New Zealand Shareholders Association Inc.® NZSA
Many Investors, One Voice

29 March 2017

New Zealand Shareholders Association Feedback on the Draft Financial Services Legislation Amendment Bill

Relationship of Submitter

The New Zealand Shareholders Association (NZSA) is the only independent national group that represents the interests of retail investors in the equity markets.

One of our major concerns is the need to engender confidence in the regulation and operation of the New Zealand capital markets. We therefore, take a close interest in the "public good" aspect of legislative changes or amendments of existing legislation as part of our core function. The availability of quality investment advice is a key component in the mix. This feedback is written to present the perspective of the prudent, but non expert retail investor.

While our views will necessarily be coloured by our advocacy for equity investment, we have attempted to consider the broader implications of advice being required for other financial activities including banking and insurance.

Key Issue: Proposed Terminology.

NZSA has strong concerns about the proposed terminology. In our view, 'Financial Advisers' and 'Financial Advice Representatives' will perpetuate the current confusion that applies with AFAs, RFAs and QFEs, a key consideration when looking at the target market for financial advice – largely retail clients who have limited knowledge of the various roles and skills on offer.

We see a need for distinct and differentiating titles for these positions and the service they provide. NZSA has considered a number of titles that would address these concerns.

These are set out below:

Current terms:	Financial Adviser (FA)	Financial Advice representative (FAR)
Proposal1	Investment Adviser (IA)	Financial Representative (FR)
Proposal 2	Financial Adviser (FA)	Service Representative (SR)

Since the higher ranked role requires qualifications/standards then perhaps the a further solution could be that the role's title has to contain a word such as Certified/ Accredited/ Qualified/ Registered, and maybe the initials of the appropriate qualification

So we could have:
Qualified Financial Adviser (QFA) and Financial Service Representative (FSR).

(This potentially confuses with the QFE terminology in the existing legislation, but since it is not known or understood by most retail clients, we do not believe this would be a significant issue.)

Part 1 of the Bill amends definitions in the FMC Act

1) If an offer is through a financial advice provider, should it be allowed to be made in the course of, or because of, an unsolicited meeting with a potential client? Why or why not?
NZSA considers the solution is not black and white. We do not want completely unsolicited financial advice to be lawful (such as cold calling). However, financial advice that is incidental to the primary purpose of a meeting should be allowed.
The question is posed from the perspective of the financial advice provider, but as the customer facing link will be via a financial Advice representative (or whatever better term is ultimately decided) that is the better point to consider. For example, a bank teller advising a customer that a term deposit may be a better option when the client has presented simply to deposit a sum of money is potentially useful advice.
We note that such advice incidental to the normal course of business is specifically excluded for groups such as lawyers - which we see as pragmatic and appropriate.

2) If the exception allowing financial advice providers to use unsolicited meetings to make offers is retained, should there be further restrictions placed upon it? If so, what should they be?
The overriding restriction should be that such incidental advice is in the best interest of the customer or client in as much as it advantages the position they would otherwise be in. We consider this is implicit in the legislation, but if there is any doubt, it should be explicitly stated.

3) Do you have any other feedback on the drafting of Part 1 of the Bill?
NZSA is not expert in drafting legislation. Our concern is with the content and intent of the Bill and we expect the legislation to reflect what is finally proposed.

Part 2 of the Bill sets out licensing requirement.

4) Do you have any feedback on the drafting of Part 2 of the Bill?
Having Financial Advice Providers licensed is a key concept which we strongly support.
NZSA accepts the drafting of the Bill is appropriate.

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?
NZSA strongly supports this option. We are aware of commentary, particularly from the current Code Committee which describes "putting the clients interests first" as aspirational in nature and not appropriate to be in black letter law. We disagree.
Most law is "aspirational" to some extent. A simple example is "you shall not murder anyone". A fine aspiration which is no doubt strongly supported by most people and especially the victims, but which does not stop murders being committed nor people being tried.
Arguments have been raised that the requirement is too narrow and is effectively only a conflict of interest restriction. In our view, putting the interests of the client first includes the conflict of interest test, but is not necessarily limited to just that. We believe that the content of Part 3, Cl 431 need to be viewed holistically and this should be a sufficient guide if the new Code Committee seek to further elaborate on what was intended in future guidelines.

Does this make it clear that the duty does not only apply in the moment of giving advice?
NZSA considers the current drafting makes the position clear.

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?
NZSA agrees with the intent of the provision. The difficulty lies in how this is observed in practice. For example churning in the insurance industry would be difficult to capture. A clear set of guidelines will need to be developed to make this provision workable. We believe that bringing financial service providers into Disciplinary Committee coverage would facilitate early action where such issues arise. See also our answer to Q 12 and Q 30.

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?
As noted previously, NZSA strongly supports the concept that the client must always come first. In most transactions, there is an inequality of information and the client first concept goes a considerable distance to addressing that.
NZSA also considers the client first concept should extend to wholesale clients. We note that clients will have the option to opt out of being wholesale clients where they otherwise would qualify under the Bill and question whether it should be made compulsory that this option is explained in all cases where certification of being a wholesale client is being sought.

A potential solution may be to exclude entities that meet wholesale requirements and "are in the business of investing" from being covered by the client first concept, but to include all others.

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8) Do you have any other feedback on the drafting in Part 3 of the Bill?
No further comment.

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

9) What would be the implications of removing the 'offering' concept from the definition of a broker?
NZSA agrees with the removal of the word. It adds no clarification to the definition.

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?
No additional comment

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?
Yes. They should have civil liability.
NZSA believes that failure to include this provision will blur the responsibilities in an unnecessary manner. Financial advisors by definition have individual responsibilities and should not be able to hide behind a corporate veil. The suggestion that they remain liable is broadly analogous to the provision introduced when the FMCA was developed that prohibited fund managers setting off their liabilities to other service providers involved in the provision of their services.

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?
We are opposed to allowing this defence. In our view, this would only serve to blur responsibilities in the same way as the answer to question 11 above. In addition, not allowing the defence will incentivise providers to be very proactive in their training of advisors and enhance their oversight of the activities of the advisors to ensure they are compliant.

13) Is the designation power for what constitutes financial advice appropriate? Are there any additional/different procedural requirements you would suggest for the exercise of this power?
NZSA agrees that the proposed designation power is appropriate and necessary.

14) Do you have any feedback on applying the concept of a 'retail service' to financial advice services? Is it workable in practice?
We consider that the providers will have enough information from their enquiries of clients to be able to comply with this requirement. We note that wholesale advice requires clients to have certificated their eligibility.

15) Do you have any other feedback on the drafting of Part 5 of the Bill?
No additional feedback.

Part 6 of the Bill amends the FSP Act

16) Does the proposed territorial application of the Act set out above help address misuse of the

FSPR? Are there any unintended consequences? How soon after the passing of the Bill should the new territorial application take effect?

NZSA believes it is very difficult to regulate effectively against internet based offers from overseas resident entities. To some extent Cl 6a(2)(b) seems to contradict Cl 6a(1)(a). The difference appears to be related to the terms "accessible to" and "promoted". In practical terms we see little difference when considering offers on the internet. Perhaps using terms such as marketing/making offers or similar terminology rather than "promote" may reinforce the intent. If entities do not meet the territorial requirements they cannot register and it will be important to continue to educate people to only utilise offers that are registered under the FSPR.

17) Do you support requiring further information (such as a provider's AML/CFT supervisor) to be contained on the FSPR to help address misuse?

This technical issue is beyond our mandate to comment.

18) Do you consider that other measures are required to promote access to redress against registered providers?

No further comment.

19) Do you have any comments on the proposed categories of financial services? If you're a financial service provider, is it clear to you which categories you should register in under the proposed list?

This question is not relevant to NZSA.

20) Do you support clarifying that schemes must provide information to the FMA if they believe that a provider may be involved in conduct that constitutes breach of relevant financial markets legislation?

We consider the provisions of S67 to be relevant and reasonable. Without such a provision it is likely that repeatedly unsatisfactory performers may never come to the attention of the regulator. It is important for public confidence in the financial markets that unsatisfactory participants are weeded out, subject of course to proper investigation and due process.
We also believe that greater protection should be afforded to "whistleblowers" who are an important source of information in such circumstances.

21) Do you have any other feedback on the drafting of Part 6 of the Bill?

NZSA shares the concerns of others that the Bill currently fails to address the issue of a financial advice representative who has been found in breach of the New Code from moving from one financial advice provider to another with no public record of the breach. This will inevitably lead to a public loss of confidence in the system once such a situation occurs and the media become involved. An example is the outcry when someone with a previous conviction commits further offences (such as theft as a servant) when the new employer had no way of determining that there had been previous transgressions. It would be naive to expect all representatives to be fully truthful in such circumstances when applying for a new position. Therefore, we support the setting up of a suitable register to record such information and available to licensed for proper purposes.

Schedule 1 of the Bill sets out transitional provisions relating to DIMS, the code of conduct and the disciplinary committee

22) When should an FMC Act DIMS licence granted to AFAs who provide personalised DIMS

*expire? For example, sh*ould it expire on the date on which the AFA's current authorisation to provide DIMS expires?
We see no reason why this expiry should not occur as soon as the Act comes into force as DIMS providers remain covered by other legislation – the very reason they are being removed from this Act.

23) Do you have any other feedback on the drafting of Schedule 1 of the Bill?
NZSA is not an expert on legislative drafting. We have no concern with the intent of Schedule 1 beyond issues already raised.

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?
Please refer to our earlier submissions and the comments in Q 7 above. In the event that there is no material change, NZSA considers it sensible that the definition in the FMCA is adopted.

25) We understand that some lenders consider that they may be subject to the financial adviser *regime because their interactions with customers during execution-only transactions could be seen to include financial advice. Does the proposed clarification in relation to execution only services help to address this issue?*
NZSA agrees that the proposed clarification is clear.

26) Are there any unintended consequences resulting from the minor amendments to the exclusions from regulated financial advice, as detailed above?
NZSA is concerned that the exemptions are less than clear for organisations such as itself. In our view NZSA would be exempt as we are a not for profit, do not charge individually for information we provide to members and others and are not in the business of providing personalised financial advice. However, we do charge a membership fee. We also make extensive commentary at times and may take a position on matters relating to investment in a specific listed entity.
While it may be argued that Clauses 6, 7(1) and 10 of the Bill give sufficient comfort, we note that clauses 7(2),(3) allow exemptions for a range of commentators such as journalists, teachers and even real estate agents. We believe that not for profit organisations providing representation, support, information, opinion and education to investors or potential investors should also be specifically excluded in the interests of promoting an informed market.

27) Do any of the membership criteria or proceedings for the code committee require further clarification? If so, what?
NZSA believes that the proposal for the Chair to have a casting vote is flawed. In our view, if there is no clear majority, the matter being voted on should fail and the status quo prevail. Arguably the membership should always be an uneven number to prevent the situation and this could be incorporated. Either way, the mandate has to be clear.

28) Does the drafting of the impact analysis requirement provide enough direction to the code committee without being overly prescriptive?
NZSA has no opinion on this matter.

29) Does the wording of the required minimum standards of competence knowledge and skill which 'apply in respect of different types of advice, financial advice products or other

circumstances' adequately capture the circumstances in which additional and different standards may be required?
We consider the wording satisfactory. It gives the new Code committee wide jurisdiction to determine the standards and to alter these as circumstances dictate.

Complaints and disciplinary proceedings

30) Should the Financial Advisers Disciplinary Committee consider complaints against financial advice providers as well as complaints against financial advisers? Why or why not?
Part 5 of the Bill appears to limit the activities of the Disciplinary Committee to only Financial Advisers. We believe this should be extended to the Providers as well, since they are the ones who are subject to the regulations and they usually set the rules that govern the actions of their employed Financial Advice Representatives. Their Representatives are effectively only subject to employment law.
Without coverage from the Disciplinary Committee, action against providers will be limited to slow and expensive processes via FMA or the courts. This would generally be beyond the ability of retail clients to initiate. We expect it would need a high level of significance for FMA to take over under S34 provisions in the FMCA.
We would expect the disciplinary committee would need to have representatives from both financial service providers and retail investors on the panel to give commercial balance to the considerations. Care would be needed to ensure Committee is properly resourced.

31) If the jurisdiction of the Financial Advisers Disciplinary Committee is extended to cover financial advice providers, what should be the maximum fine it can impose on financial advice providers?
We believe it should for the reasons outlined above.
In regard to penalties, the fines available for different levels of culpability that are used to guide the NZX market disciplinary committee may give a suitable starting point.
Many providers are large organisations, so another approach may be to set penalties that are in excess of any gain (say 150%). This would deter activities that might be commercially viable at lower levels of penalty.

32) Do you have any other feedback on the drafting of Schedule 2 of the Bill?
No further comment.

3 Transitional Arrangements

33) Are there any other objectives we should be seeking to achieve in the design of transitional arrangements?
The arrangements appear reasonable with objectives being consistent across the board.

34) Do you support the idea of a staged transition? Why or why not?
NZSA supports the concept of a staged transition. Advisors, providers and regulators all need a reasonable opportunity to adjust systems (and in some cases add resources) to enable compliance. We consider the proposal analogous to the staged introduction of the FMCA which has been largely straightforward.
It would further confuse retail investors if regulation was imposed early and different providers or advisors gave conflicting information as a result of being unprepared.

35) Is six months from the approval of the Code of Conduct sufficient time to enable existing industry participants to shift to a transitional licence?

We believe the proposal provides a practical time frame.

36) Do you perceive any issues or risks with the safe harbour proposal?

NZSA considers the safe harbour proposal to be satisfactory.

37) Do you think there are any elements of the new regime that should or shouldn't take effect with transitional licences? What are these and why?

NZSA has no view as these matters are beyond our practical experience.

38) Is two and a half years from approval of the Code of Conduct sufficient time to enable industry participants to become fully licensed and to meet any new competency standards?

NZSA cannot specifically answer this question as we are not involved in these business activities. However, in general terms, we would like standards to be introduced in the shortest time possible, and accept they will need to be staggered to achieve this.

Possible complementary options

Option 1: Temporary Grandfathering for existing Authorised Financial Advisers

39) Do you support the option of AFAs being exempt from complying with the competence, knowledge and skill standards for a limited period of time? Why or why not?

Yes we do. See below Q 42.

40) Would it be appropriate for the exemption to expire after five years? If not, what timeframe do you suggest and why?

See below Q 42.

41) Is there a risk that this exemption could create confusion amongst industry and for consumers about what standards of competence, knowledge and skill are required?

See below Q 42.

42) If you support this option do you think it should be set in legislation or something for the Code Working Group to consider as an option as it prepares the Code of Conduct?

NZSA favours a degree of 'Grandfathering' with the provision that the ongoing education programme (CPD) is a requirement for all.
Failure to provide a "grandfathering" option will risk significant numbers of experienced, but older advisors leaving the profession, something that was a problem with the initial legislation. The new Committee Code group should develop parameters allowing for this option.

However, we would oppose the finance industry (or profession) being treated differently from other industries and professions. Most have compulsory requirements for CPD (continuing professional development) programs in order to maintain registration, whether achieved by assessment or grandfathering.

Option 2: Demonstrating Competence through an Assessment Process

43) Do you support the option of a competency assessment process for existing AFAs and RFAs? Why or why not?

We do not favour this option with no grandfathering provisions for the reasons outlined in Q 42.

44) Is it appropriate for the competency assessment process to be limited to existing AFAs and RFAs with 10 or more years' experience? If not, what do you suggest?
See Q 42. Such an action would likely have negative consequences.

45) If you support this option do you think it should be set in legislation or something for the Code Working Group to consider as an option as it prepares the Code of Conduct?
See Q 42. In the event that this option was selected, we believe it would be more appropriate for the Code Committee to consider.

Phased approach to licensing
46) What would be the costs and benefits of a phased approach to licensing?
We are unable to quantify these matters as we are not industry participants.

47) Do you have any suggestions for alternative options to incentivise market participants to get their full licences early in the transitional period?
No further comment.
48) Do you have any other comments or suggestions regarding the proposed transitional arrangements?
No further comment.

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