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Financial Markets Policy
Building, Resources and Markets
Ministry of Business, Innovation & Employment
PO Box 3705
Wellington

Also by email: faareview@mbie.govt.nz

Submission - Options Paper: Review of the Financial Advisers Act 2008 and the Financial Service Providers (Registration and Dispute Resolution) Act 2008 ('Options Paper')

- 1 This submission is made on behalf of the Code Committee established under the Financial Advisers Act 2008 ('FAA') to develop and maintain a code of professional conduct for authorised financial advisers ('Code').
- 2 Given its statutory functions, the Code Committee's focus in this submission is on:
 - the role that a future professional standards setting body might have under the various options put forward in the Options Paper,
 - issues we have identified in relation to those options that might impede the optimal construction and operation of professional standards for financial advisers under a new regime, and
 - how the composition of a future professional standards setting body might best be constructed to support the objectives of the FAA.
- 3 In making a formal submission, the Code Committee considers that it would be inappropriate for it to comment on other issues raised in the Options Paper, although Code Committee members have their own views on a number of those issues. The Code Committee is grateful to the Ministry for the manner in which it has highlighted the challenges faced in designing a regime that will promote the confident and informed participation of business, investors and consumers in financial markets, with the primary goals of:
 - ensuring consumers have the information they need to find and choose a financial adviser
 - ensuring financial advice is accessible for consumers on reasonable terms, and
 - promoting public confidence in the professionalism of financial advisers.

The Ministry's work has been of considerable assistance to the Code Committee as we have considered adjustments to the Code in light of the above goals and issues identified by the Ministry in the course of its review.

The role of a future professional standards setting body

4 The FAA requires the Code produced by the Code Committee to provide for minimum standards of professional conduct that must be demonstrated by authorised financial advisers, including minimum standards of:

- Competence
- Knowledge and skills
- Ethical behaviour
- Client care.

The Code is also required to provide for continuing professional training for AFAs, including specification of minimum requirements an AFA must meet for the purpose of continuing professional training.

5 At present, the Code sets as its paramount professional standard the requirement to place the interests of the client first and act with integrity.¹ The Code Committee strongly supports the proposals in Packages 2 and 3 of the Options Paper to lock into the future legislation a base requirement for anyone holding themselves out as a financial adviser to always put the consumer first. We believe this is a pivotal requirement to be satisfied if the objectives of the regime are to be achieved, and agree with the elevation of this Code Standard to the legislation itself.

6 One of the functions of a future Code would then be providing guidance as to how this core 'consumer first' obligation might be applied in practice, against a range of circumstances. This is largely the model followed in the Code at present. The balance of the ethical behaviour and client care Code Standards after Code Standard 1 (placing client interests first and acting with integrity) flesh out various aspects of how that paramount Code Standard will be applied in practice and how it will be evidenced.

7 The Code Committee also supports locking in a statutory principles-based competency obligation, requiring financial advisers to be competent at all times to provide their services,² with a future Code then addressing specific requirements for particular types of financial advisers and types of advice, which would then form part of the licensing requirement process. This is reflected in Package 2 of the Options Paper. The licensing model outlined in Package 3 is less clear in this regard, and is not supported by the Code Committee.

8 A key advantage of the Code concept is the flexibility it offers. With the statutory framework appropriately set and fundamental obligations locked into the legislation on a principles-basis, having a relatively nimble code of professional conduct detailing the minimum professional standards for financial advisers enables the regulatory requirements to respond swiftly and appropriately to a dynamic and ever-changing environment.

9 The present requirement to have professional standards set by an independent body like the Code Committee and documented in a Code, as opposed to being left to be assessed on a case by case basis through a regulator licensing process³, carries with it a high level of

¹ See code Standard 1.

² See Code Standard 14.

³ As appears to be contemplated under Package 3 of the Options Paper.

transparency and certainty for financial market participants. The Code Committee sees this degree of transparency as essential to the integrity of the regime.

- 10 There is no reason why a Code cannot be constructed to cater for a wide array of financial advisers and types of financial advice, with the confidence of knowing that if any standards turn out to have unintended consequences in practice, the Code can be adjusted with relative ease. Such flexibility and transparency of the standard setting process is consistent with the intent of the FAA, and should remain in any future regime.

Optimising the effectiveness of a future Code

- 11 The biggest constraint on the effectiveness of the Code under the current law is its lack of universal application. There are only around 1850 authorised financial advisers who are directly subject to the Code, compared with in excess of 6,400 registered financial advisers not required by law to abide by the Code, with a further 26,000 financial advisers working for Qualifying Financial Entities. The ability of the Code to meet the statutory objective of promoting public confidence in the professionalism of financial advisers has been hamstrung as a consequence. This is notwithstanding the Ministry's observations expressed in the Options Paper that there has been an overall increase in the professionalism of financial advisers.
- 12 A key weakness of Package 2 of the Options Paper is that the complexity created by the FAA's current recognition of two substantive tiers of financial advisers would be perpetuated through the statutory recognition of 'Expert Advisers' and only requiring those advisers to abide by the Code. The Code Committee does not support the creation of a new layer of complication with an 'Expert Adviser' category. Why restrict the Code's ethical and competency standards to 'Expert Advisers'? This new category of adviser looks very much like a rebranded authorised financial adviser, and the present unevenness of the playing field would be perpetuated as a result.
- 13 The Code Committee's firm recommendation is that the professional conduct standards set out in any future Code should apply to all those who provide or hold themselves out as providing financial advice, with all financial advisers bound by a common, meaningful disclosure obligation in relation to any financial adviser service provided. The Code's professional standards will clearly need to be modified to cater for the full spectrum of financial advisers, but that should not deter the pursuit of this more principled approach to regulating the sector, with exceptions to the Code's scope minimised. Any other approach to the breadth of the Code's application is bound to deliver a sub-optimal outcome in pursuing the statutory objectives as currently stated, and will perpetuate the opportunities for regulatory arbitrage created by the current regime's uneven playing field.
- 14 The Code Committee also believes that it is important for there to be a single code to which all financial advisers must abide, at least for the foreseeable future. Otherwise, the risk of inconsistency, consumer confusion, and consequent loss of confidence created by allowing financial advisers to operate under various sets of standards is too great.

Appointment of the professional standards setting body and the role of professional bodies

- 15 The Code Committee believes that retaining the FAA's current approach of having the professional standards setting body appointed independently of the industry, operating independently of the regulator and with a single Code created, is the optimal approach. It provides for a degree of separation from the industry, while still facilitating industry buy-in

through separating the regulator from the development of the professional standards that the industry must observe in practice.

- 16 The Options Paper identifies the risk of adviser capture of the standard setting process where the professional standards are not set by statute or by the regulator. This concern was also raised in relation to the Code Committee with its early work. Notwithstanding these concerns, the Code Committee is aware of proposals from some quarters to extend the stated role of professional bodies under Package 3 of the Options Paper⁴ to setting professional standards. We do not support any such extension to the legislated role of professional bodies, for the reasons noted below.
- 17 The Code Committee acknowledges that there has been a considerable lifting in the professionalism of the approach taken by the professional bodies active in the financial advice sector over the past five years. However, having a regulatory framework that provides for professional bodies to determine their own rules of professional conduct, without a regulatory overlay and/or independent disciplinary process risks undermining the regime's objective of promoting increased consumer confidence in the professionalism and integrity of financial advisers. Inevitably, no matter how principled the approach taken by the professional bodies, ill-informed or aggrieved sections of the public will view separate segments of the profession regulating their own with a high degree of scepticism, exposing the regime to the complaint of looking after its own. We believe the outcome would be negative for both financial advisers and consumers alike⁵.
- 18 Even just providing for industry bodies to have direct input into the licensing process, as appears to be the structure put forward under Package 3 of the Options Paper, would undermine the integrity and consistency of the regime. The Code Committee firmly supports the concept of professional industry bodies assisting members with compliance, CPD, and best practice, and acknowledges the positive work existing bodies have been doing in this space in recent years, but does not see a formal place for those bodies in the legislation to directly influence either the Code or the licensing process. The Code Committee's view is that the value added by professional bodies is important to the overall success of the regime, but that value is added through the quality of the services they deliver, which is independent of the legislative framework. These services include contributing to the standard setting process on areas within their expertise, and contributions by professional bodies to the Code's development have been invaluable over the years. However, the legislated contribution should not extend to directly controlling the design of the rules.
- 19 A further concern with providing a formal role for professional bodies in the standard setting process is in the range of bodies currently active in the financial advice sector. Each professional body has a distinct area of interest, with different drivers at play. The risk of inconsistency, complexity and consumer confusion over what standards might apply would be extreme if separate codes of professional conduct were allowed to be developed by each. Instead, we see the those bodies who wish to do so playing an important role in imposing their own rules over and above the minimum standards determined under the Code, raising the bar for their own members. By doing so, those professional bodies can play a key role in

⁴ Providing materials to assist with compliance, Continuing Professional Development, and best practice.

⁵ While not directly analogous given the differences in the regulatory framework, discussion on this point has some parallels with the discussion that led to the rebooted Real Estate Agents Act 2008 and the creation of the Real Estate Agents Authority as a replacement for industry-led regulation through the Real Estate Institute of New Zealand. Prior to the legislative overhaul, a perceived lack of enforcement by the industry body combined with outdated penalty provisions for the limited number of cases the industry body chose to pursue, had created a widely-held belief that agents were looking after their own interests before those of consumers. No matter how professionally the Institute discharged its functions, the industry as a whole was exposed to reputational harm from this perception.

raising professional standards overall. Consumers should have a far better chance of not being confused by that approach – knowing that all financial advisers have a base regulatory set of professional standards, but if they deal with a member of a particular professional body then they can expect a higher level of professionalism.

Composition of the professional standards setting body

- 20 The Code Committee's view is that the rules for the composition of the Code Committee currently set out in the FAA are sound. That requires a committee of at least seven persons appointed by the Financial Markets Authority, of whom at least one must be qualified by reason of knowledge of, and experience and competency in relation to, consumer affairs, with the balance qualified for appointment by virtue of knowledge of, and experience and competency in relation to, the financial adviser industry.
- 21 The key to any successful standard setting body is to ensure that there is a wide range of perspectives and experiences at the decision making level. The FMA has achieved this through the approach it has taken to date in appointing members of the Code Committee. We do not believe any formal adjustment or greater prescription is required.
- 22 The Code Committee has considered the possibility of adding a requirement that at least one of its members be qualified for appointment by virtue of their experience in relation to professional bodies operating in the financial advice sector. On balance, we do not believe that degree of prescription is required or appropriate. The ability of the FMA to appoint individuals who it believes will best contribute to the ongoing development of the Code, with the only constant being to ensure there is someone with direct experience in consumer affairs, is important.
- 23 In light of concerns that have been raised by the financial advice sector in recent times of perceptions of the Code Committee having been captured by the FMA, there may be merit in considering adding a requirement that the Code Committee operates without being subject to undue influence by the FMA, reflecting the actual position. However, the logistical implications of doing so must be considered, and we have not seen evidence to suggest the imposition of statutory constraints in this regard is warranted.

Conclusion

- 24 We would be happy to work with the Ministry over the months ahead to explore the various issues we have raised, and assist with producing a set of workable criteria for a future professional standards setting body that we believe would best support the regulatory objectives.

Yours faithfully

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David Ireland
Chairman, Code Committee

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