The Financial Services Federation ("FSF") is grateful for the opportunity to submit on the Issues Paper: Review of the Financial Advisers Act 2008 ("FAA") and the Financial Services Providers (Registration and Dispute Resolution) Act 2008 ("FSPR") ("the Issues Paper").

Background

By way of background the FSF is the industry body representing responsible and ethical finance and leasing providers in New Zealand. The FSF has nearly fifty members and affiliates providing first-class financing, leasing, and credit-related insurance products and services to over 1 million New Zealand consumers and businesses. The FSF's affiliate members include internationally recognised legal and consulting partners. A list of the current membership is attached to this submission as Appendix "A".

As can be seen from this list, five FSF members are Non-Bank Deposit Takers (and are licensed as such by the Reserve Bank of New Zealand). All FSF members who are required to be are registered on the Financial Services Providers register and all who are required to do so belong to a registered disputes resolution scheme. Their disputes resolution scheme membership is evenly spread between the Insurance & Savings Ombudsman Scheme and Financial Services Complaints Limited with the exception of one member who, by virtue of their connection to a registered bank, is a member of the Banking Ombudsman Scheme. No FSF members belong to the Financial Dispute Resolution Scheme.

In terms of their obligations under the FAA, the majority of members of the FSF are either Qualifying Financial Entities ("QFE") or they have registered individual members of their staff as appropriate. In one instance an FSF member employs a small number of Authorised Financial Advisers ("AFA").

As such not all the issues that are raised in the Issues Paper are applicable to the members of the FSF. This submission will confine itself to the issues regarding the FAA and FSPR regimes that are of interest or concern or which are applicable to the members of the FSF and will not comment on anything beyond that. For that reason this submission will not answer all the questions included in the Issues Paper. Where the FSF does not answer a question included in the Issues Paper it can be assumed that the FSF has nothing to say on that particular question or that the question is not applicable to the members of the FSF.

The current state of the financial adviser market

The majority of those members of the FSF or their employees who are directly affected by the provisions of the FAA and who are therefore QFE's or registered advisers, are involved in the provision of credit contracts to consumers.

Para 36 of the Issues Paper talks about the areas predominantly worked in by registered advisers but does not even mention those who have had to become registered because they provide credit contracts to consumers.

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Para 39 of the Issues Paper lists the types of entities that have QFE status of which 15% are lenders (which out of 56 entity groups is equivalent to 8 entities). It is difficult to determine what type of lending business these 8 entities might be but some of these are likely to be finance companies. Some of the 18% of QFE's (or 10 entities) which are non-bank deposit takers are also likely to be finance companies rather than building societies or credit unions.

The FSF would therefore submit that only a very small number of the registered adviser population are people providing credit contracts to consumers (so small to not even have been mentioned in the issues paper) or QFE's which are finance companies.

1. **Do you agree that financial adviser regulation should seek to achieve the identified goals? If not, why not**? The FSF does not want to comment in any detail on the specific identified goals per se, except to say –

    a. Some of the identified goals, and perhaps even most of them, are expressed in terms that presuppose investment activity (for example, goal 1 in para 66 refers to a goal being to help people "to make sound saving, investment and insurance decisions");

    b. Such goals do not require the FAA to apply to consumer credit, which it presently does, because consumer credit is a "category 2" financial product for the purposes of the FAA;

    c. The FSF opposed the application of the FAA to consumer credit when the Bill that became the FAA was introduced to Parliament, and still does, for reasons outlined below;

    d. Aside from the fact that the FAA's application to consumer credit is neither justified nor necessary, the FSF is broadly comfortable with the identified goals so far as they relate to other types of financial product.

    The FSF considers it is appropriate to elaborate on points b and c above. As noted above, the goals identified in the Issues Paper generally presuppose investment activity, but in no sense does consumer credit involve an investment activity. When a person makes an investment, they create an asset. By contrast, when a consumer borrows on credit they create a liability which is exactly the opposite, and it is artificial to expect an Act that is focussed on asset creation also to be a satisfactory way to regulate the opposite type of economic activity.

    That seems to be borne out by experience since the FAA came into force in 2010, as FSF member feedback suggests that borrower awareness of the fact that consumer credit is covered by this Act is low, to the point of being non-existent, whereas consumers are very aware that their rights are covered by the Credit Contracts and Consumer Finance Act 2003 ("CCCFA").

    In that regard, the FSF accepts that the standards its members apply may be higher than some other consumer lenders, but that actually reinforces the FSF's point: the FAA seems to have done nothing at all to raise the standards applied by such other consumer lenders, as reflected in the levels of concern expressed at the Financial Summit in 2011 and ultimately in the responsible lender changes recently made to the CCCFA. The FAA has simply been ineffective in its application to consumer credit, and as above that has been no surprise to the FSF.

    Member feedback also suggests that the main impact of the FAA on them and their customers has been increased compliance costs, costs that must ultimately be passed onto consumer borrowers, for no obvious benefit.

    The reality is that consumer credit is an activity of an entirely different nature to the investment activity with which the FAA is principally concerned, as is reflected in the fact that consumer

credit is subject to its own very specific and targeted regulation via the CCCFA and the Responsible Lender Code, (including in areas that arguably overlap with the FAA, because in broad terms they involve "advice").

The fact that consumer credit is thus regulated by its own targeted legislation means it is not necessary for it also to be regulated by laws of more general application aimed at products of an entirely different kind, and the FSF strongly submits that the opportunity should now be taken to recognise that the coverage of consumer credit by the FAA was a mistake, is not necessary in a responsible lender environment, and that consumer credit should be removed from the scope of the FAA accordingly.

The FSF believes that the opportunity should now be taken to eliminate the overlap that exists for consumer credit providers between the FAA and the CCCFA by making it clear that the provision of consumer credit does not equate to providing financial advice. The precedent to do so has already been created when the regulations supporting the Financial Markets Conduct Act 2013 made it clear that credit contracts are distinct from investment activity and accordingly specifically carved them out from its coverage (Regulation 14 – "*For the purposes of paragraph (c) of the definition of financial service in section 6(1) of the Act, the service of being a creditor under a credit contract is declared not to be a financial service for the purposes of any provision of Part 2 of the Act.*").

The CCCFA and the Responsible Lending Code, quite rightly, provide the consumer with the protection they need from unethical consumer credit practices. Any failure on the part of a credit provider to behave responsibly towards consumers would result in breach and prosecution under that Act rather than the FAA. This again reinforces FSF's point: consumers are protected in credit situations by the CCCFA not the FAA.

In fact the Financial Markets Authority which has the responsibility to enforce the FAA does not enforce anything to do with credit contract issues. Any such matters are referred to the Commerce Commission which is responsible for enforcing the CCCFA under which lenders would be penalised if they were found to be behaving irresponsibly.

In summary therefore, FSF members genuinely want to meet their compliance obligations and provide responsible and ethical service to consumers. They are comfortable that this requires them to be regulated but they already are through the very comprehensive CCCFA and Responsible Lending Code. Additional regulation actually creates confusion for consumers, adds complications for consumers and business, increases compliance costs to business which is ultimately passed on to consumers and adds unnecessary complication.

None of what follows should detract from that submission. Instead what follows is generally more concerned with the FAA's application to FSF members in other ways, for example as deposit takers or insurers.

2. **What goals do you consider should be more or less important in deciding how to regulate financial advisers:** In the context of "investments" proper, the FSF has no real issue with the goals referred to in paras 63 – 68 of the Issues Paper. As stated above, the FSF's issue is that they are presently applied by the FAA to consumer credit, which is not in any sense an "investment" product. As mentioned in 1 above, the consumer is provided with appropriate protection in the matter of consumer credit through the regulatory framework that exists for lenders which has recently been strengthened.

3. **Does this definition adequately capture what financial advice is? If not, what changes should be considered**? The definition is broad and this has caused some concern amongst FSF members. The fact that the definition can be applied to the provision of credit contracts suggests to the FSF that the definition needs to be refined to make it clear that provision of credit contracts is not considered to be financial advice.

4. **Is the distinction in the FA Act between wholesale and retail clients appropriate and effective? If not, what changes should be considered**? The $1m NTA or turnover thresholds do not make it easy to identify when a customer is or is not "wholesale". The FSF suggests it might be preferable and easier to manage compliance if businesses generally were treated as "wholesale". That would align with the approach that the FAA presently takes to credit products, where the Act applies to consumer credit only and not also to some business credit (although as above the FSF does not support the FAA's continued application to consumer credit).

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**? With the proviso that the coverage of the FAA should not include the provision of credit contracts, the FSF is comfortable with this distinction, and is not aware of it having caused material issues for any FSF members.

6. **Is it appropriate to have different requirements on advisers depending on the risk and complexity of the products they advise upon**? In broad terms, "Yes": simpler products such as call investments are sufficiently widely understood so as to not require advice in respect of them to be regulated to the same degree as advice in respect of more sophisticated products.

   That applies also to term deposits, which are also very widely understood, and yet while the FAA treats bank term deposits the same as call investments, it treats non-bank term deposits differently and in a way that requires higher adviser qualifications and standards (that is, by treating them as "category 1" products). The FSF has always opposed that differentiation between bank and non-bank term deposits, and continues to do so: the focus should be on the product type, not the identity of the product provider.

   In that regard the FSF notes that since the FAA came into force, non-bank deposit takers ("NBDTs") have become subject to regulation under the Non-Bank Deposit Takers Act 2013, a prudential regime directly comparable to – and featuring the same supervisor as – the prudential regime applicable to banks under the Reserve Bank of New Zealand Act 1989. In so far as the FAA's original distinction between bank and non-bank term deposits was based on a perception that bank investments were consequently of higher credit quality, the prudential regime now applicable to NBDTs makes such a distinction untenable.

   The FSF accordingly submits that the FAA should be amended to treat NBDT term deposits the same as bank term deposits. That is, both should in future be "category 2" products).

   (The FSF also notes that the submission just made is given added emphasis by the fact that the Financial Advisers (Definitions, Voluntary Authorisation, Prescribed Entities, and Exemptions) Regulations 2011 treats some term investments with Public Trust or with credit unions as if they were "category 2". There is no good reason for treating credit unions in particular more favourably than other NBDTs, and principles of competitive neutrality thus also support the submission just made).

   Further, FSF members report that term deposits are sold as a product reactively rather than as a result of advice. Customers seek out term deposit products based on the interest rate being offered on them and the deposit term rather than any product differentiation or through the provision of advice.

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**? In broad terms, "Yes", but unfortunately in places the FAA does depart from a more coherent approach that would better reflect actual levels of product complexity: what we have said at 6 above illustrates that.

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**? In the experience of FSF members, public understanding of the various terms relating to financial advice, categories of product, types of adviser services and types of advisers is very low. It seems likely that many consumers misunderstand the term, and believe that the term Registered Financial Adviser reflects a higher level of qualification and accountability than many registered advisers actually have. The FSF would agree that solutions should be sought, which might include use of an alternative term in future, or possibly even abolition of RFA status altogether.

   The FSF also submits that one way to considerably reduce the confusion in consumers' minds would be to exclude the provision of credit contracts from the coverage of the FAA so that those people who do so will be seen by the public as what they are – lenders, not financial advisers (registered or otherwise).

9. **Are the general conduct requirements applying to all financial advisers, including RFAs, appropriate and adequate? If not, what changes should be considered**? The FSF again submits that it be made clear that the coverage of the FAA is not intended to include those people or businesses that provide credit contracts and that such people are not financial advisers. With that exception, the FSF is comfortable with the present conduct requirements applying to RFAs. The FSF accepts that they are not especially onerous, but the FSF submits that is appropriate because as already noted above, category 2 products are widely understood by most consumers already. Category 1 products are different for this purpose, and some conduct requirements applicable to category 1 advisers may warrant attention.

10. **Do you think that disclosing this information is adequate for consumers? Should RFAs be required to disclose any additional information**? The FSF submits that the disclosure requirements for consumer credit providers contained in the regulations accompanying the CCCFA have been drafted to ensure consumers are provided with all the information they need to make an informed decision when entering into a credit contract. This includes disclosure of the disputes resolution scheme to which the lender belongs. Any further disclosure is unnecessary and confusing.

    Beyond that, the FSF considers that existing disclosure requirements are adequate.

14. **To what extent do advisers need to exercise some degree of discretion in relation to their clients' investments as part of their normal role**? The FAA affects FSF members either as consumer lenders or as NBDTs. In both capacities the experience of FSF members has been that clients are generally well aware of what they want and of what is available, so that staff are rarely required to exercise discretion in terms of product selection. (This is of course also another reason why NBDT term deposits should in future be re-categorised as "category 2" products.)

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**? Most FSF members who employ "advisers" are either QFEs or employ only RFAs. For them, the initial costs of transitioning to the FAA's regime were significant, and continue to be so. They would therefore welcome any changes that lead to cost reductions, and what has been suggested at 1 is an example of how further cost savings might be achieved.

22. **Does the limited public transparency around the obligations of QFEs undermine public confidence and understanding of this part of the regulatory regime**? Those FSF members that are QFEs became so because they felt that to do so was the best way for them to be in compliance with the requirements of the FAA in order for them to be able to continue to

provide consumer credit contracts. Inasmuch as the FSF believes that the FAA should not cover the provision of credit contracts, therefore there should be no need for lenders to continue to hold QFE status.

Beyond that, the FSF does not believe that public confidence and understanding is undermined by what may possibly be "limited public transparency around the obligations of QFEs". That is more than offset by the requirements for QFE's to have and maintain an ABS, and to report to the regulator. These obligations are at least as onerous as those of organisations that employ RFAs, and the FSF considers that the FAA's provisions around QFEs have worked well in practice and should not be changed.

The FSF believes that the regulator has a function to educate the public as to what the obligations of QFEs are in order to increase public understanding and confidence.

23. **Should any changes be considered to promote transparency of QFE obligations?** As just stated, "No": the QFE concept has in the view of the FSF been one of the FAA's successes.

24. **Are the current disclosure requirements for QFE advisers adequate and useful for consumers**? While the FSF does not see any need for material changes in the QFE regime, it also notes that due to the changes to the CCCFA that have recently come into force, there is now overlap between what is required to be disclosed in QFE disclosures and in credit contract disclosures under the CCCFA (for example, FSP registration and disputes resolution details are required in both).

    For FSF members the reason they are QFEs is because they are also consumer lenders, so that that kind of duplication is both avoidable and inefficient. Since QFE disclosures disclose relatively little else of significant value to consumers, QFE disclosures might accordingly be able to be dispensed with without any adverse impact on QFE customers.

    In that regard it is relevant also to note that the FSF's QFE members report that their customers show very little interest in the QFE disclosure that is made to them but find the disclosures made to them under the CCCFA's requirements to be considerably more useful.

25. **Should any changes be considered to improve the relevance of these documents to consumers or to reduce the costs of producing them**? The FSF considers it has already addressed this in its response at 24 above.

32. **Is the scope of the FA Act exemptions appropriate? What changes should be considered and why**? The exemption most relevant to many FSF members is the exemption for "incidental" advice in section 13. This is of real importance to FSF members involved in point of sale finance (and indeed to the entire retail economy, so long as the FAA continues to apply to credit), and the reasons for section 13 remain as important now as when it was enacted. It should not be changed unless the FSF's recommendation that consumer credit be excluded from the FAA is accepted.

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**. Please see the comments already made at 8, 10 and 24 above, which also respond to this question. The FSF might not be opposed to removal of the RFA concept, but would want to consider that further in the context of what if any category 2 products continued to be subject to the FAA after that.

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**? The FSF believes that this is well understood by most customers dealing with FSF members. In that

regard the FSF notes that most FSF members who are subject to the FAA are subject to it because they are consumer lenders.

In that regard the FSF notes the point made in paras 124-126 of the Issues Paper to the effect that the "sale of credit contracts" is the subject of product-specific requirements in the CCCFA and in the Responsible Lending Code. Given that product-specific regulation, the FSF repeats the point it has made at 1 above that there is no need for credit contracts also to be subject to the more general regime in the FAA. For this reason too, consumer credit contracts should cease to be subject to the FAA.

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**? For most FSF members, commission issues do not arise, as few of their employees are remunerated by commissions.

    More generally, the customers of most FSF members are well aware that their staff must necessarily promote their employer's products in preference to those of competitors. This is especially so in the case of loan products - another reason why they do not "fit" well within the FAA at present.

47. **How can regulatory requirements be made less onerous without reducing the quality and availability of financial advice**? The FSF believes the comments it has already made at 8, 10 and 24 above also respond to this question.

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**? The costs for FSF members of meeting their obligations under the AML/CFT legislation when it came into force were very substantial and the ongoing costs continue to be so.

    The FSF does however see those costs as largely divorced from the subject of adviser regulation (so far as its members are concerned anyway) in that as lenders, NBDTs or insurers, FSF members would no doubt continue to be subject to the AML/CFT legislation whether or not they are also categorised as "advisers" for the purposes of the FAA. It notes that New Zealand's sovereign obligations effectively require that to continue to be so.

58. **Do you think that RFAs (for example insurance or mortgage brokers) should be required to meet a minimum qualification relevant to the area of advice they specialise in? If so, what would be an appropriate minimum qualification**? The FSF does not think that any minimum qualification is or should be required for RFAs that work in in the consumer credit sector. As indicated in a number of places above, the FSF tends to doubt the utility of the RFA concept anyway (certainly in the credit context) and sees no case for giving it a higher occupational threshold than is presently required either by the Act or by credit-specific legislation such as the CCCFA.

59. **How much consideration should be given to aligning adviser qualifications with those applying in other countries, particularly Australia**? The provision of credit facilities are specifically excluded from the definition of "financial product" under the Australian Financial Services Reform laws. Credit providers and intermediaries in Australia are regulated by the National Consumer Credit Protection laws enacted in July 2010. This is a further reason why the FSF submits that credit providers in New Zealand should be excluded from the FAA.

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**? As has already been noted at 22 above, "the FSF considers that the FAA's provisions around QFEs have worked well in practice and should not be changed".

Financial Service Providers (Registration and Dispute Resolution) Act

64. **Do you agree that the Register should seek to achieve the identified goals? If not, why not**? The FSF has no issue with the Register seeking to achieve the identified goals, although it does have some doubt as to whether it has been, or if a register alone ever could be, an effective ways of achieving such goals. It should also be noted that in respect of lenders the Commerce Commission, under the amended Credit Contracts & Consumer Finance Act 2014 now has powers around FSP registration and therefore the Financial Markets Authority should not need to supervise credit contract providers with regards to the Register.

66. **Do you agree that the dispute resolution regime should seek to achieve the identified goals? If not, why not**? The FSF also has no issue with the dispute resolution regime seeking to achieve the identified goals. It notes that in practice its members typically achieve those goals without necessarily having to resort to the dispute resolution regime at all: members have every incentive to resolve complaints themselves without involving external dispute resolution schemes, and are typically highly motivated to do so.

70. **Does the requirement to belong to a dispute resolution scheme apply to the right types of financial service providers**? The FSF is generally comfortable with the scope of this requirement, except that (consistent with its comments at 4 above) the FSF believes that the dispute resolution regime should be able to be accessed by consumers only, rather than also being accessible to small business as is presently possible.

73. **Is the existence of multiple schemes and the incentive to retain and attract members sufficient to ensure that the schemes remain efficient and membership fees are controlled?** While some FSF members have commented on the level of fees charged by some dispute resolution schemes, nevertheless the FSF does consider that maintaining the number of dispute resolution schemes at or above 4 is indeed likely to help ensure ongoing efficiencies of this kind.

    As previously mentioned in the introduction to this submission, FSF members have chosen to belong to either one of the Insurance & Savings Ombudsman Scheme or the Financial Services Complaints Limited scheme. This decision has been made for a number of reasons, not merely to do with the fees charged by the scheme. It has been based on other factors such as the service provided to the lender by the scheme.

    The FSF submits that it is important for there to be a choice of disputes resolution provider and suggests that the fact that there is a choice of provider ensures that the schemes remain efficient and membership fees are controlled.

74. **Should the $200,000 jurisdictional limit on the size of claims that dispute resolution schemes can hear be raised in respect of other types of financial services, and if so, what would be an appropriate limit?** Most FSF members would not oppose increasing the claim limit above $200,000 for property insurance claims, but otherwise the FSF sees no reason to increase the limit for other product types.

75. **Should additional requirements to ensure that financial service providers are able to pay compensation to consumers be considered in New Zealand?** The FSF does not consider any such additional compensation requirements to be necessary, and would oppose them, on the grounds of unnecessary cost alone. The FSF notes that in so far as loans are concerned, almost by definition it is typically the lender that suffers adverse financial consequences when the customer relationship deteriorates, not the borrower.

If you require any further information or input from the FSF, please do not hesitate to contact me.

Lyn McMorran
EXECUTIVE DIRECTOR