated with 'class' advice and may be unaware of the consequences of being deemed a 'wholesale' client.

Option 1: Introduce a mandatory Statement of Advice

Under this option all financial advisers would be required to complete a prescribed Statement of Advice document when providing a personalised service to a retail client. The Statement of Advice would specify the basis for the advice, and limitations of the advice (e.g. the number of classes of financial products considered; the number of providers considered; and the client circumstances and goals that were considered), any risks, and other relevant information that the consumer may require in a prescribed format. The Statement of Advice would also include disclosure of the conflicted remuneration that the adviser expects to receive as a result of the advice in a prescribed format (refer to option 4A in section 3.3).

Given the wide range of financial advice services and channels that exist within the regime it would be necessary to develop prescribed Statements of Advice tailored to different advice situations.

	Impact	**Incidence**	**Magnitude**
Costs	• Would significantly increase the cost of providing advice in many cases.	Advisers	High
	• Is likely to lead to delays in the advice process.	Consumers	Moderate
Benefits	• Would benefit consumers who would be provided clear information on the basis of the recommendation they receive. However, the Statements are likely to be long and complex and may not be easily read/digested by consumers.	Consumers	Low to Moderate[24]
	• Would provide clarity to advisers of what is expected in the advice process.	Advisers	Low
Risks	There is a risk that, in order to facilitate all financial advice situations, a prescribed Statement of Advice would be overly complex or that it would be unnecessary in simple advice situations. This could be mitigated by developing alternative documents which could be completed where applicable.		

[24] Advisers in Australia are required to provide a Statement similar to that described in this option. A template example provided by ASIC runs to 12 pages and would need to be updated for each advice scenario. This may run counter to our aims of simplifying information to consumers and ensuring there are no undue barriers to providing advice.

Net impact	The costs of this option would appear to outweigh the benefits to consumers. Given the significant variance in financial advice services, this option would likely lead to significant delays in the advice process despite the ability for advisers to tailor the document to the situation.

Option 2: Require all providers of advice to ensure consumers are aware of the limitations of financial advice

Rather than the prescriptive approach in Option 1, under this option all advisers would be subject to a broad obligation to ensure their clients are aware of the limitations of the advice at the point of making a recommendation. Advisers would be provided greater flexibility to ensure that consumers have the appropriate level of information for the particular situation. In some instances this may result in the production of a document similar to the Statement of Advice described above, but this would not be mandatory. For example, an adviser would be required to confirm:

- the number of classes of financial products considered (e.g. life insurance and/or Kiwisaver);
- the number of providers considered; and
- the client circumstances and goals considered.

An adviser would also be required to ensure that the consumer is aware of the limitations of services such as 'class' advice or that they may lose protections (i.e. as a consequence of being deemed a wholesale client).

A Code of Conduct would provide further detail on how financial advisers comply with this legislative obligation.

	Impact	Incidence	Magnitude
Costs	• Could lead to delays in the advice process	Advisers and Consumers	Low
	• Additional cost on RFAs and QFEs (when providing personalised advice on a Category 2 product) who are not subject to these obligations	RFAs and QFEs	Moderate
	• Would require the FMA to produce guidance and complete additional monitoring	FMA	Moderate
Benefits	• Would provide greater transparency to consumers who would have more information.	Consumers	High
	• Flexibility would ensure that the appropriate level of information is provided given the nature of the service provided	Advisers	High
Risks	• There is a risk that some information would not be provided to consumers, or that it would be provided in a way that is not readily understood by consumers. This would be mitigated through the production of guidance.		
Net impact	While there will be additional costs to the FMA and industry in some instances, there are significant benefits to consumers.		

Option 3: Require consumers to 'opt-in' to being deemed a wholesale client

This option would require consumers to classify themselves as being a wholesale client, rather than automatically being treated as a wholesale client if they meet the criteria under the Act.

	Impact	Incidence	Magnitude
Costs	• Would increase the cost of compliance for advisers.	Advisers	High
	• Would cause delays in the advice process where consumers are required to determine their classification.	Consumers	High
Benefits	• Would provide greater transparency to consumers and prevent relatively unsophisticated clients being deemed a wholesale client.	Consumers	Low
Net impact	On balance, the additional compliance costs imposed on advisers who deal with genuinely wholesale clients (such as institutional investors) are disproportionate to the benefits for consumers. The definition of wholesale clients is currently relatively narrow and the likelihood of consumers being inappropriately classified as wholesale clients is relatively small.		

Assessment of options against criteria (relative to the status quo) and summary of cost/benefit/risk analysis

	Increases consumer understanding of what they're getting and how best to respond	Improves the availability of advice	Improves the quality of advice	Reduces undue compliance costs or barriers to innovation	Contributes to the achievement of best practice regulatory design principles	Net assessment of costs, benefits and risks
Option 1: Introduce a mandatory Statement of Advice	Would increase consumer understanding. ✓	~	~	This may result in an increase in undue compliance costs if the Statement of Advice is overly complex and not readily understood by consumers. ~	May not be flexible or proportionate to the problem. ×	The costs of this option would outweigh the benefits to consumers. ×
Option 2: Require all providers of advice to ensure consumers are aware of the limitations of financial advice	Would increase consumer understanding. ✓	~	~	Should reduce undue compliance costs by imposing a similar requirement on RFAs that AFAs are currently subject to. ✓	Option is flexible and proportionate. Advisers would be able to tailor any documentation to suit the consumer's needs. ✓✓	While there will be additional costs to the FMA and industry, there are significant benefits to consumers. ✓
Option 3: Require consumers to 'opt-in' to being deemed a wholesale client	Would ensure that consumers are aware that they may lose protections as a result of being a wholesale client. ✓✓	Could increase compliance costs and, in turn, reduce accessibility to advice. ×	~	Will increase compliance costs for advisers dealing primarily with wholesale clients. ×	Does not meet best practice regulatory principles. ×	Would impose costs on the industry that are disproportionate to the benefits for consumers. ×

We favour the principles based approach to addressing the problem in Option 2 rather than Option 3 which will impose significant, disproportionate costs on the industry and may not give consumers simple and digestible information.

Key
✓✓ Significant improvement on the status quo
✓ Improvement on the status quo
× Inferior to the status quo
~ No impact relative to the status quo
☐ Shaded row = preferred option

3.5 Competency

Status quo

Different competency requirements apply to different advisers:

- RFAs are not subject to any competency requirements.
- In applying for QFE status, prospective QFEs are required to set out their procedures for training and setting standards for employees and nominated representatives, and for monitoring those standards. Guidance from the FMA states that QFEs should have governance and compliance arrangements in place to ensure individual advisers are supported to achieve and maintain the right level of knowledge, skill and competence.
- AFAs must meet the minimum standards of competence, knowledge and skills as specified in the Code of Professional Conduct for AFAs. Currently this requires all AFAs to:
    - fulfil an overarching competence requirement,
    - have knowledge of the FA Act, the Code, and other legal obligations relevant to the operation of their practice, and
    - attain the unit standard set within the National Certificate in Financial Services (Financial Advice) (Level 5) (or alternative qualification) that are relevant to their services.

Problem: Competency requirements are not always proportionate to advice complexity

Current competency requirements for different advisers are not proportionate to the knowledge and skills needed to provide the financial advice services they can offer. In particular, RFAs who provide potentially complex financial advice on products such as life insurance are not subject to any competency requirements.

Without appropriate competency requirements there is a risk that some advisers may not have the capabilities required and cumulatively this could cause significant, potentially irreversible harm to consumers. It is also thought to be inhibiting public confidence in the professionalism and integrity of financial advisers.

The options below are not mutually exclusive and any combination of options could be bound together to create a complementary suite of changes.

Option 1: Introduce a broad competency obligation for all providers of advice

Under this option, there would be a broad legislative requirement on all advisers to only provide financial advice services where competent to do so. This competency obligation would be drafted at a high level of generality so it could be applied flexibly to a wide-ranging profession and remain appropriate in the future.

	Impact	Incidence	Magnitude
Costs	• Would require individuals/firms to work	Advisers (especially sole	Moderate.

	out standards for themselves which would result in duplication of effort and cost.	traders or smaller firms)	
	• Would lead to an element of inconsistent interpretation across the profession.	Consumers	Moderate
	• Would require active monitoring by the FMA to determine how well the obligation is being met.	FMA	Moderate
Benefits	• Should increase the likelihood that consumers receive competent advice and, in turn, reduce the likelihood of harm. • The obligation would be hard to manipulate so should promote behaviour that is consistent with the objectives of the obligation (assuming monitoring and enforcement measures exist).	Consumers	Moderate
	• Would enable flexibility for individuals/firms to determine how best to comply with the obligation. • May increase public confidence in the professionalism and skill of advisers and, in turn, increase demand for advice.	Advisers	Moderate
	• Would be durable and reduce the need for future amendment.	Government	Low
Risks	• Could create a lack of certainty for both consumers and the profession that the obligation is being met. This could be managed through guidance or supporting measures (e.g. more detail in the Code of Conduct as discussed in Options 2 and 3). • Could create a disincentive for advisers to strive for higher standards. Conversely it could lead advisers to adopt an overly cautious approach and reach higher than necessary standards (this would be more likely if the penalty of non-compliance was high e.g. through high sanctions).		
Net impact	Overall this option is likely to create comparable cost and benefit, however if combined with Options 2 and/or 3 its likely there would be a greater net benefit, to overcome the costs of uncertainty and inconsistency described above.		

Option 2: Require all financial advice providers to meet common standards of competence, knowledge and skill

Under this option, all advisers would be required to meet the same foundation competence, knowledge and skill standards. These standards would be relevant to all advisers irrespective of specialism. For example, relevant common standards might include knowledge of New Zealand's financial advice and consumer laws, and skills required to assess a client's financial situation.

These standards would be developed by the Code Committee in consultation with industry and include indicators and criteria relating to relevant qualifications and practical experience and knowledge.

	Impact	Incidence	Magnitude
Costs	• Would impose costs on advisers who would be required to meet new, higher requirements.	RFAs and possibly some QFE advisers (it is anticipated that AFAs would already meet these standards)	Moderate (depends on the exact requirements)
	• Would likely lead to an increase in the cost of advice services as the cost of additional training would be passed onto consumers.	Consumers – especially those with smaller sums to invest	Low (depends on the exact requirements)
Benefits	• May increase public confidence in the professionalism and skill of advisers and, in turn, increase demand for advice.	Advisers	Moderate
	• Should increase the likelihood that consumers receive competent advice and, in turn, reduce the likelihood of harm.	Consumers	Moderate
Risks	• Could lead to an increase in the cost of advice services if additional training is required and the cost of which is passed onto consumers.		
Net impact	This option would impose costs on advisers, particularly RFAs who do not currently have to meet any competency standards. However the costs should not be high and would be outweighed by the benefit of ensuring consumers receive advice from advisers who are required to meet foundation standards of competence, knowledge and skill, and increased public confidence in advisers/advice.		

Option 3: Introduce some competency, knowledge and skill standards specific to certain parts of the industry

Under this option, there would be competency, knowledge and skill standards specific to particular parts of the industry or products or services. Advisers who wished to provide advice in these areas would be required to meet the industry specific standards prior to providing those advice services. For example, life insurance advisers could be required to demonstrate knowledge of life insurance products and skill in managing replacement business.

These standards would be developed by the Code Committee in consultation with the profession and set out indicators and criteria relating to relevant qualifications and practical experience and knowledge. To support transition into different roles the Code Committee may wish to suggest stepped pathway models that enable advisers to commence work under supervision while building up experience and working towards additional standards.

	Impact	Incidence	Magnitude
Costs	• Would impose costs on advisers who would be required to meet new, higher requirements.	Advisers – especially RFAs but possibly AFAs and QFE advisers too	High[25]
	• Would likely lead to an increase in the cost of advice services as the cost of additional training would be passed onto consumers.	Consumers – especially those with smaller sums to invest	Moderate (depends on the exact requirements)

[25] Depends on the exact requirements. For example, $3,000 per adviser based on current minimum standard of National Certificate in Financial Services Level 5.

Benefits	• Industry specific standards would be directly beneficial for advisers career and business development. • Should increase public confidence in the professionalism and skill of advisers and, in turn, increase demand for advice.	Advisers	Moderate
	• Should increase the likelihood that consumers receive competent advice and, in turn, reduce the likelihood of harm. • Should improve the public's perception of the value of advice and therefore their willingness to get it.	Consumers	High (depends on the exact requirements)
Risks	• If standards are set at higher than necessary levels artificial skill shortages could be created, competition reduced - increasing costs for consumers and reducing accessibility of advice. • If standards aren't high enough the risk of harm from incompetent advice would remain and the profession could continue to be devalued. This risk (and the above) can be mitigated by ensuring that standards are set by industry with industry. • If training can only be provided by a small group of institutions there would be implementation difficulties and increased costs. This risk could be mitigated by providing flexibility for how advisers are required to meet new standards.		
Net impact	This option would impose costs on advisers, particularly RFAs who do not currently have to meet any competency standards. However the costs are likely to be outweighed by the benefit of ensuring consumers receive advice from appropriately qualified advisers and increased public confidence in advisers/advice.		

Option 4: Require all advisers to have a degree level qualification

Under this option, all advisers would be required to have a relevant degree level qualification prior to joining the profession. The relevant degree qualifications would be determined by the Code Committee in consultation with the profession.

This option could be combined with transitional or grandfathering provisions for existing advisers who would be required to demonstrate competency through proven experience and assessments or examinations to a similar.

	Impact	Incidence	Magnitude
Costs	• Would impose costs on existing advisers who would be required to prove competency through proven experience and assessments or examinations.	Advisers	Moderate
	• Could create an undue barrier to entry, discouraging potential advisers from entering. • Would likely lead to an increase in the cost of advice services as the cost of additional training would be passed onto consumers.	Consumers	High
	• Could increase the cost on the FMA to assess the level of competency for existing advisers.	FMA	High
Benefits	• Should increase the likelihood that consumers receive competent advice and,	Consumers	Moderate

	in turn, reduce the likelihood of significant harm. • Should improve the public's perception of the value of advice and therefore their willingness to get it.		
	• Traditional higher education such as degree qualifications do not necessarily provide students with the practical skills and competence required and may therefore not be a suitable means of assessing competency levels.		
Risks	• The varied nature of the financial services industry (with numerous specialities) means this option would impose significant costs on advisers and consumers without necessarily commensurate benefit in the quality of advice received. Other options such as relevant work experience and 'apprenticeships' enabled by option 2, 3 and 5 are likely to be more useful than a set tertiary level qualification.		
Net impact			

Option 5: Require all of those providing advice to meet continuing professional development standards

Under this option, all advisers would be required to meet continuing professional development (CPD) standards in order to demonstrate ongoing competence. The standards would be developed by the Code Committee in consultation with the profession and include requirements to:

- maintain a CPD plan for each CPD period, and
- undertake sufficient professional development activities to maintain competence at a level appropriate for the services the adviser provides or intends to provide.

It is expected that the standards would not be prescriptive and would recognise that competency means more than technical knowledge and that activities may come in many forms. CPD compliance would be monitored by the FMA, through mechanisms such as information returns, thematic reviews, and site visits.

	Impact	Incidence	Magnitude
Costs	• Would impose some costs on advisers to undertake / participate in professional development activities.	Advisers	Moderate (depends on the exact requirements)
	• Would impose costs on firms and the FMA to monitor advisers and ensure compliance with meeting the ongoing CPD standards.	Firms and the FMA	Unknown – likely low to moderate
Benefits	• Would ensure that advisers maintain and enhance the knowledge and skills needed and keep pace with changing trends and standards.	Advisers	Moderate
	• Should increase public confidence in the professionalism and skill of advisers and, in turn, increase demand for advice.	Consumers	Moderate
Risks	• There is a risk that some education providers could drive costs up further by promoting		

	expensive courses. • There may not be a suitable range of professional development activities available for or relevant to some areas of advice.
Net impact	This option would impose some costs on advisers but helping advisers continue to build knowledge and skills that are relevant and up to date will benefit both advisers and consumers. It would require supervision by firms and monitoring by the FMA to ensure that the standard is being met.

Option 6: Enable flexibility in how providers of advice demonstrate compliance with the competence, knowledge and skill standards

Under this option, instead of meeting the competence, knowledge and skill standards in the ways prescribed by the Code Committee, providers of advice could choose to demonstrate their compliance to the FMA another way. For example, larger firms could develop their own internal training programmes to ensure their advisers satisfy the relevant competence, knowledge and skill standards.

	Impact	**Incidence**	**Magnitude**
Costs	• Increased reliance on the FMA to ensure compliance.	FMA	Moderate
	• May increase costs for consumers in determining the competency of advisers and may prevent simple comparability between advisers.	Consumers	Unknown – potentially moderate
Benefits	• Provides flexibility for individual firms to develop and implement fit for purpose programmes at potentially less cost.	Larger financial advisory firms	High
Risks	• This option may lead to variability across the industry in the extent of training, knowledge and skills. This would be mitigated in part by the FMA (which would only licence those who could demonstrate that their tailored training achieved the equivalent standards).		
Net impact	This option would impose some additional cost on the FMA to ensure that advisers are complying with the standards but will be outweighed by the benefit created for advisers in giving them flexibility. The risk to consumers can be mitigated through the licensing process.		

Assessment of options against criteria (relative to the status quo) and summary of cost/benefit/risk analysis

	Increases consumer understanding of what they're getting and how best to respond	Improves the availability of advice	Improves the quality of advice	Reduces undue compliance costs or barriers to innovation	Contributes to the achievement of best practice regulatory design principles	Net assessment of costs, benefits and risks
Option 1: Introduce a broad competency obligation for all providers of advice	~	~	Should encourage advisers to ensure they are competent in providing advice and therefore improve the quality of advice. ✓	~	Option is proportional (as it removes the inconsistent requirement for advisers to be competent) and durable (as it is principles-based). ✓	Net benefit overall. Is likely to create comparable cost and benefit, however if combined with Options 2 and/or 3 its likely there would be a greater net benefit. ✓
Option 2: Require all financial advice providers to meet common standards of competence, knowledge and skill	~	~	Should lift the competency of advisers and improve the quality of advice. ✓✓	~	Option is proportional (as it removes the currently inconsistent requirement for advisers to be competent) and flexible (as standards are set in a Code which can be amended as required) while also providing certainty (through the setting of clear standards). ✓✓	Net benefit overall. Would impose costs on advisers. However the costs should not be high and would be outweighed by the benefit of ensuring consumers receive advice from advisers with foundation standards of competence, knowledge and skill. ✓✓
Option 3: Introduce some competency, knowledge and skill standards specific to certain parts of the industry	~	Could incentivise some advisers to leave the industry and reduce availability of advice. ✗	Should further lift the competency of advisers and improve the quality of advice. ✓✓	~	Option is proportional and flexible as it allows different tailored standards for different specialisations within the industry. ✓✓	Net benefit overall. Would impose costs on advisers. However the costs are likely to be outweighed by the benefit of ensuring consumers receive advice from appropriately qualified advisers. ✓✓

	Increases consumer understanding of what they're getting and how best to respond	Improves the availability of advice	Improves the quality of advice	Reduces undue compliance costs or barriers to innovation	Contributes to the achievement of best practice regulatory design principles	Net assessment of costs, benefits and risks
Option 4: Require all advisers to have a degree level qualification	~	Would likely push many advisers to leave the industry and reduce availability of advice ✗✗	Should increase the capabilities of advisers and therefore improve the quality of advice ✓	Would impose undue costs on advisers ✗	Would not be proportional or flexible ✗	Net costs overall. Would impose significant costs on advisers and consumers without commensurate benefit. ✗
Option 5: Require all of those providing advice to meet continuing professional development standards	~	~	Should maintain the competency of advisers and improve the ongoing quality of advice ✓	~	Option is proportional (as it removes the inconsistent requirement for advisers to undertake CPD) and flexible & durable (as the requirement is principles based and not overly prescriptive). ✓✓	Net benefit overall. Would impose some costs on advisers but helping advisers continue to build knowledge and skills that are relevant and up to date will benefit both advisers and consumers. ✓✓
Option 6: Enable flexibility in how providers of advice demonstrate compliance with the competence, knowledge and skill standards	~	~	~	Will help ensure that new competency requirements do not impose undue costs on firms ✓	Option is flexible as it allows different parts of the industry to meet the standards through flexible means. ✓	Net benefit overall. Would impose some additional cost on the FMA to ensure that advisers are complying with the standards but will be outweighed by the benefit created for advisers in giving them flexibility. ✓

Options 1, 2, 3, 5 and 6 are all preferred as together they will create a complementary package of improvements that lift adviser competency. The proposals, taken together, provide net benefits over the other proposals by enabling competency standards to be set in a way that is tailored to what an individual adviser does and some flexibility in the channels taken to prove competence (principles based rather than prescriptive). In the absence of an industry endorsed financial service degree qualification, this is seen as more likely to provide the requisite skills and knowledge encountered in practice without imposing significantly disproportionate compliance costs on advisers. They also provide certainty (e.g. through the standards set in Option 2 and 3) and flexibility (through Option 6).

Key
✓✓ Significant improvement on the status quo
✓ Improvement on the status quo
✗ Inferior to the status quo
~ No impact relative to the status quo
☐ Shaded row = preferred option

3.6 Licensing and oversight

Status quo

Different licensing and reporting requirements apply to the different tiers of advisers (as detailed in section 3.2):

Registered Financial Advisers

To become a RFA a person must be:

- a member of a dispute resolution scheme, and
- registered on the FSPR (which must be renewed annually).

Registration is largely an administrative exercise and does not imply any meaningful entry hurdle, oversight or reporting.

Qualifying Financial Entities

In addition to being a member of a dispute resolution scheme and being registered, to become a QFE a firm must comply with any conditions the FMA sets in granting QFE status. The current Standard Conditions for QFEs includes a requirement for prospective QFEs to submit an Adviser Business Statement (**ABS**) to the FMA as part of the application process. The ABS guide currently requires that QFEs describe their adviser firm and the governance and compliance arrangements to ensure the firm and its advisers operate professionally.

QFEs are also required to comply with a number of ongoing reporting obligations and must:

- maintain an ABS, and
- provide an Annual Report to the FMA.

QFE advisers do not have to be individually registered or authorised (unless they are an AFA working for a QFE).

Authorised Financial Advisers

In addition to being a member of a dispute resolution scheme and being registered, to become an AFA a person needs to be individually authorised by the FMA and must:

- meet a good character test,
- meet the minimum standards of competence, knowledge and skills as specified in the Code of Professional Conduct for AFAs (see section 3.3),
- comply with any conditions the FMA sets in granting authorisation. The current Standard Conditions for AFAs includes a requirement for an AFA to maintain an ABS although this is not required to be submitted to the FMA as part of the authorisation process.

AFAs are also required to comply with a number of ongoing reporting obligations and must:

- maintain an ABS which describes their adviser firm and the systems and procedures in place to ensure they conduct their business in a professional way, and
- confirm that their ABS is current by annually completing an Information Return that consists of a series of questions about AFAs, their business, and their approaches to compliance and continuing professional development every year.

Problem: Varying licensing and reporting requirements result in some advisers operating with limited regulatory oversight

Different licensing and reporting requirements mean that some advice services are regulated inconsistently. In particular a key concern is the lack of oversight of RFAs and the services they provide which is inhibiting effective monitoring and enforcement.

There are also thought to be some inefficiencies with the current reporting requirements of AFAs. For example, while AFAs are required to maintain ABSs these are only provided to the FMA on request and are thought to be imposing undue cost on industry and providing little benefit to consumers. There is an opportunity for the FMA to review its regulatory reporting requirements following decisions of this review.

Options 1 to 3 below are mutually exclusive alternatives for licensing financial advisers.

Common to each option, would be the requirement for prospective licensees when applying for a license to:

- show that they meet the relevant conduct (see section 3.3) and competency (see section 3.5) requirements, and
- adhere to any granting conditions as determined by the FMA (e.g. to have an ABS).

Also common to each option, would be the requirement for licensed financial advisers to adhere to any ongoing conditions as determined by the FMA. For example this may include reporting, accounting and notification requirements.

Option 1: Require a subset of advisers to be individually licensed

Under this option, all financial advisers except those who are representatives of QFEs would be required to be individually licensed by the FMA. QFEs would continue to be licensed at the firm level.

	Impact	Incidence	Magnitude
Costs	• RFAs would be required to apply for a license. Based on existing AFA authorisation application fees this would impose an upfront fee ($1,144.89). • Based on existing AFA renewal fees this would impose a five-yearly renewal fee ($572.44).	RFAs	High – a total cost to industry of $7 million for initial licensing and $3 million for renewal (based on current fees).
Benefits	• Would require advisers to meet advice process benchmarks which should improve the quality of advice and protect consumers against poor practice.	Consumers	Moderate

	• Should aid the move towards greater professionalisation of the industry.	Industry	Low
Risks	• Could push some advisers to leave the industry – particularly RFAs who would be most affected by the changes – reducing competition and access to advice, and potentially increasing the cost of advice.		
Net impact	Net cost. This option would impose significant costs on industry and government to individually license 8,100+ advisers which would likely be passed onto consumers in the form of reduced access to advice and increased costs.		

Option 2: Require all financial advice firms to be licensed

Under this option, all firms providing financial advice services (e.g. whether a QFE, medium sized firm, or sole trader) would be required to be licensed by the FMA. Individual advisers would still need to comply with the relevant registration, conduct and competency requirements but the firm would be responsible for holding the licence and engaging with the FMA. This would also provide an opportunity to introduce additional requirements on directors and senior managers of large financial advisory firms.

	Impact	Incidence	Magnitude
Costs	• RFA firms would be required to apply for a license. This would impose upfront and renewal fees.	Existing RFAs	Moderate
Benefits	• The direct cost of licensing will be reduced for AFAs. For example the cost of licensing a firm with 125 AFAs could be reduced from \$150,000 to as little as \$4886.22 (based on current QFE licensing fees). • Streamlined compliance activities for existing AFAs and newly licensed advisers will reduce costs and obligations.	Existing AFAs	High
	• Fewer licenses (approximately 515) but greater licensed advisers (approximately 31,100)	FMA	High
	• Would require some advisers to meet higher advice process benchmarks which should improve the quality of advice and protect consumers against poor practice.	Consumers	Moderate
Risks	• Could be perceived as an additional licensing requirement rather than an alternative to individual licensing. • Could be perceived as reducing individual accountability of financial advisers by shifting onus to the firm. These risks can be addressed by still holding financial advisers accountable via a Code of Conduct, as well as licensing conditions imposed by the FMA.		
Net impact	Net benefit - significant cost and monitoring benefits to consumers, government and industry by capturing all financial advisers under a licensing regime and having the firm take accountability for some activities whilst still retaining individual accountabilities.		

Option 3: Require all financial advisers to be licensed individually *or* as a firm

Under this option, all financial advisers would need to captured by a license, whether individually licensed or as an employee or representative of a licensed firm.

	Impact	Incidence	Magnitude
Costs	• Will create a more complex regime for industry and consumers to navigate and Government to implement.	Industry, Government, Consumers	Moderate
Benefits	• Provides flexibility for different business models to be licensed in a way that suits them.	Advisers	Moderate
	• Would require advisers to meet advice process benchmarks which should improve the quality of advice and protect consumers against poor practice.	Consumers	Moderate
Risks	• Existing AFAs who are already familiar with the current individual authorisation process may elect to continue to be licensed individually without regard to the benefits of firm licensing.		
Net impact	This option provides a benefit over the status quo but its effectiveness will depend on how advisers choose to respond and may still leave some adviser and consumer confusion through a hybrid regime (as currently exists under the current regime)		

Assessment of options against criteria (relative to the status quo) and summary of cost/benefit/risk analysis

	Increases consumer understanding of what they're getting and how best to respond	Improves the availability of advice	Improves the quality of advice	Reduces undue compliance costs or barriers to innovation	Contributes to the achievement of best practice regulatory design principles	Net assessment of costs, benefits and risks
Option 1: Require a subset of advisers to be individually licensed	~	Likely to drive some advisers out of the industry and reduce the availability of advice. ××	Should improve the quality of advice and protect consumers against poor practice. ✓	Would impose undue costs on the industry. ××	Is not proportionate, flexible or durable. ×	Net cost overall. Would impose significant costs on government and industry to individually license 8,100+ advisers which would be passed onto consumers in the form of reduced access to advice and higher costs. ××
Option 2: Require all financial advice firms to be licensed	~	~	Should improve the quality of advice and protect consumers against poor practice. ✓	Will reduce compliance costs through more efficient licensing. ✓✓	Is proportionate, durable, predictable and transparent. ✓	Net benefit overall. Provides significant benefits to consumers, government and industry more efficient licensing of the all financial advisers. ✓✓
Option 3: Require all financial advisers to be licensed individually or as a firm	~	~	Should improve the quality of advice and protect consumers against poor practice. ✓	Will reduce compliance costs through more efficient licensing. ✓	Is proportionate, flexible and durable. ✓	Net benefit overall. Provides a benefit over the status quo but its effectiveness will depend on how advisers choose to respond and whether to be licensed individually or at a firm level. ✓

Option 2 is preferred as it will provide the most efficient oversight and means of licensing of firms providing financial advice.

Key
✓✓ Significant improvement on the status quo
✓ Improvement on the status quo
× Inferior to the status quo
~ No impact relative to the status quo
☐ Shaded row = preferred option

3.7 Finding an adviser

Status Quo

A number of sources of information exist to help people find different types of advisers providing different products. The Government administered FSPR contains information on the registration status of financial advisers and details of the dispute resolution scheme they are a member of. Government also provides 'plain English' information tailored for the average consumer on what to look for when getting financial advice and tools to help decide investment appetite through the Commission for Financial Capability's (**CFFC's**) Sorted website. The FMA provides a list of those advisers and QFEs licensed with the FMA and warnings about advisers to avoid.

Industry associations provide information including 'find an adviser' search engines where consumers can search for advisers who are members of that particular industry association. Consumer groups provide basic information on things that consumers should know when looking for an adviser.

Problem - Consumers struggle to know where to find good quality financial advice

We heard through submissions that there is a lot of good information already in the public domain to help people find a good adviser, provided by financial service providers themselves, professional associations, consumer groups and Government agencies.

Despite this, evidence suggests that New Zealand consumers seem to not know where to start when finding and choosing quality financial advice[26]. It is unclear if the root cause of this are:

- insufficient information located in one place that consumers can easily access and understand and may help them filter a 'good' adviser from a potentially 'bad' one;
- the complexity and parameters of the current regime (including a lack of consumer friendly disclosure, and confusing terminology and categorisation of advisers and advice) meaning consumers may not get or understand the information that might help them find quality advice;
- low consumer awareness of existing publicly available tools and information to point them to quality advice; or
- A combination of the above.

Other, larger influencing factors could include consumer apathy, low levels of financial capability, high levels of trust in the opinions of friends and family, and continued mistrust of financial advisers.

Consumer feedback suggests New Zealand users do not tend to 'shop around' for a financial adviser and rarely investigate an adviser's credentials, instead relying on family and friends' recommendations, referrals or approaches by providers themselves[27].
Submitters generally agreed that a single, centralised source of information is still of value to consumers, though it needs to provide more useful information and be more consumer-friendly than the current FSPR[28]. Some submitters thought that there was the need for further information and

[26] See, for example, Commission for Financial Capability/FMA survey 2015 (http://www.cffc.org.nz/assets/Uploads/CFFC-FMA-Survey.pdf) MBIE Issues Paper Consumer Survey 2015, Colmar Brunton for MBIE 2015
[27] See Colmar Brunton for MBIE, 2015
[28] The FSPR receives around 20,000 searches a month. Most of these searches are targeted on the search function and home page rather than consumer information provided on the site (such as factsheets).

research into where consumers currently look for advice and how current providers of information can best collaborate to raise consumer awareness of existing tools and help them navigate the range of information on offer when looking for advice.

Option 1 - Develop a recognised portal for consumers that consolidates what they need to know about getting quality financial advice and where to find it

This option would see a centralised portal developed dedicated to helping show New Zealand consumers where they can go to find the advice they need. It would be specifically written for the average consumer and would consolidate information and links to existing relevant sites in one place. It could be a new, stand-alone website or could involve developing a better central repository of consumer focussed information on an existing website that already has some profile with consumers (such as www.sorted.org.nz).

This could be run and funded by Government or non-Government (eg. industry associations) or as a joint initiative between these parties. It could include a number of features that could help consumers, such as a find an adviser search engine (drawn from registration or licensing data) or a more sophisticated 'Find the right type of advice for you' tool that would allow consumers to go through a number of steps to find out what type of advice they are after, and what specialisations they need and would build on existing tools such as the Sorted website's 'Kiwi Saver Fund Finder' tool.

	Impact	Incidence	Magnitude
Costs	• Would require either a new stand-alone site to be developed, or an existing site to be amended to incorporate new information.	Government or industry	Moderate to High (depending on the sub option chosen and tools to be provided)[29].
	• Would require promotion of the new website.	Government, industry and consumer groups	Unknown
Benefits	• Would reduce consumer search costs - definitive place where can get a range of information on financial advice.	Consumer	Unknown
	• Would pool information from a range of sources to produce a single clear place that all parties can point consumers to	Industry associations, Advisers, Government & Consumers	Unknown
Risks	There is a risk that investment could be made and consumers may still not use the portal/page. May crowd out existing industry, government and consumer websites doing the same thing so would need to ensure government agencies, industry associations and consumer groups were involved in content development.		
Net impact	Unclear. Likely high benefits if well promoted but high cost to develop a new site and would not necessarily result in more consumer clarity. Development of existing information and tools on an existing recognised site such as Sorted would likely bring best net benefit. Ongoing need to ensure data relied upon is kept accurate and up to date as this portal would be promoted to the public. Would likely require Government investment to action.		

Option 2 - Amend the FSPR to make it a more consumer friendly tool to help consumers find an appropriate adviser

Under this option the existing FSPR would be restructured to be the main consumer portal for information on financial advisers and where to find them.

[29] Around $200,000 to develop a base website plus around $150,000 to provide one tool such as Sorted's KiwiSaver Fund Finder tool.

This option could involve some major content and structural changes to the FSPR to add information that consumers say they want to know when looking for an adviser and changing the structure, functionality and language of the current FSPR to make it a more easily navigable tool for the average person.

This option could involve:

- decluttering the existing Register web pages to make it easier for customers to navigate;
- adding additional information in Register records that consumers have said they would find useful (such areas of expertise, disciplinary history and membership of industry associations and adding new simplified disclosure statements to FSPR records);
- re-writing material on the website into plain English;
- making the limitations of the Register and the registration process clear;
- making deregistered adviser records more visible; and
- adding a 'by region' search function to allow people to find advisers in their region.

	Impact	Incidence	Magnitude
Costs	• Would cost approximately $250,000 to amend the FSPR to reflect the new regime, improve deregistration visibility and add basic consumer friendly functions such as a regional search function	Government	Moderate to High depending on extent of changes
	• Communications and media costs to promote revamped Register	Government, industry associations, regulators and wider industry	Moderate
Benefits	• FSPR can be promoted as a more reliable, user friendly consumer tool	Consumer, Government	Unknown, likely Moderate
	• More searchable information consumers want to know about advisers in one place	Consumer	Unknown, likely Moderate
Risks	Major changes might be made but NZ consumers still may not use the FSPR as the main way they find an adviser. Could be mitigated by stronger public awareness campaign to promote any revamped FSPR.		
Net impact	Unclear but likely neutral to negative. Not keeping with original intent of the FSPR as a registry tool. Costs likely to outweigh benefits. Consequential changes to the FSPR as a result of introducing a new simplified regime and MBIE's planned refresh of the FSPR would likely improve the consumer experience, without requiring additional changes. Other options are likely to get better consumer visibility.		

Option 3 - Better promote the sources of information available from different parties

This option would involve increased promotion of the different sources of information already available to consumers. This could be a collaborative plan between relevant government agencies, consumer groups and industry associations to deliver key messages to consumers about financial advice and advisers.

	Impact	Incidence	Magnitude
Costs	• Additional cost for the promotion and development of marketing material.	Government, industry associations, wider industry and consumer groups	Unknown
Benefits	• Consumers should get a clearer picture of the different roles of different parties	Consumer	Unknown, likely moderate

	working in, or impacting on, the delivery of financial advice.		
	• Collaborative approach may allow more progress on projects seen as needing delivery.	Government, adviser associations, regulators and wider industry	Unknown
Risks	Clearer messaging and a joint approach may still not reduce consumer confusion. Does not reduce the need for consumers to navigate multiple information sources.		
Net impact	Unknown but likely neutral to positive. Anticipated to be low cost but would rely on input and agreement from all parties.		

Assessment of options against criteria (relative to the status quo) and summary of cost/benefit/risk analysis

	Increases consumer understanding of what they're getting and how best to respond	Improves the availability of advice	Improves the quality of advice	Reduces undue compliance costs or barriers to innovation	Contributes to the achievement of best practice regulatory design principles	Net assessment of costs, benefits and risks
Option 1: Develop a recognised portal for consumers that consolidates what they need to know about getting quality financial advice and where to find it	Would reduce search costs for consumers when searching for a financial adviser, but would require significant promotion to increase consumer awareness ✓	~	~	~	~	Slight net benefit on status quo, especially if linked to an existing site (such as Sorted). Potentially costly set-up and maintenance so should be focussed on proven info gaps for consumers. ✓
Option 2: Amend the FSPR to make it a more consumer friendly tool to help consumers find an appropriate adviser	Would reduce search costs for consumers when searching for a financial adviser, but would require significant promotion to increase consumer awareness ✓	~	~	~	~	Slight net benefit on status quo. Not within the scope of the current FSPR platform. ✓
Option 3: Better promote the sources of information available from different parties	Would increase consumer awareness ✓	~	~	~	~	May result in slight benefit on the confusion of the status quo. Collaborative approach is valuable but ongoing marketing costs may still not make things clearer for consumers. ~

As it if difficult to determine what option might be most effective in addressing the problems, we recommend deferring a decision in this area until we:

- Determine the impacts of changes made to the FSPR to address misuse and consequential changes that may be needed as a result of other changes proposed in this RIS.
- Consumer test the changes we think might solve of the problems people have finding an adviser (such as improved disclosure, removing numerous tiers of advice and advisers).
- Determine the scope of the planned FSPR 'refresh' by MBIE's Companies Office.
- Work with industry and consumer groups to get a clearer idea of what information is needed by consumers to help them find an adviser and who is best to provide this information.

Key
✓✓ Significant improvement on the status quo
✓ Improvement on the status quo
× Inferior to the status quo
~ No impact relative to the status quo
☐ Shaded row = preferred option

4 Consultation

Formal consultation on the FA Act and FSP Act has been ongoing since May 2015. This has included:

- An Issues Paper published in May 2015 that sought public feedback on key issues with the regime and opportunities for change. Alongside the Issues Paper, a simplified consumer brochure was released, with a link to an anonymous, online questionnaire. A total of 166 submissions were received on the Issues Paper. 248 respondents completed the questionnaire attached to the consumer brochure.
- An Options Paper published in November 2015 that sought feedback on potential options for changes to the regulatory regime. A consumer brochure with an online questionnaire was released alongside the Options Paper. A total of 149 submissions were received on the Options Paper. 545 respondents completed the questionnaire attached to the consumer brochure.
- Three consumer focus groups to seek public views on what is and is not working well with the current regime and where they thought improvements could be made.
- Six public forums that were each attended by over fifty individuals.
- Ongoing, targeted consultation with industry associations, regulators, other Government agencies, consumer representatives, advisers, QFEs, compliance advisers and academics.

Responses from these consultation processes have been taken account and are reflected in this RIS.

Submissions received on both the Issues and Options Papers represented the views of a wide range of stakeholders, including firms, consumer representatives, dispute resolutions schemes, individual advisers, industry associations and general members of the public. MBIE has published the submissions received on both papers and summaries of the responses to the consumer questionnaire here: www.mbie.govt.nz/faareview.

MBIE officials analysed these submissions and the potential options for change to develop their policy recommendations. Throughout this process, officials engaged closely with the FMA, the Treasury and the CFFC as key affected stakeholders and continued consultation with stakeholders to further discuss submission points and test thinking.

A high level summary of feedback received in response to the Options Paper is outlined in the table below.

Table 5 – Summary of key themes from Options Paper submissions

General agreement	***Divergent views***
Some types of advice aren't being provided	
• Compliance costs and regulatory provisions are impacting the accessibility of advice. • Support for removing the class/personalised advice distinction. • Support for removing barriers to innovation e.g. robo-advice.	
Adviser conduct, competence and oversight	
• Anyone providing a financial advice service should be required to place the interests of the consumer first.	• Distinguishing between salespeople and advisers.

• Competency requirements should be increased and apply to all advisers. • There should not be different adviser types depending on product complexity as this would perpetuate confusion. • AFA standards (for conduct and competency) as set out in the Code of Professional Conduct are appropriate and there is scope for similar standards to be applied to all advisers. • There should be no ban on commissions due to concerns that this would create an advice gap.	• Whether increasing competency standards would create a barrier to entry. • The best way to measure or demonstrate competency (prescriptive or principles based). • What the minimum competency requirement should be and whether there should be a common standard for all. • Whether all conflicted remuneration should be disclosed and how – some suggested this could be difficult in practice due to the complexity of many remuneration structures.
Compliance costs are unbalanced	
• There are areas where compliance costs could be reduced, such as simplifying or eliminating ABSs and altering disclosure provisions.	• Whether licensing should be managed on an individual or entity basis.
Unnecessary complexity is preventing consumer understanding	
• Current terminology is complex and may be misleading to consumers. • Disclosure needs to be simplified, standardised and have flexibility around delivery. • There may be issues around consumers accessing and utilising information when looking for an adviser.	

5 Conclusions and recommendations

Achieving the objectives of the regulatory regime

To ensure the FA Act better meets the objectives identified, MBIE recommends that the following preferred options be implemented. These have been grouped according to the objective they most clearly contribute to.

Table 6 - How preferred options achieve the objectives for the FA Act regime

	Overall objective: Confident and informed participation of consumers in financial markets			
	Consumers can access the advice they need	**Advice makes consumers better off**		**Regulation is enabling with no undue compliance costs, complexity, or barriers to innovation**
		Improves consumer understanding of what they are receiving and how best to respond	**Improves the quality of advice, adviser conduct of and competence**	
Preferred Options	Enable robo-advice (with licensing and broadly the same controls as apply to traditional advice)	Improve the disclosure of conflicted remuneration by advisers	Universal conduct obligation to put the consumer's interest first	Provide greater clarity as to what is not financial advice
	Remove the class/ personalised advice distinction	Require product providers to disclose soft commissions paid	Code of Conduct to provide minimum standards of conduct and client care for all financial advice	Ability to designate activities as advice on basis of substance over form
	Remove the current distinction between Category 1 and 2 products – all financial products treated equally	Introduce simplified disclosure	Obligation for firms to ensure they do not incentivise their representatives to sell a product in a way that does not put the consumer first	Ability for firms to take on all accountability for the advice of their agents
		Require all providing advice to ensure consumers are aware of the limitations of financial advice	Introduce a broad competency obligation for all providers of advice	Dual accountability between the firm and the adviser
		Re-label representatives of a firm as 'agents'	Require all providers of advice to meet common standards of competence, knowledge and skill	Enable flexibility in how advisers demonstrate compliance with the competence, knowledge and skill standards
			Introduce some competency, knowledge and skill standards specific to certain parts of the industry	Require all financial advice firms to be licensed
			Require all advisers to meet continuing professional development standards	

MBIE considers the above preferred options represent a comprehensive package of changes that will make improvements on the current regime across the all the objectives identified. The key elements are to:

- Remove the regulatory boundaries which are preventing the provision of some types of advice. In particular, ensuring there are no barriers to the provision of robo-advice or advice that takes into account the clients particular situation or goals.
- Establish a level playing field of conduct and competency requirements. In particular, requiring all financial advisers to be held to a Code of Conduct that establishes appropriate client care, competence, knowledge and skill standards.
- Require anyone (or any robo-advice platform) providing financial advice to be subject to active regulatory oversight, and requiring this to be done at a firm level so it does not impose undue costs on industry or Government.
- Create two types of advisers – 'financial advisers' who would be individually accountable for complying with regulation and 'agents' who would be the responsibility of the firm which they are an employee or representative of.
- Remove unclear terminology and introduce simplified and common disclosure requirements to remove limitations on access to advice and ensure that consumers can access the right information in the right ways to make informed financial decisions.

Tables 7 and 8 illustrate the structure of the regime compared to the status quo.

MBIE considers that there are net benefits to these proposals being implemented as a package. For example, removing the distinction between class and personalised advice to allow any type of advice to be provided by a financial adviser needs to be supported by appropriate conduct, competency and licensing requirements to ensure consumer protection and certainty.

Some of the options contained in this RIS could be implemented as standalone options. However, a number of options are dependent on the implementation of other options as has been identified throughout the document.

Table 7 - Status Quo

Legislative obligations which apply to anyone providing a financial advice service

Must not engage in misleading or deceptive conduct; and must exercise care, diligence, and skill.

Minister responsible

- Responsible for legislation and FMA.
- Appoints FADC members.
- Approves dispute resolution schemes.
- Approves final Code of Professional Conduct.

Financial Markets Authority

- Approves QFEs and authorises AFAs.
- Monitors QFEs and AFAs.
- Approves the draft Code of Professional Conduct.

Appoints members

Code Committee for Financial Advisers

Members must be knowledgeable, experienced and competent in relation to consumer affairs and the financial adviser industry.

Authors, reviews and recommends changes to

Code of Professional Conduct

- Minimum standards of ethical behaviour.
- Minimum standards of client care.
- Minimum standards of competence, knowledge and skills.
- Minimum standards of continuing professional training.
- Competence alternatives.

Financial Advisers Disciplinary Committee

Hear conduct proceedings brought by FMA against AFAs.

Subject to

Required to apply similar standards to those in the Code of Professional Conduct in respect of Category 1 products

Authorised financial advisers
(Can provide personalised advice on Category 1 and Category 2 products)
Approx. 1,860

- Must be authorised to provide financial advice services.
- Must satisfy additional entry requirements including a good character test.
- Must meet standards in the Code of Professional Conduct.
- Must comply with any conditions the FMA sets in granting authorisation.
- Required to provide two disclosure statements to consumers.

Qualifying financial entities
(Can provide personalised advice on Category 2 products and on own Category 1 products)
Currently 56
Approx. 23,000 QFE advisers

- Must be approved to provide financial advice services.
- Must comply with any conditions the FMA sets in granting QFE status.
- Must apply for renewal every 3-5 years.
- Required to disclose some information to consumers.

Registered financial advisers
(Can provide personalised advice on Category 2 products only)
Approx. 6,400

- Limited disclosure obligations.

- Must be registered as a financial service provider.

Member of

Member of

Member of

Dispute resolution schemes
Resolve disputes and award compensation

Table 8- Proposed Regime

Legislative obligations which apply to anyone providing a financial advice service

- Must not engage in misleading or deceptive conduct; and must exercise care, diligence, and skill.
- Must place the interests of the consumer first (conduct obligation). (***NEW***)
- Must only provide advice where competent to do so (competence obligation). (***NEW***)
- Improved disclosure requirements (disclosure obligation). (***NEW***)
- Must ensure that consumers are aware of the limitations of their advice. ***(NEW)***

Minister responsible

- Responsible for legislation and FMA.
- Appoints FADC members.
- Approves dispute resolution schemes.
- Approves final Code of Conduct.

Financial Markets Authority

- Licenses financial advice firms.
- Monitors licensed financial advice firms.
- Approves the draft Code of Conduct.

Appoints members

Code Committee

Members must be knowledgeable, experienced and competent in relation to consumer affairs and the financial adviser industry.

The membership and proceedings of the Code Committee are to be reconsidered in a subsequent Cabinet paper (Sept 2016)

Authors, reviews and recommends changes to

Code of Conduct

- Prescribes in more detail how to comply with the legislative conduct and competence obligations
- Will include standards of conduct, client care, competence, knowledge and skill and continuing professional development requirements.
- Will detail prescribed courses which are deemed to comply with the standards of competence, knowledge and skill.

Financial Advisers Disciplinary Committee

Hear conduct proceedings brought by FMA against financial advisers.

Detail regarding FADC and the range of compliance and enforcement tools are to be considered in subsequent Cabinet paper (Sept 2016)

Subject to

Financial advice firms *(NEW)*

Unknown

- Must be registered as a financial service provider.
- Must be licensed to provide financial advice services (including robo-advice).
- May be a sole trader.
- Can engage financial advisers and / or agents.
- Accountable for its obligations under the legislation and code and the agents under its licence.
- Must ensure they do not incentivise their agents to sell products without regard to the consumer's interests.
- Must put in place processes and provide resources to assist their financial advisers to meet their obligations.

Financial advisers (restricted title) ***(NEW)*** Est. 3,000-8,000	**Agents *(NEW)*** Est. 20,000-25,000
• Must be registered as a financial service provider. • Accountable for complying with the legislative and code obligations.	• Must be titled using the descriptor 'agent'
• Must be engaged by a financial advice firm	

Member of

Dispute Resolution Schemes

Resolve disputes and awards compensation.

Options for improvements to scheme rules to be reported back to Cabinet (late 2016)

Net impacts

Overall, the net benefits of the preferred options are expected to outweigh the net costs. Table 9 below summarises the expected impact of the proposed changes on existing advisers, consumers and the Government.

Table 9 – Expected impact of proposed changes on key parties

Affected party	One off transactional impacts	Ongoing impacts
Authorised Financial Advisers (AFAs)	- Minor transitional costs associated with re-packaging compliance material (e.g. so that material covers the firm's approach to compliance rather than the individual's – note that for small firms and sole traders this will involve only very minor changes), updating disclosure documents, and applying for new licences. - Detailed transitional arrangements to be determined by September 2016.	- AFA could coordinate licensing activities at the firm level with potentially significant savings. E.g. lower direct licensing costs for a firm of 10 financial advisers who currently apply for 10 individual licences. - AFAs who work for QFEs would no longer need to be regulated twice (e.g. AFAs would not need to separately apply to the FMA for authorisation, since they would be covered by the firm's licence). - Savings associated with more efficient ongoing reporting and compliance activities through greater ability to utilise business-wide processes (and alignment with AML reporting requirements).
Qualifying Financial Entities (QFEs)	- Minor costs associated with updating compliance material to reflect conduct obligation and new disclosure material. - Minimal transitional impacts as proposal retains broad approach to regulating QFEs. - Detailed transitional arrangements to be determined by September 2016.	- Retains efficiencies of the QFE model (e.g. firms can take advantage of economies of scale and removes duplication) - Ensures firm processes are robust and are providing consumers with what they need - Costs associated with meeting, and demonstrating compliance with, conduct obligations (e.g. identifying conflicts of interest and ensuring their sales and advice processes have sufficient regard to the consumer's interest).
Registered Financial Advisers (RFAs)	- Costs associated with meeting higher competency standards. - Costs associated with obtaining a licence to provide financial adviser services and preparing new disclosure material. - Detailed transitional arrangements to be determined by September 2016.	- Costs associated with meeting the conduct obligations. - Costs associated with increased disclosure requirements. - Greater credibility and professionalism.
All advisers/consumers	- Costs associated with changing systems and processes to ensure ongoing compliance with new obligations. - During the transitional phase there could be confusion to consumers (as existing terminology is replaced and firms change their operating models to meet new standards).	- Technological innovations/robo-advice enabled - advice provided in a wider number of formats at lower cost. - Confusion and 'boundaries' created by complexity of status quo are removed - sensible advice conversations across a more open advice spectrum. - Access to more accurate, useful information from advisers including details of conflicts of interest. More flexible regime supports a range of business models, with more tailored conditions. - Enables the option of tailored competency requirements or the certainty of meeting prescribed standard.
Government (e.g. MBIE, FMA)	- Costs associated with ensuring systems can operationalise the preferred options.	- Fully monitored adviser population held to the same standards. - Allows more flexible risk-based monitoring

	- Costs to the FMA to produce new licensing guidance, processes, terms and conditions etc. - Costs associated with consequential changes to the FSPR. - Costs associated with producing a new Code of Conduct.	(rather than having to focus on limited areas where obligations currently apply) but holding a greater population of advisers to higher standards may be more resource intensive for the FMA. - Costs associated with producing guidance.

6 Implementation plan

The Bill and regulations are expected to come into force in late 2017.

If approved, MBIE anticipates a staggered approach to introducing the provisions in the Bill (for example, immediate introduction of the consumer first obligation but a longer transitional period to comply with increased competency standards). As set out below, MBIE will consult on appropriate transitional arrangements as one of the first priorities.

Consequential changes will also need to be made to the FSPR to reflect any changes to the existing regulatory structures (eg. removing 'QFEs' and introducing 'financial adviser firms' as a new category).

Successful implementation of the suite of preferred options will be dependent on the continued active participation and resource from a number of key parties, namely:

- Consumers and consumer groups - testing and refining disclosure statements, including how best to present conflicted remuneration.
- The FMA - development and implementation of operational policies, market guidance and enforcement tools.
- The Code Committee - developing and testing an expanded Code of Conduct, minimum standards for robo-advice, stepped pathway requirements, grandfathering provisions, and competency standards.
- Adviser associations and advisers - supporting development of ethical and competency requirements, disclosure documents and possible further tools for consumers to find quality financial advice.
- CFFC - development of possible further tools for consumers to find quality financial advice, and leading the Government's strategy to improve financial capability.

There are a number of factors MBIE wants to explore further and report back to Cabinet on by September 2016, namely:

- Transitional arrangements that might reduce the impact on existing advisers (in areas such as needing to meet competency standards). MBIE will work with industry to determine appropriate transitional arrangements.
- Elements needed to support the new regime, such as compliance and enforcement tools and, and the membership and proceeds of the Code Committee within the new regime.
- Complementary measures which could help address misuse of the FSPR.

7 Monitoring, evaluation and review

The impact of the proposals in this RIS will be monitored by MBIE, in close cooperation with the FMA, on an ongoing basis as part of MBIE's ongoing regulatory stewardship obligations. Moreover, MBIE's role as a member of the New Zealand Council of Financial Regulators (**COFR**) means impacts of the proposed changes will be monitored to ensure the changes made are resulting in a well-functioning financial markets regime. [

WITHHELD

] Other members of COFR (the FMA, the Reserve Bank of New Zealand and the Treasury) will continue to provide ongoing support to MBIE in monitoring of the impact of the proposals in this RIS.

Specific monitoring resources and activities that will be utilised in monitoring the effectiveness of this regime include:

- FMA and CFFC surveys into public confidence of financial advice.
- FMA information gathering and surveillance activities (as per FMA's current powers), for example, through setting continuous and periodic reporting requirements for advisers. [**WITHHELD**], the FMA would feed their intelligence back to MBIE as relevant to MBIE's regulatory stewardship obligations.
- Information on complaints received about financial advice, including received by the FMA and by the dispute resolution schemes.
- Ongoing engagement with key stakeholders including advisers, professional associations, dispute resolution schemes, consumer representatives, the Code Committee, and academics.

In addition to monitoring the overall effectiveness of the regime, there are some particular elements of the regime that MBIE will monitor (utilising the above resources and activities):

- The effectiveness of the proposals to address conflicts of interest (e.g. the 'consumer first' obligation, disclosure of conflicts of interest, a requirement for Financial Advice Firms to ensure they do not incentivise their Agents to sell products without regard to the consumer's interests) and whether these are sufficient.
- The impact the changes proposed in this paper are likely to have helping people find advice more easily and whether additional changes should be made to help consumers find advice.
- The availability and quality of financial advice that New Zealanders want and need through different channels.

- The development of the robo-advice industry and any associated risks that need to be managed or any unintended hurdles that should be removed.
- The legislative exemptions and any associated risks or concerns.