CHAPMAN TRIPP

TO: THE MINISTRY OF BUSINESS, INNOVATION AND EMPLOYMENT

ON: THE REVIEW OF THE FINANCIAL ADVISERS ACT 2008 AND THE FINANCIAL SERVICE PROVIDERS (REGISTRATION AND DISPUTE RESOLUTION) ACT 2008

INTRODUCTION

1 Thank you for the opportunity to submit on the Issues Paper: Review of the Financial Advisers Act 2008 and the Financial Service Providers (Registration and Dispute Resolution Act) 2008 (*Issues Paper).*

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2 Chapman Tripp is a leading New Zealand full service law firm with a strong practice in financial services, funds management, KiwiSaver, superannuation, insurance, banking and general corporate, commercial, property and tax advice. This submission reflects the views of the following specialists in our financial sector regulation team:

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3 We have been at the forefront of advising on the Financial Advisers Act 2008 (*FAA*) and Financial Service Providers Act (Registration and Dispute Resolution Act) 2008 (*FSPA*), as well as the Financial Markets Conduct Act 2013 (*FMCA*). Our clients include major banks, brokers, insurance companies and adviser networks. As a result, we have been exposed to the "sharp end" of the compliance outcomes the FAA and FSPA have driven, and have a deep insight into the issues, challenges and frustrations the industry has faced.

4 We have discerned a number of themes from our experience. We summarise those themes in the "Key Points" section below, before turning to our answers to the questions in the Issues Paper in **Schedule 1**.

KEY POINTS

5 **Complexity**
One of the concerns we had at the outset of the new FAA regime was the complexity created by the multiple "filters" in the regime (different service types; category 1/category 2; class/personalised; wholesale/retail). We have included a slide from a presentation we gave at the time in the **Appendix**, to illustrate that complexity. We believe that the review presents a unique opportunity to address that complexity to the benefit of consumers, and many of our submissions are targeted at that objective.

6 **Key points**
We see the key points as follows.

(a) **Consumers are not always able to access suitable products** because advisers are either nor permitted to advise on those products, or are reluctant to present them to clients for fear of breaching the FAA. The product may be suitable but does not "reach" the customer even if they do not want advice. There is a clear disconnect here – advisers are reluctant to advise, but customers do not always want advice. **We therefore support the proposal to distinguish between sales and advice.**

(b) **Consumers do not appreciate the difference between adviser types.** We support a move to a single category of adviser, with different levels of education required depending upon the types of products on which the adviser advises. There should be a minimum level of education for all advisers, with specific training required for, say, derivatives and other more complex products for

advisers who wish to advise on them. The exception to this model would be Qualifying Financial Entities (*QFEs*), where we think the model is generally sound and should continue, albeit with a clear boundary between sales and advice (see below).

(c) **Class/personalised divide.** One of the most tortuous questions affecting the industry has been how to distinguish between personalised advice, class advice and no advice. This question also gave rise to a 27 page guidance note from FMA, which (while well intentioned) has proven difficult to implement and led to some advisers defaulting to giving no advice. The review is an opportune time to revisit and provide certainty on this question. In our view:

- the FAA should regulate advice from non-sales persons to retail clients, whether personalised or otherwise, but allow greater exceptions for publications, journalism, sales processes, simple advice etc; and
- sales should be regulated solely by the Part 2 fair dealing provisions of the FMCA, provided it is clear that the adviser is acting as a sales person only.

(d) **Remove product distinctions for consumer facing activity.** For the most part we agree with the current category 1 and category 2 product boundaries. However, we believe those boundaries should be used only as a tool to define the competencies required of advisers, rather than as a consumer-facing distinction (where we believe the categories cause confusion). In our view, it would be sensible to allow advice on entry into KiwiSaver (and possibly other "vanilla" managed funds), where the choice is between generic funds, as an area where a "sales person" or "unqualified adviser" can advise, so as to facilitate their distribution and the provision of financial advice in relation to those products. KiwiSaver in particular is now a widely understood product and we see no policy rationale to categorise it as a complex product. Re-categorising KiwiSaver is also likely to meet what we understand to be one of FMA's objectives – facilitating access to advice on KiwiSaver.

(e) **Wholesale/retail divide.** There are currently four different wholesale/retail divides in the relevant legislation. Different tests apply under the FAA, FSPA, FMCA and Financial Advisers (Custodians of FMCA Financial Products) Regulations 2013 (*FAA Custody Regulations*). In our view:

- the tests should be rationalised so that there is a consistent definition of the wholesale/retail boundary across all of the legislation;

- as set out above, the FAA should regulate financial advice to retail clients only – with the Part 2 fair dealing provisions of the FMCA being sufficient for financial advice provided to wholesale clients; and

- the wholesale/retail boundary in the FAA Custody Regulations is incorrectly set and should be extended to include all categories of wholesale client in clauses 3(2) and 3(3) of Schedule 1 to the FMCA.

(f) **Technological change.** The FAA will need to be "future proofed" to deal with the increasingly rapid onset of technological change. It is now possible for advice to be generated on an automated basis, both in simple situations (e.g. an email recommending travel insurance for a person who has just booked an overseas trip), through to more sophisticated levels of advice as to an appropriate managed fund in which to invest. At present, this advice can be given only by an individual, not an entity. In our view:

- as in Australia, licensed entities should be able to give all types of advice in these scenarios;

- this advice should be subject to the same level of regulatory compliance as the sections currently applying to individuals (e.g. disclosure and conduct), but need not be given by an individual;

- it may be possible to address this, in practice, through an appropriate use of the sales/advice divide; and

- some questionnaires which recommend a risk tolerance are unsophisticated to a degree that they could generate poor recommendations. We recommend that, if Robo advice is to be encouraged, minimum standards need to be imposed to ensure the advice generated is reliable.

(g) **DIMS.** We question whether DIMS should be regulated under two different statues – the FMCA and FAA. We understand that, anecdotally, personalised DIMS is relatively rare (and many of the major financial advisers are applying for class DIMS licences accordingly), which accords with FMA's view. Rather than have a split regulatory regime, we would endorse shifting the regulation of personalised DIMS wholly to the FMCA and require that it be provided by a licensed person under a generic DIMS licence. This would also remove duplication and any regulatory arbitrage between the two regimes. (Although the opportunity for arbitrage has been minimised through substantial alignment between the FMCA and FAA DIMS regimes, we nevertheless see no compelling reason why there should be "dual" regimes in this context.)

(h) **Broking services/custody.** Our experience of the "broking services" regime is that it has been difficult to comprehend, advise on and implement. This is particularly the case where (as is the common model) there is a split between the customer facing entity providing the advice and undertaking the trading activity, and a third party custodian. At present, the situation is that:

- the customer facing entity has obligations as a "broker" and must procure the compliance of any third party custodian, even where it does not hold, in the ownership sense, the financial products in question; and

- the third party custodian does not have direct obligations as such but is still required to register as a broker.

In our view, whatever solution is reached it needs to address this issue, possibly by ensuring that the broker definition is replaced with a custodian definition which applies only to persons who hold client money or property in their name.

(i) **Territorial scope.** The territorial scope of the FAA has meant that overseas providers, whose only connection with New Zealand is the location of clients, are caught by the FAA's territorial scope (on the basis that a service is "received by a client in New Zealand"). This is despite the fact that all other aspects of the service are provided offshore, and are regulated in those offshore jurisdictions – resulting in dual regulation and increased (and unnecessary) compliance costs. We believe that this issue could be addressed by creating an "approved list" of offshore jurisdictions so that qualified providers located in those jurisdictions do not have to comply with the additional requirements under New Zealand law (with some tolerance for offshore idiosyncrasies where the requirements may differ from New Zealand requirements – for example, jurisdictions where the concept of holding assets "on trust" does not exist).

While there is relief already for Australian AFAs, this has been achieved through the use of two exemptions. We see this as a matter that should be dealt with as part of the regulatory framework, not sporadically through exemptions.

We also think that the registration requirements in the FSPA should not apply if an organisation is not providing financial services to persons in New Zealand (bringing alignment with the AML legislation) and that the removal powers of the FMA should be broadened so it can remove, or approve non-registration, where limited or no services are provided to New Zealanders. Where services are provided solely or substantially offshore, entities should have to notify the Registrar, but not be registered.

(j) **Alignment with new market opportunities under FMCA.** The FMCA allows innovative new capital raising opportunities, such as small offers and equity crowd funding, without the need for full regulated offer disclosure. The FAA should be calibrated so that advisers are able to advise on these offers, without the need for full FAA compliance. A possible approach would be to

relax the statutory duties under the FAA for these types of offers.

(k) **QFE model should be continued.** We believe that the current QFE model should continue, on the basis that:

- a distinction is made between sales people and advisers; and

- as they are technically able to do so now, QFE advisers are able to provide advice on QFE-issued products, including KiwiSaver (see (d) above).

We disagree with commentary that QFEs are not sufficiently regulated and enjoy a concessionary regulatory advantage. Our observation is that QFEs are subject to extensive levels of regulation, take their compliance obligations and frontline supervisor role seriously and are focused on what is good for the consumer. We see no reason why this model should not be retained.

(l) **Liability with entity, not individual.** The current liability settings, which mean AFAs and RFAs share liability with their employers in some cases, are confusing, and in our view difficult to justify as a matter of principle. Liability should rest with the employer/QFE, except in cases where an AFA has breached the Code of Professional Conduct or CPD requirements.

(m) **Code of Professional Conduct for AFAs should be a Code of Ethics, and not overlap with legislative requirements.** The Code of Conduct should be targeted at the ethical baselines expected of AFAs, rather than regulating conduct and disclosure. For example, requirements in the Code of Conduct regarding the assessment of suitability and disclosure should be in legislation or regulation governing the provision of advice, not "homogenised" into the hybrid Code of Professional Conduct, which tries to serve too many purposes. Similarly, minimum qualification levels and CPD requirements could be set by regulation or, to provide more flexibility to adapt to changing standards, by the FMA.

(n) **The current disclosure regime does not facilitate useful and timely information for consumers.** Our

experience has been that there are variable approaches to disclosure, lengthy documents with variable levels of "plain English" and (as we understand it) low levels of readership by consumers. We support a mixture of brief, upfront disclosure, more detail on the Financial Service Providers Register and much more flexibility on fee disclosure (for example, where it is not possible to give percentage based fees upfront, disclosure on a transaction by transaction basis should be allowed, as is currently the industry norm for brokers through the use of "contract notes").

(o) **Boundary issues.** The boundary between an "investment planning service" and "financial advice" is unclear, and our experience has been that it has given rise to issues in the advisory community (for example, whether an AFA requires authorisation to provide an investment planning service). This confusion is exacerbated by AFA Code Standard 8, which requires AFAs to have an up to date understanding of the client's "financial situation, financial needs, financial goals and risk profile" before providing financial advice. In complying with that standard, it becomes almost impossible not to provide an investment planning service when providing financial advice that is more than purely one-off. We would endorse an approach which consolidates the two services, with perhaps the boundary used only as a tool requiring competencies.

(p) **Align categories used by FSPR with FSPA.** At present, the registration categories used by the Registrar of Financial Service Providers do not align with the statutory categories set out in section 14 of the FSPA. This is strange and, in our view, illogical as it means that providers are required to confirm their status according to Registrar categories, rather than statutory categories (as well as the undesirability of misalignment generally). As an aside, a similar issue arises with the Anti-Money Laundering and Countering Financing of Terrorism Act 2009 – where the list of categories in which an entity is considered to be a "financial institution" does not align with the FSPA categories – despite one of the intentions of the FSPA being to "capture" details of those entities which should be subject to the anti-money laundering regime.

(q) **Rationalise financial services definitions.** In relation to the FSPA, a threshold issue is that the definitions of "financial service" in section 5 of the FSPA can be confusing in parts and potentially misaligned to the regime's objectives – for example, the reference to credit contracts in section 5(1)(e)) anomalously extends beyond consumer credit contracts (i.e. retail facing activities) to create (in our view) unnecessary uncertainty, regulatory cost and potential reputational harm. Ultimately each item in the list of financial services should be clearly and rationally drafted on the basis of recognised statutory categories of regulated services.

7 We have canvassed many of these points in our previous Brief Counsel publications on the review. These publications are attached to this submission (as **Schedule 2**).

TRANSITIONAL ISSUES

8 While we see the review as a positive opportunity for meaningful change, as a practical matter, it is important to appreciate that many of the entities which will be affected by any changes to the FAA are also currently transitioning their product and service offerings under the FMCA.

The level of change being driven by the implementation of the FMCA is such that providers have little capacity to either engage in the current review or absorb any further change in the near future.

For that reason, we submit that the review should allow providers to continue to operate under the current regime for a period beyond the end of 2016.

APPENDIX – FAA

√ Yes

X No

		Retail			Wholesale
		Personalised		***Class***	
		Category 1	*Category 2*		
Only individuals (i.e. not the Entity itself) can perform?		√	√	X	X
Registered?	Individual* - Employee	√	√	X	X
	Entity	√	√	√	√
Dispute Resolution Scheme?	Individual – employee / agent	X	X	X	X
	Non employee / agent	√	√	X	X
	Entity	√	√	√	X
Disclosure required?		√	√	X	X
Statutory Conduct Obligations ss33-35?		√	√	√	√
Regulated Conduct s36?		X	X	X (Regs can be made)	X
Code of Conduct?		If AFA	If AFA	If AFA	If AFA

******Excludes QFE adviser*

SCHEDULE 1 – ANSWERS TO QUESTIONS

1 Do you agree that financial adviser regulation should seek to achieve the identified goals? If not, why not?

Yes, however we consider that the goals which the FAA should seek to achieve should align as far as possible with those of the FMCA.

We have the following general comments on the goals and the issues identified in the Issues Paper.

Goal 1 - Consumers have the information they need to find and choose a financial adviser

Do consumers understand the complexities of the regulatory framework?
No. The multiple categories of financial adviser in the FAA and the differentiation as to both the types of advice and products that can be advised on are confusing to investors.

Should there be a clearer distinction between advice and sales?
Yes. The current regulatory setting – in particular the breadth of the term "financial advice" – means that activities that would usually be considered to be sales have become categorised as advice. This has resulted in a proliferation of persons required to call themselves financial advisers, diluting the meaning of that terms in the eyes of the investing public.

As identified in the Issues Paper, the use of the term financial adviser also creates the impression on the part of consumers that an adviser is acting in consumers' interests in selling a product.

How should we regulate commissions and other conflicts of interest?
Any move to restrict commissions needs to bear in mind that financial advisers and sales people who are currently remunerated by commission would need to be remunerated from other sources for their services – most likely by a fee charged to a client.

We understand that consumers are often unwilling to pay for financial advice, so it falls to commissions to fund this gap. If clients are unwilling to meet these fees directly then they need to be met elsewhere. In the absence of commissions, the result of charging direct fees would likely lead to a significant decline in advice being sought, and, consequently, a decline in the number of financial advisers, to the detriment of consumers, financial literacy and an informed market.

Any restrictions on commissions should not apply to sales persons, if the proposed distinction is adopted. These people are ordinarily paid by the issuer on an incentive basis. There should not be any perceived independence for sales people, so they can be rewarded on commission.

Goal 2 - Financial advice is accessible for consumers

Does the FA Act unduly restrict access to financial advice?
The direct cost and wider burdens of compliance with the FAA have resulted in some experienced and talented financial advisers leaving the business or ceasing to provide advice.

We also understand that some financial advisers have sought to mitigate these costs, together with other costs resulting from the ongoing broader reform of the financial services industry, by entering into “tie up” relationships with financial service providers. This has had the effect of reducing the independence of these advisers and accordingly reduced the pool of financial professionals able to provide independent financial advice.

How can compliance costs be reduced under the current regime without limiting access to quality financial advice?
While many of the costs imposed on financial advisers in recent years have been primarily one off costs involved in establishing systems to meet new requirements, we understand that ongoing compliance costs are nevertheless reasonably significant. We believe that compliance costs on an individual basis could be reduced by a combination of the following:

- a more sophisticated and streamlined disclosure regime;
- imposing the responsibility and liability for compliance on the employer/QFE rather than the AFA personally; and
- recalibrating the Code of Professional Conduct so that it is a Code of Ethics only, again meaning that the bulk of the regulatory burden and cost would fall on the entity (and could be “centralised” accordingly).

How can we facilitate access to advice in the future?
One of the key impediments to online advice under the FAA is that personalised advice must be provided by an individual. This means that online delivery platforms are limited to providing class advice.

We are aware of a number of providers who have considered implementing online advice models but have opted not to implement them on the basis that they cannot personalise that advice e.g. by using a simple questionnaire.

We therefore support a move to allow entities to provide personalised advice, to allow the use of these types of tools.

In addition, facilitating advice in relation to KiwiSaver funds (for example by re-categorising those products as category 2) is likely to have the greatest impact in increasing the spread of advice among consumers, particularly as to entry level issues in relation to (for example) informed choices about risk/return and asset allocations.

It is important, also, to align the advisory regime with the deliberate policy choices made in the FMCA with respect to innovative capital-raising opportunities. The restrictions and regulatory burdens relating to advising on areas such as P2P lending, equity crowd funding and small offers should be appropriately revised to align with the intent of those new tools as at present the need to have analysed a product then (under Code Standard 6) before giving advice in respect of that product constrains the ability of AFAs to advise on products where the level of information available is deliberately set at a lower level.

Goal 3 - public confidence in the professionalism of financial advisers is promoted

Should the individual adviser or the business hold obligations?
Section 20F of the FAA means that AFAs and RFAs share liability with their employers in some cases. In our view, liability should rest with the employer/QFE, except in cases where an AFA has breached the Code of Ethics.

Could the Register provide better information to the public?
We believe that the Register could contain information that helps the consumer to identify an appropriate financial adviser, while relieving the need for extensive "point of advice" (primary and secondary) disclosure which (for the reasons set out below) we do not believe is optimal.

We have no fixed views on exactly what the Register could contain, but it could be a minimum of the following:

- qualifications of the adviser;
- the dispute resolution service they (or their employer) are a member of;
- a list of products that the adviser can advise on;
- disciplinary actions and history.

That would mean that disclosure to clients could be much more streamlined and targeted and be limited to matters such as conflicted remuneration arrangements (e.g. commissions) and fees.

How can we avoid misuse of the Register by overseas financial service providers?
The recent efforts of the Financial Service Providers Registrar to remove companies exploiting the New Zealand register, coupled with the recent changes to the FSPA and the Companies Act (requiring local subsidiaries to have a New Zealand resident director), have commenced minimising the misuse of the FSPR.

We have no particular issues with the territorial test – that an overseas provider must have a "place of business" in New Zealand.

We also think that the registration requirements in the FSPA should not apply if an organisation is not providing financial services to persons in New Zealand (bringing alignment with the AML legislation) and that the removal powers of the FMA should be broadened so it can remove, or approve non-registration, where limited or no services are provided to New Zealanders. Where services are provided solely or substantially offshore, entities should have to notify the Registrar, but not be registered.

As a practical matter, this issue will often be considered in concert with the test under the Companies Act for carrying on business in New Zealand (section 332) and the related potential requirement to register as an overseas company. Both tests should be reviewed together – and, to the extent practicable, aligned – with a view to achieving an optimal "local registration" regime in terms of clarity, efficiency, consumer choice, and consistency with norms in relation to the extraterritorial application of statutes.

What is the impact of having multiple dispute resolution schemes?
Slight differences between the rules imposed by different providers conceptually allow for arbitrage between service providers. For this reason we support the codification of basic features of all dispute resolutions schemes (such as claim limits).

3 Does this definition adequately capture what financial advice is? If not, what changes should be considered?

No. The breadth of the current definition means that "sales" type conduct is likely to be financial advice falling outside of the exclusions contained in the FAA.

This in turn has resulted in persons undertaking sales type activities either registering as financial advisers or being classed as QFE advisers within a QFE. This also has the potential to mislead clients into believing that they are in an advice process when they are in reality in a sales process.

We support the inclusion of a bright line exclusion from the FAA for "sales" type activities. We consider that the current exclusions in the FAA are at times ambiguous and create a risk that a person may inadvertently provide financial advice.

Please refer to our comments under Question 5 below, which discuss providing the ability to expressly disclaim the giving of advice.

4 Is the distinction in the FA Act between wholesale and retail clients appropriate and effective? If not, what changes should be considered?

We consider that the wholesale definition in the FAA and FSPA should be wholly aligned with that in the FMCA.

There are currently four different wholesale/retail divides in the relevant legislation. Different tests apply under the FAA, FSPA, FMCA and the FAA Custody Regulations. A consistent definition of the wholesale/retail boundary should apply across all of the legislation.

We also believe that the wholesale/retail boundary in the FAA Custody Regulations is incorrectly set. It should be extended to include all categories of wholesale client in clauses 3(2) and 3(3) of the Schedule to the FMCA.

The ability to treat clients as wholesale for advice purposes but not for FMCA distribution and disclosure purposes or for the purposes of custody is both difficult to reconcile from a policy perspective and administratively unworkable. We are aware that many financial service providers require a client to be "wholesale" for all purposes before they are eligible to receive wholesale services.

The misalignment across the legislation also makes it very difficult to draft clear, concise and effective safe harbour and eligible investor certificates. Our experience has been that, due to the variable certification requirements between the FAA and

FMCA, it has been necessary to prepare multiple certificates, rather than a single document. The certificate requirements for eligible investors in the FMCA and FAA should be aligned to enable a client to certify in a single document as to their status under each regime.

5 Is the distinction in the Act between a personalised financial service and a class service appropriate and effective? If not, what changes should be considered?

We consider that the distinction between class and personalised advice in the FAA is difficult, both for advisers and from the point of view of investors.

However, in addition to a new distinction between advice and sales/distribution, we do not see some merit in retaining the class service category, as the original purpose for which it was introduced – so entities can produce research notes etc without a need to attribute them to individuals – remains valid. In our view:

- the FAA should regulate independent advice to retail clients, whether personalised or otherwise, but allow greater exceptions for publications, journalism, sales processes, simple advice etc; and
- sales should be regulated solely by the Part 2 fair dealing provisions of the FMCA, provided it is clear that the adviser is acting as a sales person only.

If the distinction is retained, a refinement would be to amend the definition of what is a class service by removing the subjective element inherent in the phrase *"in the circumstances in which the service is provided, reasonably expect the financial adviser to take into account the client's particular financial situation or goals",* so that the test is solely whether the adviser has in fact taken into account a client's personal circumstances. This could be combined with a requirement that class advice in "one to one" situations is prohibited unless a safe harbour disclaimer has been signed by the client.

6 Is it appropriate to have different requirements on advisers depending on the risk and complexity of the products they advise upon?

The key principle is that advisers should be competent to advise on the products they are authorised to advise on.

The use of category 1 and category 2 products in setting restrictions is a broad based tool which does not recognise the breadth of those categories or the nature of the advice being provided. The broad division of products means that advisers could well be permitted (in terms of categorisation under the FAA) to advise on products of which they have no knowledge. For example a residential mortgage broker may have no knowledge about life insurance but as they are both category 2 products would be able to advise on them under the FAA.

In practice this issue is addressed by the general duty of financial advisers to, when providing a financial adviser service, exercise the care, diligence, and skill that a reasonable financial adviser would exercise in the same circumstances.

From a consumer perspective, we consider that there is little practical utility in categorising financial products for the purposes of who can advise on them. More specifically, our perception is that consumers are unlikely to appreciate the distinction between product categories, but are entitled to expect that the adviser advising on the product is appropriately qualified to do so.

We believe the solution is to:

- retain the product categories as a tool for differentiating the baseline requirements for competency for advisers advising on them;
- introduce a general requirement that advisers must have that minimum competency before they can advise on a product (e.g. to address the mortgage broker advising on insurance scenario, as described above);
- remove the requirement to distinguish between categories when dealing with consumers (because adequate consumer protection is achieved through the baseline requirement for minimum competency for the product concerned); and
- impose requirements based on the nature of the advice: e.g. entry into KiwiSaver (low level), choice between conservative / balanced / growth (low level), financial planning (high level), portfolio construction (high level) etc.

7 **Does the current categorisation system accurately reflect the level of complexity and risk associated with financial products? If not, how could it be improved?**

No. The types of products which could fall within the definition of "category 1 products" could be as simple as, or simpler than, some "category 2 products". For example, medium term notes (a type of debt security) issued by banks are, in terms of economic substance, identical to bank term deposits (category 2) but are regulated as more complex products.

While it was originally intended that this would be addressed by regulations made under the FAA, this has not happened to any significant degree.

For the most part we agree with the current category 1 and category 2 product boundaries. However, we believe those boundaries should be used only as a tool to define the competencies required of advisers, rather than as a consumer-facing distinction (where we believe the categories cause confusion).

In our view, it would be sensible to allow advice on entry into KiwiSaver (and possibly other "vanilla" managed funds), where the choice is between generic funds, as an area where a "sales person" or "unqualified adviser" can advise, so as to facilitate their distribution and the provision of financial advice in relation to those products. KiwiSaver in particular is now a widely understood product and we see no policy rationale to categorise it as a complex product. Re-categorising KiwiSaver is also likely to meet what we understand to be one of FMA's objectives – facilitating access to advice on KiwiSaver.

Whatever the outcome here, careful consideration needs to be given to any knock on effects of any changes to the definition of category 2 products to the regulatory boundaries set under the FMCA.

8 **Do you think that the term Registered Financial Adviser gives consumers an accurate understanding of what these advisers are permitted to provide advice on and the requirements that apply to them? If not, should an alternative term be considered?**

No. We understand that there is a level of confusion in the market as to the distinction between and RFA and AFA. We therefore support:

- a distinction being made between advisers and sales people – recognising the fact that in many cases those persons registered as RFAs are in fact sales people or distributors; and
- with the exception of QFE advisers, there being a single category of financial adviser – an AFA – with a baseline requirement for minimum competency and a restriction that AFAs can provide advice only on products for which they are qualified.

11 **Are there any particular issues with the regulation of RFA entities that we should consider?**

Consistent with our comments above, we consider that the RFA distinction should be abolished, and replaced with qualified adviser and sales person. All advisers and entities (particularly QFEs) should be permitted to provide advice, subject always to the baseline obligation to act with care, diligence and skill.

The inability of entities to provide advice means that new technologies, (for example, apps or websites which provide advice to consumers based on a questionnaire), are not able to be implemented in New Zealand. We understand that these technologies have been successfully deployed in the United States and are beginning to be trialled in Australia. We believe standards need to be applied to questionnaires to ensure they are reliable.

The requirement for advice to be provided by a named individual is also inconsistent with the fact that, at law, an employee is acting on behalf of their employer and that their employer is responsible for ensuring that they comply with the FAA (with some limited exceptions with respect to AFAs).

More generally, the current liability settings, which mean RFAs share liability with their employers in some cases, are confusing, and difficult to justify as a matter of principle. The general presumption is that the entity employing the individual, rather than the individual, should have responsibility and liability for actions taken by an individual in the course of their employment. We see no reason for a distinction in these circumstances.

13 **Is the distinction between an investment planning service and financial advice well understood by advisers and their clients? Are any changes needed to the way that an investment planning service is regulated?**

We consider that the definition of an investment planning service needs to be amended to create a distinction between the provision of an investment planning service and the requirements of Code Standard 8 of the Code of Conduct for Financial Advisers (*Code*). The old title "financial planning service" is preferred, and emphasis should be on the

preparation of a detailed plan that covers the investors' long term goals and how to save for them, using personalised information.

As a definitional matter, for the purposes of the FAA, a person is considered to be providing an investment planning service where they:

> *…design[s], or offer[s] to design, a plan for an individual that—*
>
> *(a) is based on, or purports to be based on, an analysis of the individual's current and future overall financial situation (which must include his or her investment needs) and identification of the individual's investment goals; and*
>
> *(b) includes 1 or more recommendations or opinions on how to realise those goals (or 1 or more of them).*

This leads to a situation where AFAs may be providing an investment planning service on the basis that they:

(a) collect general information about a client's investment needs, which includes the capture of information in respect of their financial situation, investment objectives and investment needs and goals (as Code Standard 8 requires); and

(b) based on the above information provide personalised financial advice.

This leads to the problematic conclusion that, by meeting their obligations under Code Standard 8, AFAs are in every case also providing an investment planning service. This undermines the intent in the FAA of treating an investment planning service as a separate category of service from financial advice.

We would endorse an approach which consolidates the two services, with perhaps the boundary used only as a tool requiring competencies.

15 Should any changes be considered to reduce the costs on advisers who exercise some discretion, but are not offering a funds management-type service?

We consider that an AFA should be entitled to use the same custodian as their employer in the event that they provide contingency DIMS under regulation 183 of the FMCR:

- where the AFA is employed by a markets services licensee who is licensed to provide DIMS; and
- that employer is permitted to use an associated custodian as a condition of their markets services licence.

Currently, AFAs employed by a licensed DIMS provider which does not use an associated custodian can provide contingency DIMS to their non-DIMS clients in reliance on the exemption in regulation 183 for contingency DIMS.

This means that if the relevant market services licensee uses an associated custodian to provide its DIMS the AFAs it employs could not provide contingency DIMS if they were required to use that associated custodian for their contingency DIMS, as regulation 183 does not currently allow that.

Alternatively, the relevant AFAs could each seek approval, in terms of regulation 183(2)(i) of the FMCR, to use an associated custodian when providing contingency DIMS – but that involves further fees and administrative process.

This outcome has the effect of privileging AFAs employed by a licensed DIMS provider which does not use an associated custodian. We would therefore support an amendment to regulation 183 to allow AFAs providing contingency DIMS to use the same associated custodian as their employer, assuming that employer's DIMS licence allows the use of an associated custodian.

16 Are the current disclosure requirements for AFAs adequate and useful for consumers?

We consider that the level of disclosure required by the FAA regulations is not useful to investors. We understand anecdotally that clients often do not engage with the disclosure process and therefore the requirement for AFAs to provide more detailed disclosure achieves little. Secondary disclosure is particularly problematic as the "generality" of the requirements makes it difficult to interpret exactly what the requirements are, and this has led to variable approaches across the industry (e.g. in the area of conflicts of interest disclosure).

We also consider that a uniform system of disclosure should be used for all advisers which clearly identifies for an investor whether the person they are dealing with is selling them a product or providing advice about the product.

The review is an opportune time to look afresh at disclosure. We support a combination of:

- brief, upfront disclosure of key details which the consumer should know, most logically any conflicts of interest, commissions the adviser (or their employer) would earn or any other fees;
- more detail on the Financial Service Providers Register (see above for suggested topics);
- much more flexibility on fee disclosure (for example, where it is not possible to give percentage based fees upfront, disclosure on a transaction by transaction basis should be allowed, as is currently the industry norm for brokers through the use of "contract notes").

Critically, the fee disclosure regime should be "right-sized" to recognise the fact that most adviser models charge a percentage of assets under management, with one-off fees for trading and similar activities. The current disclosure regime places far too much emphasis on quantifying those fees upfront, when that is impossible as the level of fees depends on the level of assets under management and the type, value and

regularity of subsequent activity. Our experience is that these fees are disclosed at the time, when they are relevant, and the disclosure regime should allow for that.

17 Should any changes be considered to improve the relevance of these documents to consumers and to reduce the costs of producing them?

See our comments under question 16 above. In addition, we consider that disclosure documents could be improved by enabling them to be provided electronically and to incorporate material by reference.

We also consider that a uniform system of disclosure should be used for all types of advisers which clearly identifies for an investor whether the person they are dealing with is selling them a product or providing advice about the product.

22 Does the limited public transparency around the obligations of QFEs undermine public confidence and understanding of this part of the regulatory regime?

No. What is relevant from a client's perspective is that the QFE takes responsibility for the financial adviser service/s provided by its QFE advisers and this is already required to be disclosed to clients by QFE advisers as a standard condition of QFE status.

24 Are the current disclosure requirements for QFE advisers adequate and useful for consumers?

We consider that a uniform system of disclosure should be used for all types of advisers which clearly identifies for an investor whether the person they are dealing with is selling them a product or providing advice about the product.

26 How well understood are the broker requirements in the FA Act? How could understanding be improved?

In principle, the drivers underpinning the broking services regime – protection of client assets and appropriate accountability to clients – are absolutely sound.

However, our experience of the "broking services" regime is that it has been difficult to comprehend, advise on and implement. This is particularly the case where (as is the common model) there is a split between the customer facing entity providing the advice and undertaking the trading activity, and a third party custodian. At present, the situation is that:

- the customer facing entity has obligations as a "broker", and must (where a third party custodian is involved) procure that the custodian complies, even though they do not hold (in the ownership sense) the financial products in question; and
- the third party custodian does not have direct obligations as such but is still required to register as a broker.

In our view, whatever solution is reached it needs to address this issue, possibly by ensuring that the broker definition is replaced with a custodian definition which applies only to persons who hold client money or property in their name.

In addition, some difficult scenarios arise (in terms of how they fit with the broking service regime) when the third party service provider is nothing more than a technology platform, but nevertheless falls within the requirements. This essentially creates a third category of market participant, and we believe the review should encompass that category as well. (We see a case for those types of entities to be outside the regime, and for the customer facing entity to have primary responsibility for implementing appropriate contractual arrangements with the third party. But that is a matter on which industry feedback will be essential.)

29 What would be the costs and benefits of applying the broker requirements in the FA Act to insurance intermediaries?

It would be suitable to apply custodian obligations to insurance intermediaries only if they hold client money in their own name.

31 Should any changes to these requirements be considered?

The reporting required by custodians should be aligned with that required for licensed DIMS providers. While the FMCA contemplates third parties such as a custodian being able to provide this reporting, the differences between the matters required to be reported mean that practically a bespoke set of reports needs to be prepared which meets the requirements of both DIMS and custodian reporting.

35 What changes should be considered to make the current regulatory regime simpler and easier for consumers to understand? For example, removing or clarifying the distinction between AFAs and RFAs.

There is a significant level of complexity given the number of “filters” in the FAA (category 1/category 2; personalised/class; wholesale/retail). When presenting seminars on the FAA we represented this complexity in a table, which is set out in the Appendix).

See our answers to questions 4 - 8 above for our suggestions on how to address this complexity. In summary:

- the retail/wholesale divide should be consistent across the FMCA, FAA, FSPA and FAA Custody Regulations, and the FAA should regulate advice from non-sales people to retail clients only;

- advice (as opposed to sales) should be regulated as one category by “qualified advisers” (removing current acronyms) but exceptions established for publications etc); and

- the product distinction can usefully be retained, but not as a “customer facing” distinction.

We think that the key issue facing consumers is recognising when they are receiving advice and when they are being sold a product. Accordingly, we support the introduction of a new category of “sales person” who is able to give advice in a sales capacity provided that this is disclosed to consumers.

36 To what extent do consumers understand that some financial advisers' primary roles may be selling financial products, rather than solely acting as an unbiased adviser to their clients?

While some advisers are required to disclose that they are remunerated by commission we query the level of consumer "appreciation" of this disclosure. Branding would be improved by adopting a "qualified adviser"/"sales person" distinction.

We also expect that many consumers do not understand that the breadth of the definition of "financial advice" requires persons who would be better categorised as sales people to provide disclosure as an adviser. Hence our support for the distinction between advice and sales.

37 Should there be a clearer distinction between sales, information provision, and advice? How should such a distinction be drawn? What should or should not be included in the definition of financial advice?

We consider that the best way to provide for a legislative distinction between sales and advice is to provide "sales people" with the ability clearly to disclose that they are "sales people" not acting in the capacity of a "qualified adviser".

This could be achieved by including an express inclusion in the list of activities which do not constitute advice for:

> "where a person makes a recommendation or gives an opinion about acquiring or disposing of (including refraining from acquiring or disposing of) a financial product where that statement is accompanied by a statement in the prescribed form"

The prescribed statement could be framed along the following lines:

> *Warning*
> *I am a sales person and am not providing you with financial advice.*
>
> *The law normally requires people who provide financial advice to comply with certain duties. These duties do not apply to me.*
>
> *Ask questions, read all documents carefully, and seek independent financial advice before committing yourself.*

38 Do you think that current AFA disclosure requirements are effective in overcoming problems associated with commissions and other conflicts of interest?

No. However, this does not mean that we support the abandonment of commissions, rather we prefer a more coherent and understandable disclosure regime for them.

In large part this is because the fact that an AFA receives commissions is not given prominence within required disclosures and the detail of those commissions is not required to be disclosed in a consistent manner. This could be solved by requiring a specific "Commission Disclosure Statement", or similar, to be provided to a consumer prior to or at the time at which the advice is provided (or a sale is made).

See also our answer to question 16 above.

39 How do you think that AFA information disclosure requirements could be improved to better assist consumer decision making?

We question the value of AFA secondary disclosure. The free form nature of this disclosure means that the required information is difficult to compare across advisers. See our answer to question 16 above for our suggested approach to disclosure.

40 Do you support commission and conflict of interest disclosure requirements being applied to all financial advisers? If so, what requirements are appropriate for different adviser types?

Yes. We consider that the fact of commission payments and conflicts of interest is relevant to all adviser types (for example, commission disclosure for insurance products is equally relevant to commission in other scenarios). We consider that all advisers should be required to disclose this in a prescribed manner to aid comparison by investors.

41 Do you think that commissions should be restricted or banned in relation to financial advice, and if so, in what way? What would be the costs and benefits of such an approach?

No. We understand that many advisers are remunerated primarily on commission. We do not consider that the FAA should compromise existing business.

48 What impact has the Anti-Money Laundering and Countering Finance of Terrorism Act had on compliance costs for advisers? How could these costs be minimised?

Our experience has been that most of the compliance costs are borne by the adviser's employer, rather than the adviser. That said, we understand compliance costs have been significant and, for small financial adviser entities, this could be disproportionate to the risk involved.

We believe that the review should consider whether there is a case for some limited relief from the AML requirements for smaller firms, where the AML risks are assessed as low.

It would be helpful if adviser groups could have a single audit.

51 Do you think that international financial advice is likely to increase? Is the FA Act set up appropriately to facilitate and regulate this?

Yes.

The territorial scope of the FAA has meant that overseas providers, whose only connection with New Zealand is the location of clients, are caught by the FAA's territorial scope (on the basis that a service is "received by a client in New Zealand"). This is despite the fact that all other aspects of the service are provided offshore, and are regulated by those offshore jurisdictions – resulting in dual regulation and increased (and unnecessary) compliance costs.

We believe that this issue could be addressed by creating an "approved list" of offshore jurisdictions so that qualified providers located in those jurisdictions do not have to comply with the additional requirements under New Zealand law (with some tolerance for offshore idiosyncrasies where the requirements may differ from New Zealand requirements – for example, jurisdictions where the concept of holding assets "on trust" does not exist).

53 In what ways do you expect new technologies will change the market for financial advice?

We consider that the advent of "Robo" or electronic advice is inevitable, and will provide a useful, low cost tool for service providers to engage with their clients. New Zealanders are often early (and fulsome) adopters of technical solutions, so these types of offerings are simply a matter of time. These tools are already in use in other jurisdictions but cannot be implemented in New Zealand due to the requirement that personalised advice be provided by an individual adviser.

We do not consider that there is a problem with allocating responsibility for the provision of electronic advice. Responsibility for this advice would sit with the entity which provides the electronic advice service and be subject to the same general duties as all financial advisers.

Some questionnaires which recommend a risk tolerance are unsophisticated to a degree that they could generate poor recommendations. We recommend that, if Robo advice is to be encouraged, minimum standards need to be imposed to ensure the advice generated is reliable.

If there is a concern about the quality of such advice this is best addressed by either:

- imposing duties on the providers of the advice over and above the general conduct based duties (i.e. to act with reasonable care, diligence and skill and refrain from misleading conduct); or
- limiting the persons who are able to provide this type of advice to entities holding an appropriate licence such as QFEs or the holders of market service licences.

54 How can government keep pace with technological developments to ensure that quality standards for advice are maintained, without inhibiting innovation?

We consider that the best way for the Government to deal with electronic advice and the possibility that other avenues for the delivery of advice may develop in future is to allow entities to provide all types of advice, subject to appropriate duties. This could be future proofed by providing adequate flexibility to allow regulations to respond to new technologies as they arise.

62 Should any changes be considered to the relative obligations of individual advisers and the businesses they represent? If so, what changes should be considered?

See our answer to question 11 above. Liability should rest with the entity except in limited circumstances where an AFA breaches the Code of Ethics, or fails to comply with CPD requirements.

63 Is the QFE system achieving its goals in terms of consumer protection and reducing compliance costs for large entities? If not, what changes should be considered?

Yes, we strongly believe that the QFE model is achieving its goals.

In our view consumer protection is achieved within the QFE model by the QFE ultimately being responsible for any advice received by clients. QFEs in turn meet these obligations by putting in place systems and controls around what advice their employees can give.

We understand, anecdotally, that the employees of QFEs are in many instances reluctant to provide advice, even where permitted by their employers' ABS, as they are concerned that they personally are giving that advice and therefore personally liable under the FAA.

We therefore believe that the current QFE model should continue, on the basis that:

- a distinction is made between sales people and advisers; and
- QFE advisers should continue to be able to provide advice on QFE-issued products, including KiwiSaver (see (h) above).

74 Should the $200,000 jurisdictional limit on the size of claims that dispute resolution schemes be raised in respect of other types of financial services and if so, what would be an appropriate limit?

Yes

78 Do you consider misuse of the Register by offshore financial service providers is a significant risk to New Zealand's reputation as a well-regulated jurisdiction and/or to New Zealand businesses?

Yes, misuse would place us at risk in this context (in the same way that use of a New Zealand company for recalcitrant purposes has in the past).

However, as set out in our answer to Goal 3 above, recent efforts of the Registrar to remove entities exploiting the New Zealand register, coupled with the recent changes to the FSPA and the Companies Act, should be bolstered by requiring entities who do not provide substantial services to persons in New Zealand to notify their details to the FMA (but not be registered) or enabling the FMA broader powers to remove persons with limited connections with New Zealand.

79 Are there any changes to the scope of the registration requirements or the powers of regulators that should be considered in response to this issue?

In relation to the FSPA, a threshold issue is that the definitions of "financial service" in section 5 of the FSPA can be confusing in parts and potentially misaligned to the regime's objectives – for example, the reference to credit contracts in section 5(1)(e)) anomalously extends beyond consumer credit contracts (i.e. retail facing activities) to create (in our view) unnecessary uncertainty, regulatory cost and potential reputational harm. Ultimately each item in the list of financial services should be clearly and rationally drafted on the basis of recognised statutory categories of regulated services.

SCHEDULE 2 – PREVIOUS PUBLICATIONS

brief counsel FINANCIAL SERVICES REGULATION

17 OCTOBER 2014

Five year fitness test for financial advisers regime up next year

The Financial Advisers Act 2008 (*FAA*[1]) had a difficult birth, requiring several Supplementary Order Papers and a highly unusual eleventh hour "Pre-Implementation Adjustments Bill".

Partly in acknowledgement of the risks implicit in such a process, a clause was inserted into the Act promising a review by the Ministry of Business, Innovation and Employment (*MBIE*) within five years of the Act's commencement.

MBIE plans to initiate public consultation on this next year for completion before 1 July 2016.

This is an important chance to drive change in those parts of the FAA regime which have caused confusion or frustration. We will be engaging fully in the review and urge you to do likewise.

A brief history

The new framework came into effect[2] fully on 1 July 2011, having been delayed as a result of industry input about the unworkability of the FAA and the companion Financial Service Providers (Registration and Dispute Resolution) Act 2008 (*FSPA*[3]) in their original form.

This feedback culminated in a substantial re-working of the FAA and FSPA prior to commencement in the shape of the Financial Service Providers (Pre-Implementation Adjustments) Bill (which was eventually split into two acts amending the FAA and FSPA).

The result was a workable regime, but one which reflected a slightly muddled policy underpinning – a mixture of both investor protection and occupational regulation. This has led to some challenges, which the review will provide a one-off opportunity to address.

Areas for improvement

We have chosen to produce this commentary to coincide with Money Week 2014[4], organised by the Commission for Financial Literacy and Retirement Income, and with the launch this week of the Financial Markets Authority (*FMA*) survey of New Zealanders' attitudes to investment.

Commenting in Good Returns on the survey results, Simone Robbers said public confidence in financial advisers had improved in the last four years but that AFAs still had to find *"their value proposition and the sweet spot where the business model works and the consumer outcome is optimal"*.

The review of the FAA has the potential to assist that process. Topics which we believe should form part of the agenda are set out below. No doubt there will be many others.

Alignment of FAA requirements with new market opportunities under FMCA

It is important that the FAA allows advisers to advise clients on the exciting new capital raising opportunities created in the Financial Markets Conduct Act (*FMCA*[5]) through the new small offer exemption and equity crowd funding and peer to peer lending platforms.

But this is made difficult because AFA Code Standard 6 requires Authorised Financial Advisers to "assess and review" financial products to a level that provides a reasonable basis for a recommendation. Meeting this requirement, while straightforward for IPO or listed stocks which are supported by offer documents and/ or broker research, is much more problematic for small offers that are exempt from the normal disclosure requirements – which is where the advice is really needed.

A possible approach would be to relax the statutory duties under the FAA for offers under the new exemptions, possibly up to a maximum value and with investor consent.

This would facilitate a discussion along the lines of "I know very little about this company but its directors and management have a good track record and if you have a spare $5,000 it wouldn't be a bad investment for you". The alternative is that these types of conversations – which, if well controlled, have their place in financial markets – will simply not happen.

Investment planning service – boundary issues

The definition of "investment planning service" in the FAA gives rise to a range of boundary issues affecting AFAs, and non-AFAs who voluntarily elect to apply AFA Code Standard 8 (which requires an up-to-date understanding of the client's "financial situation, financial needs, financial goals and risk profile").

Anomalies include:

- non-AFAs being effectively debarred from recommending plans involving solely category 2 products (e.g. layered bank term deposits) should they voluntarily consider the Code Standard 8 matters when tailoring their advice
- non-AFAs being unable to recommend a plan to a client based on class goals and financial circumstances and on that client's needs and risk profile, but being able to give other class advice to that client
- QFE advisers who are not also AFAs being prohibited from providing any advice which may constitute a plan, after considering the Code Standard 8 matters (which may be required or contemplated by the adviser's QFE Adviser Business Statements), and
- AFAs finding that any financial advice or discretionary investment management service tendered in compliance with Code Standard 8 is automatically deemed to be an investment planning service within the terms of the FAA, and therefore beyond the categories in their authorisation.

From a policy perspective, we question whether these are the right settings.

Certainty of boundary between personalised advice, class advice and no advice

In October 2012, the FMA issued a 27 page guidance note setting out its expectations for the sale of KiwiSaver scheme memberships within the requirements and spirit of the FAA. While provided in the context of KiwiSaver sales, the principles were expressed to be relevant to other financial products (though not universally so given KiwiSaver's unique characteristics).

FMA scrutiny is appropriate if KiwiSaver sales practices have been questionable. But we suggest that the necessity for a 27 page guidance note to determine whether financial advice has been provided indicates the degree of complexity in the Act's distinctions around the boundaries which is unhelpful to those seeking to comply.

Anecdotally, we understand it has had a negative impact in some instances – with advisers reluctant to provide any form of assistance in relation to KiwiSaver in case they fall on the wrong side of the boundaries which the guidance note attempts to draw.

A starting point may be to revisit the exemptions in section 14 and section 10(3) of the FAA, which set out those scenarios that do not constitute (respectively) a financial adviser service or financial advice. Regulatory certainty may be highly preferable here. After all there may not be much difference in effect between "I recommend this product to you in your circumstances" (personalised advice), "I recommend this product generally to all my clients" (class advice) or "Here is some information which recommends this product" (no advice).

Keeping pace with technological change

It is now possible to identify potential product needs for customers and to advise on those products through online channels, without any need for human involvement. Take, for example, the client who books an overseas trip by credit card and receives an automatically generated email about travel insurance for their particular journey and profile.

At present, this advice could be construed to amount to personalised advice to a retail client and would therefore need to be provided by an individual because under the FAA such advice cannot be given by an entity.

We believe licensed entities should be able to give personalised financial advice on simple products, as in Australia. The rest of the FAA provisions would continue to apply (for example, the duty of care, diligence, skill and disclosure). But those obligations would attach to the entity rather than any particular individual.

A look to Australia?

There has been huge debate across the Tasman on the so-called Future of Financial Advice (*FOFA*) reform wind-back, which included watering down the previously proposed ban on some forms of commission-based sales and "conflicted remuneration".

We strongly urge MBIE to use the review to look at the FOFA process as there may be some significant policy learnings relevant to the New Zealand environment. On the vexed question of commissions, we consider that the current regulated standards and remuneration disclosure requirements are appropriate and that a ban would be likely to lead to a significant decline in advice being sought.

From here

We are encouraged that INFINZ has already convened an industry discussion on the review as this indicates a high level of interest.

Chapman Tripp has closely followed the debate around the FAA from inception to final passage. We will monitor the review process, and publish on key developments as they occur.

Footnotes

1. http://www.legislation.govt.nz/act/public/2008/0091/latest/DLM1584202.html?src=qs
2. http://www.legislation.govt.nz/regulation/public/2010/0232/latest/whole.html#whole
3. http://www.legislation.govt.nz/act/public/2008/0097/latest/DLM1109427.html?src=qs
4. http://moneyweek.org.nz/
5. http://www.legislation.govt.nz/act/public/2013/0069/latest/DLM4090578.html?src=qs

CHAPMAN TRIPP

FINANCIAL SERVICES REGULATION

brief counsel

4 MARCH 2015

Prime opportunity to sort out financial advisers' regime

The Terms of Reference[1] for the much-anticipated review of the Financial Advisers Act 2008 (*FAA*) and the Financial Service Providers Act 2008 (*FSPA*) are now out – and seem to offer a prospect for genuine reform.

The Ministry of Business, Innovation and Employment (*MBIE*) will lead the review, which will run over 18 months. A discussion document will be released in May.

Scope of review

The review will cover the full operation of the FAA and FSPA with a view to identifying any requirements that are "unnecessary, ineffective or excessively costly".

MBIE's remit extends to other legislative regimes which are "imposing undue compliance costs on the adviser sector". In particular, MBIE will examine the impact of the Anti-Money Laundering and Countering Financing of Terrorism (*AMLCFT*) Act to ensure that any feedback is fed into any future changes to this Act.

Chapman Tripp intends raising problem areas such as beneficiary identification, reliance on third party identification and whether identification is needed for long term savings.

Hopefully, the impending 'Managing Intermediaries' exemption will go a long way to aligning the requirements of the AML regime with the reality of how client relationships are intermediated in the financial services industry.

Outside the scope of the review are:

- the development of strategies to promote financial literacy, and
- substantive changes to other legislation, unless consequential to any amendments to the FAA or FSPA.

Hot topics

Topics which we think could be usefully addressed include:

- the definition of who is a 'wholesale' client – this is currently fragmented across the FAA, Financial Markets Conduct Act (*FMCA*[1]), Non-Bank Deposit Takers Act and Financial Advisers (Custodians of FMCA Financial Products) Regulations 2014 (Custody Regulations)
- the custody regime – the application of the Custody Regulations and the FAA to the provision of custody services by offshore custodians seems over-zealous and may result in New Zealanders being unable to access offshore wealth management services
- the territorial scope of the FAA
- the re-categorisation of certain products as either Category 1 or Category 2.

These are in addition to the issues we raised in a commentary[2] last year that looked forward to the review. Those areas were:

- the alignment of FAA and FMCA – it is important that the FAA allows advisers to advise clients on the exciting new capital raising opportunities created in the FMCA through the new small offer exemption and equity crowd funding and peer to peer lending platforms
- the porous definition of "investment planning service" in the FAA gives rise to a range of boundary issues affecting AFAs, and non-AFAs who voluntarily elect to apply AFA Code Standard 8 (which requires an up-to-date understanding of the client's "financial situation, financial needs, financial goals and risk profile"), and
- the boundary between personalised advice, class advice and no advice.

From here

MBIE's indicative timeline is set out below. It shows that there will be many opportunities for industry participants to engage with this process. We recommend early engagement to give yourself the best chance of getting your issues and ideas included in the reform agenda.

Key stages of the review process	Indicative timing
Research: • Analysis of the intervention logic • Literature review • Consumer focus groups • Consumer surveying • Adviser surveying	**First half of 2015:** Consumer surveying, supplemented by consumer focus groups and adviser surveys
Issues Identification: • Stakeholder meetings • Consultation on the intervention logic and issues • Open forums on issues paper • Engagement through stakeholder forums • Analysis of submissions	**February-April 2015:** development of issues paper May-July 2015: public consultation on issues paper and ongoing stakeholder engagement
Report to Minister: • Report on the results of our research and issues identification and outlining the options identification process • Statutory report on Part 2 of the FSP Act, with the intention of further work in this area being undertaken as part of the broader review	**By 15 August 2015:** statutory deadline for report on the operation of Part 2 of the FSP Act
Options identification: • Development of options to address key issues identified • Discussions and workshops on options • Release options paper for consultation • Analysis of submissions	**November 2015:** release options paper for public consultation
Report to Minister: • Overall findings of the review • Recommendations on what, if any, legislative changes are needed and a plan for these changes • Tabling of report in the House	**1 July 2016:** statutory deadline for report to the Minister on the operation of the FA Act

Footnotes

1. http://www.mbie.govt.nz/what-we-do/review-of-financial-advisers-act-2008/faa-review-tor.pdf
2. http://www.legislation.govt.nz/act/public/2013/0069/latest/DLM4090578.html?src=qs
3. http://www.chapmantripp.com/publications/Pages/Five-year-fitness-test-for-financial-advisers-regime-up-next-year.aspx

CHAPMAN TRIPP

FINANCIAL SERVICES REGULATION

briefcounsel

26 MAY 2015

Financial advice regime under review

The regime created by the Financial Advisers Act and the Financial Service Providers (Registration and Dispute Resolution) Act, both of which were passed in 2008, is under review.

The Government today released a consultation document, submissions on which will close on **22 July 2015**.

We outline the issues on which comment is sought, and the timeline from here.

The issues paper[1] outlines three proposed goals, and the key questions for feedback.

GOAL	ISSUE
Consumers have the information they need to find and choose a financial adviser.	• Do consumers understand the regulatory framework? • Should there be a clearer distinction between advice and sales? • How should commissions and other conflicts of interest be regulated?
Financial advice is accessible for consumers.	• Does the FAA unduly restrict access to financial advice? • How can compliance costs be reduced without limiting access to quality financial advice? • How can access to advice be facilitated?
Public confidence in the professionalism of financial advisers is promoted.	• Should professional, ethical and education standards for financial advisers be raised? • Should the individual adviser or the business hold obligations?

| BRIEF COUNSEL PAGE 1

Timeline

A review within five years of the regime's commencement was mandated into the Financial Advisers Act out of recognition that the legislative process which gave birth to both Acts was tortuous. This is an important opportunity for industry to input on potential improvements and enhancements, and we anticipate that there will be high levels of engagement from market participants.

Submissions close on 22 July. Chapman Tripp will be making a submission. We commented in a Brief Counsel[2] last year on the main areas we see for improvement, with some further commentary[3] earlier this year.

The recommendations for regulatory reform which the Ministry of Business, Innovation and Employment (MBIE) develops out of this exercise will be incorporated into a second consultation document to be circulated toward the end of this year.

Footnotes

1. http://www.mbie.govt.nz/pdf-library/what-we-do/financial-advisers-act/final-issues-paper-20-may-2015.pdf
2. http://www.chapmantripp.com/publications/Pages/Five-year-fitness-test-for-financial-advisers-regime-up-next-year.aspx
3. http://www.chapmantripp.com/publications/Pages/Prime-opportunity-to-sort-out-financial-advisers%27-regime.aspx

For further information, or help in preparing a submission, contact the lawyers featured.


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