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SUBMISSION ON CONSULTATION PAPER – NEW FINANCIAL ADVICE REGIME

As a NZX Participant firm, QFE and one of the largest single employers of AFAs, Forsyth Barr has a unique perspective on the operation of the Financial Advisers Act ("FAA").

We have contributed to the Security Industry Association submission, but also wish to provide a separate but simpler submission on what we see as some key issues raised by the options paper. We otherwise support the Security Industry Association submission.

As this submission focuses on a small subset of the consultation questions, we have not used the submission template.

No part of this submission is confidential.

While every effort has been made to obtain accuracy, no liability is accepted for any errors or for opinion expressed. Disclosure Statements are available on request and free of charge.

Part 3 of the Bill sets out additional regulation of financial advice

5. **Do you agree that the duty to put the client's interest first should apply both in giving the advice and doing anything in relation to the giving of advice? Does this make it clear that the duty does not only apply in the moment of giving advice?**

   We support a general "client first" duty, but have concerns with the current formulation.

   First, we think the duty should relate only to provider/client and adviser/client conflicts. Client/client conflicts (such as can arise when advising two clients on the same investment opportunity) should not be captured; there are obvious issues if there is a requirement to put the interests of each client ahead of those of the other clients.

   Secondly, we are concerned that extending the duty to apply whenever "doing anything in relation to the giving of the advice" will have unintended consequences. Without a clear boundary as to when the duty applies, there is likely to be a chilling effect on adviser activities that are not clearly outside the duty, which in turn is likely to impact on access to advice. In particular, difficulties potentially arise if the duty applies when giving the client information on the scope of the service, where advisers may in effect feel that they are required to advise the client whether the scope of service is appropriate to meet their needs.

   Accordingly we believe the "client first" duty should be linked to the scope of service being provided to the client.

   We also agree with the Code Committee's submission that the best way to implement this duty would be to impose a general duty to place clients' interests first in accordance with relevant standards of the code of conduct. This would allow a nuanced approach that, for example, could differentiate between wholesale and retail clients. This step of course pre-supposes that the Code should apply to providers who do not provide a retail service (see Q7 below).

6. Do you have any comments on the proposed wording of the duty that a provider must not give a representative any kind of inappropriate payment or incentive? What impacts (both positive and negative) could this duty have?

   We agree that incentives should not be inappropriate. However we think the wording of proposed s 431O(2) should expressly recognise that the assessment of whether an incentive is likely to have the effect of encouraging breaches of the other duty provisions takes place in light of the provider's internal processes and controls.

7. Do you support extending the client-first duty to providers who do not provide a retail service (i.e. those who only advise wholesale clients)? Why or why not?

   Generally speaking, we think it is consistent with the aims of the legislation that the

client-first duty should apply to everyone who provides financial advice, particularly given that the threshold for being a "wholesale client" will be crossed by many retirees who will not necessarily be financially sophisticated.

We also support the Code Committee's submission that the code should apply not just to retail services. In particular, we also support the Code Committee's submission that the proposed new s 431J is changed so that rather than stating the section only applies to a retail service, it states that the Code may impose different standards for a financial advice service that is not a retail service, or impose standards that only apply when dealing with a retail client. This could allow (for example) the Code to specify standards for the client-first duty that were different not just as between retail and wholesale clients, but as between "retiree" wholesale clients and truly professional investors.

Alternatively the definition of "wholesale client" could be amended to reflect those parties that are truly professional/institutional investors and exclude parties who are high net worth individuals but are effectively retail investors in terms of their sophistication.

8. Do you have any other feedback on the drafting in Part 3 of the Bill?

It was common ground heading into the FAA review that the various acronyms in use in the market (AFA, RFA, QFE etc) had created consumer confusion. The replacement terms (financial advice provider, financial adviser, financial advice representative) seem unlikely to alleviate this situation. We suggest that:

(a) the term "financial adviser" be replaced by "authorised financial adviser" as per the current regime. This will allow for continuing use of a term that many consumers are familiar with. There has been considerable investment in this brand and it is held with some pride by those individuals who have spent time obtaining and maintaining that status. We do not believe "AFA" is broken. We believe it has been crowded out by too many other similar acronyms. The proposed new terms are all too similar and will re-create the current problem that people cannot distinguish between acronyms.

(b) the term "financial advice representative" be shortened to "provider representative" or, at the provider's option, "XYZ representative" (where XYZ is the trading name of the provider). We believe this shorter name more accurately signals to consumers the kind of advice they are likely to get from financial advice representatives (that is, it is likely to be limited in scope to the provider's products). We do not agree with using the words "financial" or "advice" to associate with these individuals as it will create confusion to clients between those who can genuinely provide financial advice and others who are effectively selling products.

We also query why, in proposed s 431E, financial advice representatives should not be subject to disciplinary action in the case of a breach of a duty provision. Under the draft legislation, financial advisers and financial advice representatives are, subject to compliance with the various duties, able to provide the same advice on the same

financial products. It therefore seems odd that financial advice representatives are not subject to disciplinary action, when (given the absence of civil liability) this is likely to be an extremely important incentive to comply with the duties (and, given the likely publicity, for the provider to ensure that they comply with the duties). In fact as drafted the proposed legislation has no accountability mechanism for financial advice representatives at all. This carries the additional risk that poorly-behaving representatives are able to move from one provider to another with no register or record of any disciplinary issues.

We believe that, to avoid the risk of unintended consequences such as were seen with the QFE regime, it is important for the playing field to be as level as possible as between financial advisers and financial advice representatives. We therefore submit that financial advice representatives should be subject to disciplinary action in the case of a breach of a duty provision.

Part 4 of the Bill sets out brokers' disclosure and conduct obligations

10. Do you have any other feedback on the drafting of Part 4 of the Bill, for example any suggestions on how the drafting of broker provisions could be simplified or clarified?

    We think that the term "broker" is confusing – brokers are generally thought of as those who buy and sell for others, rather than those who hold money and property on behalf of others. A better term could be "holding agent" (and "holding service" instead of "broking service").

    We also note that the "commingling' prohibition (s 431X(2)) has been carried over from the Financial Advisers Act. This prohibition was introduced to the Financial Advisers Act without full consultation and, for various technical reasons relating to the way in which the New Zealand financial system works, has resulted in extensive practical difficulties for NZX firms. We suggest that MBIE considers whether an absolute prohibition on commingling remains appropriate, or whether, given the other statutory protections relating to client money and property, a better cost/benefit result would be achieved if commingling was permitted to the extent reasonably necessary for a broker's business. Please refer to the SIA submission on this point for more detail.

Part 5 of the Bill makes miscellaneous amendments to the FMC Act

11. Should financial advisers have direct civil liability for breaches of their obligations, if the financial advice provider has met its obligations to support its advisers? Why or why not?
    We do not believe that there would be any useful purpose in extending civil liability to financial advisers, who (unlike licenced providers) are not subject to any financial resources or insurance requirements and are thus able to arrange their affairs to ensure that they do not have any assets.

    If civil liability was to be extended to financial advisers, then logically it should be extended to financial advice representatives also.

12. Should the regime allow financial advice providers to run a defence that they met their obligations to have in place processes, and provide resources to enable their advisers to comply with their duties?

    No, we believe that financial advice providers should stand behind the actions of their advisers and representatives. In many cases a statutory defence would not actually protect financial advice providers in any case, as the relevant contract is likely to be with the provider not the adviser or representative, meaning that the provider would likely be liable for contract damages.

Schedule 2 of the Bill creates a new schedule to the FMC Act with detail about the regulation of financial advice

24. Should the FMC Act definition of 'wholesale' be adopted as the definition of wholesale client for the purposes of financial advice? Why or why not?

    We believe the definitions should be aligned to the extent possible, both for consistency and to create a clearly demarked boundary for clients. We note that some aspects of the FMCA definition relate to particular offers of financial products and may not carry over for the purposes of financial advice.

    We also believe that there should be an express "safe harbour" for clients self-certifying as wholesale for advice purposes (cf FMCA Schedule 1 clause 44).

30. Should the Financial Advisers Disciplinary Committee consider complaints against financial advice providers as well as complaints against financial advisers? Why or why not?
    We think the Committee should be able to consider complaints against providers (as well and financial advisers and financial advice representatives – see Q8 above). The adverse publicity from disciplinary proceedings is an important incentive for providers to ensure that their advisers and representatives comply with their duties, particularly in cases of lower-order infringements where litigation costs mean that civil action is unlikely.

32. Do you have any other feedback on the drafting of Schedule 2 of the Bill?
    We note that the Bill carries over the existing "ancillary services" carve-outs for accountants and lawyers. We note that this carve-out is not well policed and that anecdotal evidence suggests that some accountants and lawyers are offering financial advice that goes well beyond what would normally be considered to be "in the ordinary course" of carrying out those occupations. To avoid doubt, the drafting could perhaps be amended to state that the advice would need to be a "necessary incident" of carrying out the occupation in the relevant case.

About transitional arrangements

33. Are there any other objectives we should be seeking to achieve in the design of transitional arrangements?
    It will be important to ensure that there can be a smooth transition from existing arrangements to the new regime. Providers will not be able fully to analyse changes to their requirements until the amending legislation is enacted, so it will be important that the process by which transitional arrangements are finalised allows for a period following enactment for any potential issues to be identified and addressed.

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