How to have your say

Submissions process

The Ministry of Business, Innovation and Employment (MBIE) seeks written submissions on the questions raised in this document.

- Submissions on the questions in Part 3 of this paper (relating to the Financial Service Providers Register) are due by **5pm on Friday 29 January 2016**.
- Submissions on the questions in Part 1 and Part 2 of this paper are due by **5pm on Friday 26 February 2016**.

Your submission may respond to any or all of these questions. We also encourage your input on any other relevant work. Where possible, please include evidence to support your views, for example references to independent research, facts and figures, or relevant examples.

Please include your name, or the name of your organisation, and contact details. You can make your submission:

- By filling out the submission template online.
- By attaching your submission as a Microsoft Word attachment and sending to ***faareview@mbie.govt.nz***.
- By mailing your submission to:

  Financial Markets Policy
  Ministry of Business, Innovation & Employment
  PO Box 3705
  Wellington
  New Zealand

Please direct any questions that you have in relation to the submissions process to: ***faareview@mbie.govt.nz***.

Use of information

The information provided in submissions will be used to inform MBIE's policy development process, and will inform advice to Ministers on the operation of the Financial Advisers Act 2008 and the Financial Service Providers (Registration and Dispute Resolution) Act 2008.

We may contact submitters directly if we require clarification of any matters in submissions.

Submissions are subject to the Official Information Act 1982. MBIE intends to upload PDF copies of submissions received to MBIE's website at ***www.mbie.govt.nz*** and will do so in accordance with that Act.

Please set out clearly with your submission if you have any objection to the release of any information in the submission, and in particular, which part(s) you consider should be withheld, together with the reason(s) for withholding the information under that Act.

If your submission contains any confidential information, please indicate this on the front of the submission, mark it clearly in the text, and provide a separate version excluding the relevant information for publication on our website.

MBIE reserves the right to withhold information that may be considered offensive or defamatory.

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Chapter 3 – Barriers to achieving the outcomes

1. Do you agree with the barriers outlined in the Options Paper? If not, why not?

   The key question is whether seeking or receiving advice actually results in better outcomes for a significant proportion of the population. Advice does not come free and therefore the cost of provision can and often does exceed the benefit. Additionally, the size and complexity of most consumers' affairs does not warrant (in most cases) the provision of a full financial plan or advice.

   Personalised advice does not always improve a consumer's financial outcomes, indeed in the non-financial world a salesman in Harvey Norman is trusted with "advice" even where the purchase again exceeds that of an investment.

   So, why do I need advice re a $3k investment, but not to buy a $300k house. The key is that most consumers do not seek (or need) financial advice given the quantum of their finances.

   Basic advice is largely common sense:
   Pay off your mortgage
   Pay off your credit card
   Put money in Kiwisaver
   Have some basic life insurance

   Personalised advice is really only necessary where significant sums are involved. Experience in the UK was that RDR reforms effectively closed the door to advice for a significant portion of the population.

2. Is there evidence of other major barriers not captured in the Options Paper? If so, please explain.

   Of far more impact on the ultimate outcome is the margin and commission charged for most financial services. For example, product fees on Kiwisaver accounts probably have a far more significant impact on the ultimate size of the final pension pot than risk profiling/ asset allocation/fund selection or indeed anything else. It would therefore make far more sense for the Government to legislate for (probably low cost tracker products with capped fees) which

would deliver a higher return to consumers in most cases than any other advised solution.

The principle is that some products should be advice free on the basis that their purchase can "do no harm", and should be preferably fee and commission constrained….and which can be accessed easily through generic and widely diseminated advice….eg Kiwisaver

Category 1 and 2 etc simply mumbo jumbo to most consumers and also potentially the wrong way around.

Chapter 4 – Discrete elements

3. Which options will be most effective in achieving the desired outcomes and why?
   Remove distinctions between products. Divide activities into advice and sales. Simplify regulation by relying on common-law protections and the duty of care. Standardise dispute resolution.

4. What would the costs and benefits be of the various options for different participants (consumers, financial advisers, businesses)?
   My proposals would give significant benefits to consumers (lower cost better investment outcomes), businesses (simple regulation) and financial advisers (much clearer differentiation between advice and sales).

5. Are there any other viable options? If so, please provide details.
   Create simple products which can be sold with the minimum of complexity and cost.

4.1 Restrictions on who can provide certain advice

6. What implications would removing the distinction between class and personalised advice have on access to advice?
   Solution of dividing “advice” into personalised advice and sales largely addresses this. Only advice would be sol classified, all other activities arepurely the provision of generic or product specific information. This eases the regulatory burden on all non advice businesses.

7. Should high-risk services be restricted to certain advisers? Why or why not?
   No. The problem here is that the legislation defines products as “high-risk” rather than the outcomes which impact the client. For example a Kiwisaver account is described as “high-risk” yet the maximum amount which could be lost is the investment (and in most cases the investment is relatively small). By contrast a mortgage or credit contract can have much greater implications, with default leading to bankruptcy and a loss greater than the amount borrowed. Consequently the current framework is deficient.

   The suggested solution (advice and sales) largely addresses this, with advice restricted to properly licenced advisers and all other activities being defined as sales, with suitability and miss-selling penalties. Product restrictions should therefore be removed.

8. Would requiring a client to ‘opt-in’ to being a wholesale investor have negative implications on advisers? If so, how could this be mitigated?
   Where an opt-in is not exercised, the adviser would merely then not be able to provide/advise on certain products which are deemed to be only suitable for wholesale/sophisticated investors. Given that advisers generally have to be able to deal with wholesale and retail

customers, this doesn't add any further complexities or negative implications for advisers.

4.2 Advice through technological channels

9. What ethical and other entry requirements should apply to advice platforms?
   The protections afforded to consumers can therefore be covered off neatly under the Common Law duty of care – "a legal obligation imposed on an individual requiring adherence to a standard of reasonable care when performing acts that could foreseeably harm others" and a suitability test such as demonstrated by the miss-selling of PPI insurance in the UK. All platforms should therefore have this obligation which can be linked to appropriate levels of liability insurance (which could be prescribed by legislation).

   There should also be clarity around the question of whether the platform is giving advice (ie Financial Advice (see my revised definition at 27) or whether it is purely a sales platform using technology and intelligent system driven questionnaires to determine an appropriate acquisition of disposal of a financial product.

10. How, if at all, should requirements differ between traditional and online financial advice?
    Key differences can be addressed by ensuring the wording covers both methods of delivery. The ultimate protections for consumers should however, be the same. An example of this is Uber. Government determines that for a variety of reasons cabs should be licenced. Logically, all Uber drivers should meet the same standards. If Government determines that some of the standards are not necessary, then those requirements should be removed from the licenced taxi industry. Advice is no different.

11. Are the options suggested in this chapter sufficient to enable innovation in the adviser industry? What other changes might need to be made?
    Option 2 is not workable and is irrelevant. If you want advice to be given by a person, the consumer should go to an adviser that provides that option. There should not be a constraint on pure technological providers, provided, of course, that this is made clear to the consumer at the outset. Under my proposals (see above) there could be robo-sales platforms which sell products, and robo-advice platforms which deliver advice for a fee. In the case of the latter, the regulatory framework can be broadly the same for both human and technological delivery.

4.3 Ethical and client-care obligations

12. If the ethical obligation to put the consumers' interests first was extended, what would the right obligation be? How could this be monitored and enforced?
    It is unnecessary to extend the obligation provided there is the clear distinction between "advice", where the obligations hold true, and all other transactions which are in essence "sales" (which in my view includes all transactions involving QFEs and RFAs). Once these are classified as "sales", then the suitability test and the duty of care would apply. This would actually reduce the compliance costs (as per Option 3) not increase them, and bring financial services alongside other retail operations (which often have a higher impact on a consumer's financial affairs than a financial services product).

13. What would be some practical ways of distinguishing 'sales' and 'advice'? What obligations should salespeople have?
    There should be a simple division between advice (non- product related and provided in return for a fee by an AFA) and all other "advice" such as that provided by QFEs or RFAs. This activity should be simply classified as "sales". It therefore becomes completely clear when someone is advising and when someone is selling.

The consumer clearly understands this; for example a visit to Harvey Norman demonstrates a customer being "advised" as to the most appropriate TV, but all parties are clear that the process is one of selling. The protections afforded to consumers can therefore be covered off neatly under the Common Law duty of care – "a legal obligation imposed on an individual requiring adherence to a standard of reasonable care when performing acts that could foreseeably harm others" and a suitability test such as demonstrated by the miss-selling of PPI insurance in the UK.

The advantage of relying on the common law is it maintains an element of uncertainty so far as the seller is concerned, which is far more effective as a deterrent than terms and conditions primarily designed to limit liability rather than accept it.

14. If there was a ban or restriction on conflicted remuneration who and what should it cover?

The most obvious solution is to ban up-front commissions, especially for products which exhibit high incidences of churn. Whilst ongoing commissions are potentially necessary to fund service obligations, it is also necessary to recognise that the commission structure and therefore the product fee structure required to support such commissions, have largely been reverse engineered so the fees and commissions sustain the distribution process, rather than the actual cost of service provision.

This leads to the obvious dilemma that "advice" (and compliance costs) which may of itself not really drive performance, has an immediate and demonstrable impact on outcomes by reducing returns to investors. For example a low cost <25 basis point Kiwisaver product sold with no advice and without any regulatory oversight of sellers (but with the product regulated) would deliver on average 30+ years of compound earnings of c75 basis points above comparable full fee products. This would result in a substantially increased pension pot over traditional advised products.

Products such as insurance should have a blanket ban imposed on upfront commissions.

4.4 Competency obligations

15. How can competency requirements be designed to lift capability, without becoming an undue barrier to entry and continuation in the profession?

At the heart of this is the ability to charge an appropriate fee for the provision of financial advice. Currently this is confused by the varying compensation options open – fees, upfront commissions and trailing commissions, and the confusing status of AFA, RFE and QFE advisors. By clearly identifying sales and advice, a company can ensure that its employees are appropriately equipped to sell the specific products and services it provides, and this non-advised segment of the market provides an entry point for people to come into the industry. Those who wish to process to adviser status can therefore study for the appropriate qualifications. The requlatory body has therefore only the need to set detailed criteria for the adviser qualification, the sales based roles are controlled by principles based obligations monitored and set by their employers (as per option 4)

16. Should all advisers be subject to minimum entry requirements (Option 1)? What should those requirements include? If not, how should requirements differ for different types of advisers?

If the concept of a clear distinction between advice and sales is adopted, then the requirements for the provision of advice become clear. Additionally as being a qualified adviser is clearly

differentiated (rather than the current somewhat confused system) then there is a stronger incentive to achieve the qualification. Equally, the number of advisers under this regime does not have to be as large, as the number of consumers who actually need and seek full financial advice is likely to be limited (in the context of the overall market).

Therefore Advisers could have minimum entry requirements, mandatory and structured CPD and a stepped pathway to an adviser role (provided the final advice is signed off by a fully qualified adviser – akin to the current structure adopted by the legal profession).

Principles based obligations linked to the common law duty of care is appropriate.

For all other salespeople, a principles based approach linked to the duty of care would provide flexibility for businesses to determine how their salespeople will be competent in the light of the specific products and services they provide (sell).

4.5 Tools for ensuring compliance with the ethical and competency requirements

17. What are the benefits and costs of shifting to an entity licensing model whereby the business is accountable for meeting obligations (Option 1)? If some individual advisers are also licensed (Option 2), what specific obligations should these advisers be accountable for?

    Under my proposed solution, Advisers (AFAs) will continue to be regulated on an individual basis. This is preferred because it reflects the personal qualification and the attendant obligations (CPD) which attach to being a licenced adviser. For all other "sales" individuals, their employer would be responsible for ensuring that they met required standards.

    Sales staff should be largely covered by a miss-selling obligation linked to the common law duty of care – "a legal obligation imposed on an individual requiring adherence to a standard of reasonable care while performing acts that could foreseeably harm others".

    This should minimise the costs to the consumer as the regulation of sales staff (who are likely to represent the bulk of transactions) under this model is likely to reduce (and even more so if commissions on a range of simple products are capped).

18. What suggestions do you have for the roles of different industry and regulatory bodies?

    Individual licensing (for AFAs) and Entity (or Product Licencing for low cost products) Licencing remains the preferred option. Noting under these proposals that all staff other than AFAs would not require to be registered, and the obligation for compliance would lie with the Entity. In this structure, there is no direct regulatory role for Industry Bodies, which reduces complexity.

4.6 Disclosure

19. What do you think is the most effective way to disclose information to consumers (e.g. written, verbal, online) to help them make more effective decisions?

    In reality, very few consumers read terms and conditions, and the increasing complexity of regulation only leads to longer and longer disclosure statements – whose primary role is to protect the institution or the adviser, not the consumer. Consequently a simpler set of disclosures, linked to concepts of the duty of care and suitability, would put the onus back on the adviser or the salesperson to understand the restrictions as they apply to a product or service, and to determine the suitability of a particular product or service to the client.

This would result in shorter statements (which are capable of being disseminated using all available channels) and would bring clarity to the process. Length and complexity is the issue here, not method of communication.

20. Would a common disclosure document for all advisers work in practice?
    If restricted purely to licenced advisers rather than sales, a common disclosure document could be produced, as advisers would have a common set of obligations, and fees that were either flat or time-based, so could be easily incorporated into the document via a schedule.

21. How could remuneration details be disclosed in a way that would be meaningful to consumers yet relatively simple for advisers to produce?
    On the assumption that all advice is fee based, the remuneration would be simple to understand (flat fee or time based). Complexity arises when there is also a mix of commissions. In an environment where there is a clear separation between advice and sales, a simple fee structure for advice would provide clarity.

    In all other circumstances, sales would be linked to either a fee or, more likely, a commission (both could be expressed as a % of the monies invested). Both options would be easy for advisers/sales organisations to produce and for consumers to understand.

4.7 Dispute resolution

22. Is there any evidence that the existence of multiple schemes is leading to poor outcomes for consumers?
    In a country of four million people why are there multiple dispute resolution schemes. This HAS to add costs for consumers.

23. Assuming that the multiple scheme model is retained, should there be greater consistency between dispute resolution scheme rules and processes? If so, what particular elements should be consistent?
    Do not retain. Schemes should be consistent, in which case, we only need one.

24. Should professional indemnity insurance apply to all financial service providers?
    For all advisers, yes, as they should be considered as no different to other professional services firms. For sales staff (ie all other financial services employees) the insurance could form part of the normal corporate suite of insurance, potentially with a mandated minimum level of cover.

4.8 Finding an adviser

25. What is the best way to get information to consumers? Who is best placed to provide this information (e.g. Government, industry, consumer groups)?
    All of the above can provide information. Having removed all sales people from the register, the register would only contain advisers and licenced entities. The master register would be maintained by the regulator and of necessity would have to accessible on line.

26. What terminology do you think would be more meaningful to consumers?
    Under the proposed structure only Advisers (AFAs) could give financial advice. All other professionals would be classified as “Sales people” and would therefore provide sales.
    This eliminates the RFA and QFE designations, as well as class and personalised advice. The designation of wholesale and retail is less of an issue. Once things are classified as sales, the designation becomes largely redundant, other than the need to have received “advice” before investing in certain “wholesale” products (and therefore likely to carry more risk) if you are not

a “wholesale” investor. The designation “retail” is redundant, as a consumer is either “wholesale” or not.

4.9 Other elements where no changes are proposed

The definitions of ‘financial adviser’ and ‘financial adviser service’

27. Do you have any comments on the proposal to retain the current definitions of ‘financial adviser’ and ‘financial adviser service’?
    Financial advice is a recommendation or opinion relating to the structuring of an individual’s affairs, taking into consideration their age, needs and current and future financial position. Financial advice can also extend to the acquisition or disposal of a financial product, but only where the advice fee is not linked to the acquisition or sale of a financial product, nor is there any commission due to the adviser as a consequence of that recommendation or action.

    A recommendation or opinion relating to acquiring or disposing of a financial product in all other circumstances should be deemed to be a “sale”.

    The definition “Financial Adviser” should be restricted solely to licenced advisers (AFAs).

Exemptions from the application of the FA Act

28. Are those currently exempt from the regime posing undue risk to consumers through the provision of financial advice in the normal course of their business? If possible, please provide evidence.
    This is again dealt with by effecting the separation of sales and advice. It should be a principle that any individual providing advice is suitably licenced to the same standard, ie accountants and lawyers etc should not be permitted to provide advice without qualification. They could, of course, sell products in the normal course. The suggestion that lack of evidence of harm is an excuse for not changing the regulatory regime is unacceptable. If that is the lest to be applied, then there should be no regulation of any group (or business) that can demonstrate no harm to the consumer.

Territorial scope

29. How can the FA Act better facilitate the provision of international financial advice to New Zealanders, without compromising consumer protection? Are there other changes that may be needed to aid this, beyond the technological options outlined in Chapter 4.2?
    Restriction of advice provision to licenced NZ advisers and classifying all other activities as sales would assist in facilitating access by international groups to the NZ market. It also recognises that advice in its purest from is highly unlikely to be provided by external groups given its fee nature and the separation of advice from product sales.

30. How can we better facilitate the export of New Zealand financial advice?
    Implementation of a simple framework of regulation will facilitate the development of new methods of product sales and delivery of

The regulation of brokers and custodians

31. Do you have any comments on the proposal to retain the current approach to regulating broking and custodial services?
No

Chapter 5 – Potential packages of options

32. What are the costs and benefits of the packages of options described in this chapter?
In reality Package 1 merely perpetuates the current confusing approach to advice, and although Package 2 simplifies the situation somewhat, the reality is that Package 3 provides the clearest separation of activity, and reduces any confusion in the mind of the consumer. It also aligns financial services with the reality of sales made in other sectors, thus ensuring that the consumer is familiar with the concepts and responsibilities of the various parties to the transaction.

The benefit to the consumer (and the financial institutions) is that compliance costs are reduced and this should result in a reduction in the fees charged (but see below re low cost products), and hence a disproportionate improvement in returns to investors. It also simplifies the regulatory framework which should of itself facilitate the sale of appropriate financial solutions and reduce barriers set out in the paper.

33. How effective is each package in addressing the barriers described in Chapter 3?
Packages 1 and 2 largely attempt to address the barriers by a resort to yet more complexity. Consequently the improvements suggested, though well meaning, will be doomed to fail. By contrast, Package 3, with its inherent simplicity, has a much greater chance of achieving the stated objectives.

34. What changes could be made to any of the packages to improve how its elements work together?
In Package 3, Robo-advice(if fee only and not linked to a sale of a product) could sit in the advice (lhs) box, if linked to sales, would sit in the Sales box. There would always be an appropriateness test for any sale, so miss-selling could be addressed in the usual way. The key division between advice and sales is that the former only advises for a fee, and does not sell a product. When a product is sold it is clearly classified as a sale. Obviously we are also looking at a single dispute resolution scheme. I would also make the distinction that certain sales processes (eg a robo-sales platform) could sell multiple financial products, and they should not be restricted to a single "own-brand" product. Again the analogy is the sale of a television. Stores sell different brands of televisions which in essence perform the same function. Financial products (despite conventional wisdom) are no different.

35. Can you suggest any alternative packages of options that might work more effectively?
An addition to the packages (it would work with all 3) is the concept of simple generic "approved" products which require no advice. In essence this extends the concept of a default provider for Kiwisaver, or the UK ISA. Under this scenario, certain products would be approved by the regulator as being low-risk and with a profile which would make them suitable for all consumers. An example might be a balanced index tracking fund with low (say 15bp) fees. Another example might be a simple low cost life policy with a maximum value of $100,000. These products would have as a common theme, characteristics where there is no obvious harm which could fall to the purchaser. In a majority (almost all) of cases, advisers would recommend a balanced approach to investing, so such a product would generally err on the side of caution for consumers. Linked to low fees, no expensive distribution costs and little capacity to be enticed into more complex offerings, the vast majority of consumers would end up substantially better off due to the compounding benefits of low fees. As an aside, government should be capping fees on Kiwisaver accounts at no more than 50bp in any event.

This would move investing profits from the institutions into the pockets of the savers. As a general rule, financial advice such as 1. Pay off your mortgage 2. Pay off your credit card 3. Save for your pension 4. Put some money aside for a rainy day 5. Have a will and EPA 6.Have a basic level of life cover; should be so self-evidently beneficial as to not require formal advice. In these circumstances simple low cost products (which are regulated rather than the process of sale) are the obvious answer.

Chapter 6 – Misuse of the Financial Service Providers Register

36. Do you agree with our assessment of the pros and cons of the options to overcome misuse of the FSPR?
    Broadly, but complexities appear over-stated

37. What option or combination of options do you prefer and why? What are the costs and benefits?
    Option 6. Significant benefits to consumer protection. I believe the level of changes to legislation etc are overstated.

38. What are the potential risks and unintended consequences of the options above? How could these be mitigated?
    Can see little risks or unintended consequences

39. Would limiting public access to parts of the FSPR help reduce misuse?
    It is highly likely that there is almost no consumer use whatsoever of the FSPR. If the purpose of the register is to ensure compliance with NZ regulations etc, then it is logical to make the register non-public which minimises the potential for miss-use and provides the maximum protections for NZ consumers.

Demographics

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