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Corporate Law
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SUBMISSION IN RESPONSE TO THE ISSUES PAPER ON THE REVIEW OF THE FINANCIAL ADVISERS ACT 2008 AND THE FINANCIAL SERVICE PROVIDERS (REGISTRATION AND DISPUTE RESOLUTION) ACT 2008 – MAY 2015

Introduction

1. Financial Services Complaints Limited (FSCL) welcomes the opportunity to make a submission on the issues paper on the review of the Financial Advisers Act 2008 (FAA) and the Financial Service Providers (Registration and Dispute Resolution) Act 2008 (FSP Act).

2. Our submission is made from our experience as an approved dispute resolution scheme for over 6,000 financial service providers including over 1300 individual financial advisers and 330 QFEs or large companies which have a further 3,000 (approximately) advisers. For the year ended 30 June 2015 we received 2615 telephoned or emailed complaints and inquiries about financial service providers and formally investigated 193 complaints, including 27 complaints about financial advisers. The subject matter of the complaints covered a broad range of issues including complaints about unsuitable advice when taking out a new insurance policy or investments and complaints relating to the sale of replacement insurance.

3. We have not commented on aspects of the issues paper which are not directly relevant to our work as a dispute resolution scheme or to issues we have considered in our complaint investigations.

4. FSCL is happy for this submission to be made public as part of the consultation process.

Goals for Financial Adviser Regulation

5. We agree with the stated goals for regulation, being that:

- consumers have information to find and choose a financial adviser
- financial advice is accessible
- public confidence in the professionalism of financial advisers is promoted.

(Question 1)

How is financial advice defined?

6. Given New Zealanders' love of property as an investment tool, it is strongly arguable that the definition of financial advice should capture advice about purchasing physical property. **(Question 3)**

What are the different types of financial advice?

7. Consideration should be given to reviewing the definition of wholesale client. There are currently a number of different definitions in the FAA, the FSP Act and the Financial Markets Conduct Act 2013. It would be simpler and less confusing for consumers if there was one definition for wholesale clients. In our view, the bar for qualifying as a wholesale client should be set high. Simply because the person has money of over $1 million or even $5 million to invest does not necessarily make that person an experienced or sophisticated investor. A person may retire and sell a business, a farm or an investment rental property and suddenly has a large lump sum to invest for the first time in their life. That does not mean that person is an experienced investor.

   A prime example of this is the [redacted] collapse that occurred a few years ago where a number of the people who lost considerable sums of money and, in some cases, their entire life savings, were retired farmers and business men and women who had invested all of their wealth with [redacted] **(Question 4)**

Registered Financial Advisers (RFAs)

8. In our experience consumers are not aware of, and do not understand, the difference between an Authorised Financial Adviser (AFA), a Registered Financial Adviser (RFA) or an adviser employed by a Qualifying Financial Entity (QFE). Some consumers have said to us that they thought that an RFA has higher status than an AFA, merely by use of the term "registered". As such, consumers do not appear to understand what products the various advisers are permitted to provide advice on and the requirements that apply to them. **(Question 8)**

9. We are aware of suggestions that the current designations for financial advisers should be removed and possibly replaced with two new groups, such as:

   - advisers, who would give advice and have a fiduciary responsibility to clients, and
   - product sellers or distributors.

   We would caution that it is important that if such a change were to be made, measures and safeguards would need to be put in place to:

- ensure that consumers are aware of and understand the difference between an adviser and a product seller or distributor, and
- consumers still have access to an independent dispute resolution scheme for complaints against product sellers. In our experience there is still room for problems to arise where a person is merely "selling" a product, particularly, when selling a replacement insurance product. Further examples of the types of complaints we see from the sale of replacement insurance can be provided on request.

10. We consider the general requirements applying to all financial advisers as set out in the FAA section 75 are appropriate and adequate and note that the requirements reflect consumer protection law provisions, that is the Fair Trading Act 1986 and the Consumer Guarantees Act 1993. **(Question 9)**

11. RFA disclosure – we consider that information disclosure about the adviser's dispute resolution process and scheme membership should be continuing and should be provided both at the point of sale of or advice about the product and again at the time that the client raises a problem or complaint (see our submission in paragraph 43 below). We also consider that RFAs should be required to fully disclose how they are remunerated, including advice as to any commissions or other incentives they receive from financial product providers (see our submission in paragraph 15 below).

    There should be the same requirements for RFAs and AFAs to disclose how they are paid, there is no apparent reason for having different requirements. **(Question 10)**

Code of professional conduct

12. We would not want to see the Financial Advisers Disciplinary Committee's (FADC) jurisdiction expanded if any expanded powers conflicted with the dispute resolution schemes' role, for example, any expansion so that the Committee could award financial compensation to a complainant for direct financial loss. At present the Committee's powers are disciplinary only and we suggest that it is appropriate that the Committee's role remain that of a disciplinary tribunal, and that awards of compensation where an adviser's act or omission has caused the consumer a direct financial loss be left to the dispute resolution schemes. We consider that any overlap in jurisdiction would be confusing for both consumers and advisers. It would also be difficult for the dispute resolution schemes and the FADC to be aware if compensation had been awarded as a result of an investigation by the other body. **(Question 21)**

Do consumers understand the regulatory framework?

13. As noted above in paragraph 8 our experience shows that consumers do not understand the distinction between AFAs and RFAs and consideration may wish to be given to removing or clarifying the distinction between the two. **(Question 35)**

14. Again from our experience in investigating complaints, we do not think that consumers understand or even turn their minds to the fact that some financial

advisers' primary objectives may be selling financial products, rather than solely acting as an unbiased independent adviser to their clients. **(Question 36)**

Information disclosure and conflicts of interest

15. We consider that all advisers, both AFA and RFA advisers, should be required to disclose what commission, including soft commission, they are receiving from a product provider and any conflict of interest they may have. In our view, it is inevitable that payment of commissions has an effect on the quality of advice given, especially where commissions, soft commissions in particular, are provided by the product providers as incentives to sell their products.

    We have seen a number of complaints arise from consumers who have not been aware that their insurance or mortgage adviser is receiving commission from the product provider. When the consumer cancels the insurance policy within the first two years, the adviser in question has "clawed back" the commission from the consumer, leading to a complaint. In our view, in the interests of fairness and transparency, all advisers should be required to clearly disclose both the facts that (a) they are receiving commission from a product provider and (b) the amount of the commission in dollar terms (once that is able to be calculated).

16. In our view, consideration should be given to banning commission clawbacks. Where a client cancels an insurance policy within the first two years, a question is raised as to whether that policy was ever suitable for that particular client's needs. If the adviser is going to charge a fee, and where an adviser has spent time meeting the client, analysing the client's needs and making a recommendation as to a suitable product, it is fair that the adviser receive a fee, but that fee should be based on the time spent advising the customer and the nature of the service provided. We do not consider it fair that the fee amount should simply be the amount of the commission clawback. **(Questions 38, 39 and 40)**

Role of financial service provider registration and dispute resolution

Goals for dispute resolution regime

17. We agree with the identified goals that:

    - consumers are aware of dispute resolution
    - consumers can access dispute resolution, and
    - consumers are confident in dispute resolution.

    However, we would add that as well as being aware of dispute resolution, consumers also need to be aware of what a dispute resolution scheme can do for them, in particular that compensation can be awarded for cases of direct financial loss caused by the adviser's act or omission. In our experience, even if the consumer has heard about the dispute resolution scheme, they very often do not understand the dispute resolution scheme's role and extent of its powers.

In particular, a very important factor in achieving consumer confidence in the financial markets is that consumers are assured in knowing that, in the unlikely event that something goes wrong:

- the consumer can access an independent dispute resolution scheme that has expertise in investigating complaints about financial services, at no cost to them, and
- the dispute resolution scheme has power to award compensation (currently up to $200,000) for any direct loss suffered by the consumer as a result of the financial service provider's act or omission.

We note that a recent Colmar Brunton survey on the FAA/FSP review commissioned by MBIE found that consumers' reaction to the need for financial advisers to belong to a scheme is positive. In particular the requirement gives consumers a measure of confidence in the financial services sector (see page 24 of the Colmar Brunton report dated 24 June 2015).

18. Prior to the enactment of the FSP Act and the requirement for all financial service providers to belong to an independent dispute resolution scheme, consumers' only redress against a financial service provider was to seek legal advice and/or go to court (apart from those with complaints against banks and insurers) – the expense of which is beyond the means of many New Zealanders. **(Question 66)**

19. We consider that all the goals are of equal importance when reviewing the dispute resolution regime. **(Question 67)**

Registration

20. We are not aware of any prosecutions by the FMA of any person or organisation for non-compliance with registration requirements. We suggest that as a further enforcement aid, the FMA has the power to issue a compliance notice requiring a non-registered financial service provider to register immediately. If the compliance notice is not complied with within a set time period, say ten days, the FMA should be given the power to order the provider to stop trading immediately. We consider that such an aid would encourage swifter compliance by non-registered providers. **(Question 68)**

21. We do not consider there need to be any changes made to minimum registration requirements. **(Question 69)**

Dispute resolution

22. We consider the requirement for all financial service providers who provide services to retail clients to belong a dispute resolution scheme is correct. However, we question whether the definition of "wholesale" client should be changed and narrowed (see our submission in paragraph 7 above). **(Question 70)**

23. We consider the current framework for the approval of dispute resolution schemes is appropriate, particularly as the standard dispute resolution principles of accessibility, independence, fairness, accountability, efficiency and effectiveness comply with international standards. In particular the required

approval benchmarks comply with the effective approaches to fundamental principles approved by the International Network of Financial Services Ombudsman Schemes ("the INFO network") in September 2014 (http://www.networkfso.org/principles.html). We suggest that the benchmarks for approval continue to be periodically assessed against international standards for Ombudsman and external dispute resolution schemes , for example the Australian Government's Benchmarks for Industry-based Customer Dispute Resolution - http://www.treasury.gov.au/PublicationsAndMedia/Publications/2015/benchmarks-ind-cust-dispute-reso). We suggest that a requirement for clarity of scope and powers could be usefully added to the dispute resolution principles. We also suggest that in order to ensure true independence of approved dispute resolution schemes, there be a requirement that the scheme operates on a not-for-profit basis – see ANZOA essential criteria for describing a body as an Ombudsman (http://www.anzoa.com.au/assets/anzoa-policy-statement_ombudsman_essential-criteria.pdf). **(Question 71)**

24. We consider that the existence of three competing schemes (we have excluded the Banking Ombudsman Scheme as that scheme's membership is limited to banks and large bank-like institutions) and the incentive to retain and attract members is sufficient to ensure that the schemes remain efficient and membership fees are "controlled". We suggest that efficient operation is one of the principal benefits of having competing schemes. If there was one scheme only, there would be little incentive to "control" membership fees. **(Question 73)**

25. We consider that the current framework for monitoring dispute resolution schemes is adequate, although government may wish to consider setting some minimum requirements or parameters for the schemes' independent reviews. For example, it could be stipulated that the review must assess whether the scheme is meeting each of the dispute resolution benchmarks and that the scheme is fully accountable and transparent by, for example, publishing case notes on cases that have been subject to determinations and publishing financial accounts specific to the scheme.

    It is also worth considering that schemes' reporting requirements be clearer and more prescribed. It is important for consumer confidence that all schemes operate in accordance with (and in the same manner) the benchmarks. In particular, an approved scheme must be a financially stable entity as a stand-alone organisation and be able to show that annually to the Minister. It is not appropriate for a scheme to be financially subsidised by any associated entities as this may impact on the scheme's independence. **(Question 72)**

26. A jurisdictional limit of $200,000 is sufficient for the size of most consumer complaints coming before FSCL, except occasionally those complaints involving insurance – life and disability insurance as well as property insurance. As the dispute resolution schemes have historically been seen as an alternative to the District Courts for the determination of financial complaints, government may wish to give consideration to:

- pegging schemes' jurisdictional limits to those of the District Court, given that the schemes are intended to provide a low cost, speedier alternative than Court, or,
- allowing a complainant to waive an amount of a claim that is over $200,000 up to, say, a maximum of $350,000. In other words, the complainant can waive the excess that is being claimed over and above the sum of $200,000, but up to a maximum of $350,000. This would need to be on the proviso that if compensation is awarded by the scheme and accepted by the complainant, the settlement sum must be in full and final settlement of the complainant's claim and complaint. **(Question 74)**

27. We agree that consideration should be given to making professional indemnity insurance cover mandatory for all advisers who are giving advice on investment and insurance products over a certain monetary limit, say, $50,000. However, we note that there are still gaps in protection for consumers where, for example, advisers leave or retire from the industry, have de-registered from the FSP register, are no longer members of a dispute resolution scheme, and sometimes when an adviser switches schemes due to a change in employer. The only remedy in those cases is for a consumer to go to Court. **(Question 75)**

Could the Register be used to provide better information to the public?

28. It may be helpful for an adviser to list their qualifications and number of years in the industry on their financial services provider registration. Registration details should also have the financial service provider's postal address, telephone number and email address. It may also be helpful for the adviser to confirm that s/he carries professional indemnity insurance. **(Question 76)**

29. When considering whether the Register should also include information on a financial adviser's disciplinary record, it depends what is meant by "disciplinary" record. If this is limited to including details of any hearings before the Financial Advisers Disciplinary Committee and details of any disciplinary action taken, we support that information being disclosed, but with the proviso that any adverse record drops off after, say, a period of five years without further incident. We do not support an adviser or financial service provider having to disclose details of any complaints against them or that have been made and/ or subject to review by a dispute resolution scheme. Such a requirement would act as a major deterrent to financial service providers sending unresolved complaints to a dispute resolution scheme. **(Question 77)**

30. We agree that the Register's misuse by offshore financial service providers is a risk to New Zealand's reputation as a well regulated jurisdiction, but we are not sure that the risk is "significant". FSCL has a number of offshore financial service providers who have cooperated fully with our process where a complaint(s) has been made, have resolved complaints to the customer's satisfaction, and, in some cases, paid compensation to the customer. Unfortunately, in our experience, a number of rogue operators tend to give offshore transactional service providers a bad name. **(Question 78)**

31. The changes to the scope of the registration requirements and regulator's powers made in 2014, for example, the FMA's powers to prevent registration of and to de-register offshore financial services providers with no legitimate place of business in New Zealand, seem to be working effectively (see sections 15A, 15B and 15C of the FSPA). We have noticed a large drop in new membership applications from overseas based transactional service providers and there is a steady flow of existing overseas based financial service providers being de-registered. As such, we do not consider that any further changes need to be made at this time. **(Question 79)**

What is the impact of having multiple dispute resolution schemes?

32. First, New Zealand is not unique or "unusual" in the fact that it has a number of different schemes effectively competing for financial service providers as members. There are three competing schemes in Australia – the Financial Ombudsman Service, the Credit and Investment Ombudsman, and the Superannuation Complaints Tribunal. We understand that the feedback that competition between dispute resolution schemes may be constraining the activities of some schemes referred to in paragraph 276 of the Issues Paper, is anecdotal feedback only. FSCL has not at any time felt "constrained" in its activities as a result of competing for members with two other schemes (ISO and FDR). We are pleased to note that the Ministry has had no indication that competitive tensions influence a scheme's judgment or independence in relation to individual disputes – that is also our experience.

33. We understand that when the combined Financial Ombudsman Service model in Australia came into existence (merging three schemes into one), this resulted in increased costs to participants; increased case investigation times; dissatisfaction and confusion with the process; a major restructure; and no savings in terms of back office operations (https://www.fos.org.au/custom/files/docs/independent-review-final-report-2014.pdf).

34. In FSCL's recent independent review report by the Foundation for Effective Management and Governance (FEMAG), the reviewer tested the efficacy of the competitive external dispute resolution model which operates in New Zealand. The reviewer came to the conclusion that, on balance, competition between schemes has not been dysfunctional. The reviewer notes that the advantages of competition are to push schemes to greater levels of efficiency and potentially greater levels of quality in their services. The reviewer also noted that any potential disadvantages could be overcome by co-operation, collaboration and co-ordination between the schemes with the proviso that anti-competitive acts are avoided (see FEMAG independent review report dated February 2015 (http://www.fscl.org.nz/fscl-independent-review-report-0). In short, competition between schemes acts against complacency setting in.

35. We have seen little to no evidence of "scheme hopping" by financial service providers. In nearly five years' operation, FSCL has had one participant resign from our scheme because it did not like our case investigation process and one other because it was unhappy with decisions that had been made against it.

36. The differences between the four schemes' rules are minor and are not causing any issues for consumers of which we are aware. We do consider it important that all schemes "play by the same rules" and are subject to the same level of scrutiny. For example, currently, one scheme does not appear to be held to the same level of accountability as the other three schemes. As far as we are aware the scheme in question does not produce a separate annual report relating to its activities nor financial statements detailing financial activities particular to that scheme.

37. The Minister now has regulatory power to require schemes to amend their rules and any changes that a scheme may wish to make to its rules have to have Ministerial approval. This ensures Ministerial oversight that the schemes' rules are consistent and fair to consumers.

38. In our view the benefits of competition between the schemes far outweigh any perceived disadvantages. The benefits of competition are:

- Schemes are encouraged to run efficiently and provide the best possible service to their financial service provider members and their customers. Efficiency benefits both scheme participants and consumers as schemes' fees are kept as low as possible while still providing effective, efficient and world class dispute resolution services. For consumers that means speedier complaint resolution. Low fees also benefit consumers to whom compliance costs are ultimately passed on.

- Schemes are encouraged to add value to participants' businesses by, for example, providing participants with training and resource materials and help with early complaint resolution.

- Schemes are enabled to develop specialisations in some areas.

- Consumer groups are enabled to have close working relationships with individual schemes. Smaller sized schemes enable more personal and constructive working relationships with both consumer and participant organisations.

- The not-for-profit nature of three of the four existing schemes effectively addresses any potential mischiefs that may arise from competition between schemes, as the incentive to behave so as to attract members by lowering standards is virtually eliminated.

- Where there is competition, it is a "competition of ideas" or a diversity of approaches. This can only be positive for improving dispute resolution schemes across all of the dimensions identified by the benchmarks.

- High standards of criteria for a scheme's approval and Ministerial oversight of schemes' rules and operations, should overcome any potential disadvantages.

- Financial service providers are able to choose the scheme they feel is the "best fit" for their business in terms of approaches to complaints and customer service.

39. It is sometimes argued that a potential disadvantage of competition is that there is inconsistency in decision-making – but there is no evidence of this as yet. **(Question 80)**

40. In terms of identifying mitigating issues without losing the benefits of the multiple schemes structure, we suggest that this is satisfied by the Minister and a scheme's board being satisfied that the scheme's decision-maker is experienced, competent and capable of making robust decisions on complaints.

    Where there are differences in schemes' rules, the Minister can now regulate to require a scheme or schemes to change their rules, possibly to bring a scheme into line with other schemes if the Minister was concerned a scheme's rules set lower standards than those of a competing scheme. It may be useful to require schemes to have the same approach to "deadlock" on a complaint to avoid consumer confusion and to ensure ease of consumer accessibility.

    Further, schemes are required to cooperate under the FSP Act and to this end hold regular quarterly meetings to discuss issues of interest and/or concern. **(Question 81)**

41. We do not agree that current regulatory settings are adequate in raising awareness of available dispute resolution options. Currently all schemes have requirements in their rules that financial service providers tell their customers about the scheme and this is usually done in disclosure documents or in loan contracts.

42. It is important to have details of the financial service provider's dispute resolution scheme in disclosure documents handed to a consumer at the time the service or advice is provided. However, it is just as important that at the time a complaint arises, which may be some months or years after the disclosure documents were given, a consumer is provided with the details of the dispute resolution scheme.

43. The best and most effective way of raising consumer awareness is for a financial service provider to refer a customer with an unresolved problem or complaint to the dispute resolution scheme. Currently FSCL's statistics show that less than 50% of the complaints we formally investigate are referred to us by the financial service provider. This figure is too low. We strongly suggest consideration be given to making it a legal requirement for a financial service provider to tell a consumer with an unresolved problem or complaint of its dispute resolution scheme, and to give the scheme's contact details to the consumer, both upon receipt of a complaint and when the financial service provider has processed the complaint through its internal complaints process. We suggest that there be sanctions or penalties when a financial service provider fails to do so. **(Question 82)**

44. We also suggest that financial service providers and advisers be given a clear definition and guide as to what is a complaint so that they know how to recognise a complaint.

45. We also suggest and believe that Government should dedicate some resources to publicising the dispute resolution schemes. Unfortunately, when the FSP Act came into force, no money was allocated to a media or advertising campaign. This was disappointing as considerable time and effort had gone into the Act's drafting and enactment. It goes without saying that in order to raise consumer confidence in financial markets, consumers have to know about the dispute resolution schemes. We suggest that consideration be given to running periodic advertising campaigns by Government in newspapers and on-line media, including perhaps a complaints "app" for mobile phones.

46. We have seen no evidence that having multiple schemes has caused consumer confusion or has contributed to consumers' lack of awareness of dispute resolution. If anything, having more than one scheme promoting their services and speaking to consumer organisations increases the potential to educate consumers about the dispute resolution schemes' role. Any confusion is mitigated by all schemes cooperating to refer complaints to the correct scheme. We also suggest and support a single entry point for the schemes, for example, a shared Freephone number for financial complaints as a means of improving consumer accessibility to the schemes.

47. Thank you for the opportunity to provide these submissions. Please contact me if you wish to further discuss any issues.

Yours sincerely,

Susan Taylor
Chief Executive Officer

APPENDIX 1: BACKGROUND ON FINANCIAL SERVICES COMPLAINTS LIMITED (FSCL)

FSCL is an independent, not for profit, approved dispute resolution scheme under the Financial Service Providers (Registration and Dispute Resolution) Act 2008. FSCL is the dispute resolution scheme of choice for over 6,000 financial services providers in New Zealand. This includes financial advisers, non-bank lenders and credit unions, insurers, trustees and transactional service providers. We have been in operation since 2010.

We provide an alternative to Court proceedings for the resolution of complaints up to a value of $200,000 between consumers and financial service providers who are FSCL scheme participants. Complementary schemes covering other financial service providers are the Banking Ombudsman Scheme, the Insurance and Savings Ombudsman Scheme and Financial Dispute Resolution.

Our services are free of charge of consumers.

For the year ended 30 June 2015, we received 2615 telephone or emailed complaints and inquiries about financial service providers and formally investigated 193 complaints.