OFFICE OF THE MINISTER OF
COMMERCE AND CONSUMER AFFAIRS

Chair
Cabinet Economic Growth and Infrastructure Committee

Further Policy Decisions to Improve Access to High Quality Financial Advice

Proposal

1 This paper seeks additional decisions on a number of features of the new regulatory regime for financial advice.

2 It also seeks delegated authority for me to approve and release an exposure draft of the legislation and related commentary later this year.

Executive Summary

3 In July 2016 Cabinet agreed to the overarching design of an amended regulatory regime for financial advice [CAB-16-MIN-0336]. The new regime is intended to improve access to high quality financial advice.

4 The Parliamentary Counsel Office is preparing an exposure draft of the amendment Bill that will give effect to the new regime. This will involve repealing the Financial Advisers Act 2008 (FA Act) and incorporating the regulation of financial advice into the Financial Markets Conduct Act 2013 (FMC Act) and amending the Financial Service Providers (Registration and Dispute Resolution) Act 2008 (FSP Act).

5 Cabinet invited me to report back on several aspects of the proposed regime, which officials were continuing to analyse. Some additional matters requiring decisions have also come to light through the drafting process. This paper sets out my recommendations on the following matters:

5.1 Compliance and enforcement tools

5.1.1 I propose that financial advice firms be subject to compliance and enforcement tools provided under the FMC Act for other licensed services. I propose to retain the Financial Adviser Disciplinary Committee for breaches by individual financial advisers.

5.2 Mechanics of the Code of Conduct and Code Committee

5.2.1 Under the new regime, all financial advice will be subject to a Code of Conduct. (Currently only a subset of advisers is subject to a Code of Conduct.) I am proposing to carry over provisions for the existing Code

of Conduct and Code Committee, which oversees the Code, subject to minor amendments to ensure they are consistent with previous Cabinet decisions and reflect best practice. I also propose to appoint a Working Group to begin drafting the new Code of Conduct prior to legislation being enacted.

5.3 Transitional arrangements

5.3.1 The paper outlines a transitional regime that requires all advice to be covered by a transitional licence within six months of the new Code of Conduct being approved. Transitional arrangements will be consulted on when I release the exposure draft of the amendment Bill.

5.4 Regulation of discretionary investment management services (DIMS)

5.4.1 DIMS are currently regulated in two separate ways, under the FA Act and the FMC Act. I propose that all providers of DIMS be subject to the same requirements and regulated in the same way under the existing FMC Act licensing provisions.

5.5 Regulation of advice provided to wholesale clients

5.5.1 I propose that advice to wholesale clients be subject to the legislative consumer first and disclosure obligations, but those who only advise wholesale clients not be required to be covered by a financial advice firm licence. The implications of this proposal will be consulted on when I release the exposure draft.

5.6 Options to publish an annual register of soft commissions paid to financial advisers and agents

5.6.1 This paper includes a summary of work on soft commissions and my plan to use existing powers under the Financial Markets Authority Act 2011 to request that the Financial Markets Authority (FMA) collect and publish information on soft commissions.

5.7 Complementary measures to help address misuse of the Financial Service Providers Register (FSPR)

5.7.1 The paper seeks agreement on additional measures to complement the changes already agreed by Cabinet that will address misuse of the FSPR.

6 For expediency, I am seeking delegated authority from Cabinet to approve and release an exposure draft of the amendment Bill and related commentary, once complete.

7 I aim to release an exposure draft of the amendment Bill at the end of this year, and to introduce the Bill into the House next year.

Background

8 This Government has a goal, set out in the Business Growth Agenda, of building a more productive and competitive economy that creates business opportunities and jobs, grows

wages, and ultimately provides the higher living standards to which New Zealanders aspire.

9 To achieve this, New Zealand needs thriving financial markets in which investors can participate with confidence. A necessary condition for this is a fair and accountable financial advice regime that ensures consumers can access high quality financial advice that meets their needs. The regime also needs to avoid unnecessary compliance costs and enable innovation.

10 As required by statute, the Ministry of Business, Innovation and Employment (MBIE) reviewed the Financial Advisers Act 2008 (FA Act) and the Financial Service Providers (Registration and Dispute Resolution) Act 2008 (FSP Act), and made recommendations to improve New Zealand's financial advice regime.

Cabinet agreed to a new regime for financial advice

11 In July 2016 Cabinet considered the outcomes and recommendations of the review and agreed to the overarching design of an amended regulatory regime for financial advice [CAB-16-MIN-0336].

12 The new regulatory regime will achieve the following outcomes:

12.1 create an even playing field for the provision of advice by requiring all advisers to put the interests of the consumer first and meet competency requirements;

12.2 remove regulatory boundaries to encourage innovation, enable the provision of online 'robo' advice, and ensure consumers can access good advice in response to simple questions such as 'what KiwiSaver fund is right for me?';

12.3 improve consumer understanding by introducing simplified disclosure requirements and removing confusing terminology; and

12.4 maintain the integrity of New Zealand's financial markets by requiring businesses to demonstrate a stronger connection to New Zealand in order to be registered on the Financial Service Providers Register (FSPR).

13 The key structural changes that will be introduced by the new regime are:

13.1 The three current types of advisers – 'Authorised Financial Adviser' (AFA), 'Registered Financial Adviser' (RFA) and 'Qualifying Financial Entity' (QFE) – which each have different standards, will be removed. Instead, anyone providing financial advice will be held to the same standards.

13.2 All financial advice will be required to be covered by a licence granted by the Financial Markets Authority (FMA) and licensing will occur at the firm level. Anyone providing financial advice will need to be engaged by a licensed financial advice firm.

13.3 All financial advice will be subject to the same broad legislative requirements, which are as follows:

13.3.1 a conduct obligation to place the interests of the consumer first;

13.3.2 a competency obligation to only provide financial advice where competent to do so;

13.3.3 a disclosure obligation to disclose prescribed information; and

13.3.4 a client care obligation to ensure that consumers are aware of the limitations of their advice.

13.4 All financial advice will be held to a Code of Conduct, which will contain minimum standards of conduct, competence, client care and continuing professional development. (Currently a Code of Conduct only applies to AFAs.)

14 The changes will be achieved by repealing the FA Act and incorporating the regulation of financial advice into the FMC Act. A Bill that would give effect to these changes is currently being drafted.

This paper reports back on remaining decisions for the new regime

15 In July 2016 Cabinet invited me to report back on several aspects of the proposed regime, which officials were continuing to analyse [CAB-16-MIN-0336]. This paper sets out my recommendations on these matters:

15.1 compliance and enforcement tools;

15.2 mechanics of the Code of Conduct and Code Committee;

15.3 transitional arrangements;

15.4 complementary measures which could help address misuse of the FSPR; and

15.5 a timeline for the legislative process.

16 Cabinet also directed officials to explore options to require financial product providers to publish an annual register of soft commissions paid to financial advisers and agents. This paper includes a summary of that work and my recommendations regarding soft commissions.

17 Since Cabinet last considered the proposed new regulatory regime for financial advice, further matters that require consideration have come to light. This paper includes my recommendations on these matters, which are:

17.1 how discretionary investment management services (DIMS) should be regulated under the new regime;

17.2 how advice provided to wholesale clients should be regulated; and

17.3 additional technical matters that have arisen through the drafting process.

Compliance and enforcement tools

Cabinet has already made high-level decisions on the accountabilities of financial advisers and firms

18 Cabinet agreed that, under the new regime, financial advice firms would be licensed consistently with the licensing regime under Part 6 of the FMC Act and would be accountable for the firm's legislative and regulatory obligations and for their agents.

19 Cabinet also agreed that individual financial advisers would be accountable for their legislative and regulatory obligations. This gives rise to the question of how these obligations will be enforced and what the consequences of breach will be.

Proposal: Compliance and enforcement tools for financial advice firms

20 I propose that, consistent with Cabinet's previous decisions, financial advice firms be subject to the FMC Act compliance and enforcement tools for licensed services. These are as follows:

20.1 Civil pecuniary penalties and compensation for persons who operate without a licence, falsely hold themselves out as licensed, or provide a disclosure document containing false or misleading statements.

20.2 The ability for the FMA to undertake a number of licensing actions, such as censure, imposition of action plans, directions, or the suspension or cancellation of a licence.

20.3 Civil pecuniary penalties and compensation for licensee breaches of obligations. Actions of individuals acting on behalf of the licensee are attributable to the licensee for this purpose.

20.4 Criminal offences for matters such as knowingly or recklessly providing a disclosure document containing false or misleading statements, or failing to follow an FMA direction or order.

21 I propose that breaches by financial advice firms of the core legislative obligations for financial advice (such as the requirement to place the interests of the consumer first) result in civil pecuniary penalties of up to up to $200,000 for an individual (e.g. a sole trader) or $600,000 in any other case. This is consistent with how breaches of similar obligations are treated under the FMC Act, such as the obligations on DIMS providers to comply with professional standards of care.

Proposal: Compliance and enforcement tools for individual financial advisers

22 Under the FA Act, Authorised Financial Advisers (AFAs) who breach their obligations (apart from the Code of Conduct) can have their authorisation suspended, removed or debarred by the FMA. The FMA can also amend the terms and conditions of authorisation, and issue directions to financial advisers who breach terms and conditions.

23 AFAs who breach their obligations under the Code of Conduct are subject to a Financial Advisers Disciplinary Committee. The Disciplinary Committee can censure, impose conditions, require the adviser to undergo training, impose a fine of up to $10,000 or recommend that FMA suspend or cancel an authorisation. The FMA can also amend,

suspend or cancel an AFA's authorisation for breaches of various statutory provisions, such as failing to act with care, diligence and skill.

24 I propose to carry forward these enforcement mechanisms as follows:

24.1 The FMA will be able to suspend, cancel or debar the registration of a financial adviser. The FMA's direction powers in the FMC Act will also apply to financial advisers.

24.2 The Financial Advisers Disciplinary Committee will be retained, and will consider complaints against financial advisers.

25 Under the new regulatory regime, there will be less of a distinction between conduct that breaches legislative obligations and conduct that breaches the Code of Conduct. I therefore propose that the FMA and Disciplinary Committee will each be able to address breaches of both legislative conduct obligations and the Code of Conduct.

26 Currently if an FMA investigation finds than an AFA has breached the Code of Conduct it *must* refer the complaint to the Disciplinary Committee. This may be unnecessary and costly where the breach is minor and technical – such as a minor error in record keeping – and is inconsistent with FMA's prosecutorial discretion in other legislation that it enforces. By requiring the FMA to refer complaints to the Disciplinary Committee it may also impede the ability of the FMA to settle claims against AFAs.

27 I therefore propose to provide that where the FMA finds a breach, it may refer a complaint to the Financial Advisers Disciplinary Committee, but is not required to do so.

Additional options to be consulted on in the exposure draft

28 Although there has been substantial consultation on the obligations of financial advice firms and advisers, we expect to receive more detailed comment on the enforcement of these obligations once stakeholders can see their implementation in legislation.

29 Two issues where the compliance and enforcement regime could be further refined are:

29.1 whether the Financial Advisers Disciplinary Committee should consider complaints against financial advice firms as well as complaints against financial advisers; and

29.2 whether financial advisers should be solely accountable for breaches of their obligations, where the financial advice firm has met its obligations to support its advisers.

30 While I am not seeking agreement on these matters at this stage, I propose to consult on them with stakeholders by including them as options in the exposure draft of the Bill.

Proposal: Align liability for breaches of other obligations with the FMC Act liability regime

31 The FA Act currently includes criminal offences for a wide range of breaches. This contrasts with the approach of the FMC Act, which provides a mix of criminal offences and civil remedies. In 2011 Cabinet considered the FMC Act liability regime, and agreed the following [CBC Min (11) 4/3]:

31.1 Civil remedies (i.e. pecuniary penalties and compensation orders) should be available for contraventions of securities law.

31.2 Serious criminal penalties should be available only for egregious breaches.

31.3 Regulatory offences (minor offences) would apply for breaches of securities law that were harmful, but not sufficiently serious to be treated as standard criminal offences.

32 Cabinet agreed six tiers of liability, and the option of issuing infringement notices (of up to $20,000) for regulatory offences, as an alternative to prosecution. [CBC Min (11) 6/9].

33 I propose that in carrying over obligations from the FA Act into the new regime, or creating any other obligations, liability for breaches should be aligned with the more recent FMC Act regime, which represents best practice. This includes:

33.1 Recommending an offer (e.g. recommending a consumer buy a particular financial product) that contravenes financial markets legislation will have civil remedies.

33.2 Failures by brokers to comply with requirements around client money and property will have civil remedies.

33.3 Failure to comply with a disciplinary committee order or a summons to attend a disciplinary committee hearing will be a regulatory offence.

Mechanics of the Code of Conduct and Code Committee

Cabinet has agreed a Code of Conduct will apply to all financial advice

34 Under the current regime, a subset of financial advisers – AFAs – must adhere to a Code of Conduct, but the less-regulated majority of advisers are not required to.

35 Cabinet agreed that under the new regime all financial advice will be held to a Code of Conduct, which will set minimum standards of conduct, competence, client care and continuing professional development [CAB-16-MIN-0336].

36 Because the existing Code Committee for AFAs is operating well, it makes sense for the new Code Committee to inherit some of its features. However, given that the regulatory regime is changing, and the new Code of the Conduct will apply to all financial advice, the new Code Committee will need to differ from the current Code Committee in a number of ways.

Proposal to carry over some features of the existing Code of Conduct

37 I propose that the new Code Committee inherit some features from the existing Code Committee for AFAs, set out in sections 81–95 of the FA Act. The key features to be carried over are:

37.1 The Code Committee must have no fewer than seven and no more than eleven members.

37.2 The appointment of a member of the Code Committee must be for a specified period, but a member may be discharged before his or her period of appointment has expired.

37.3 The quorum for a meeting of the Code Committee is five members.

37.4 Every question before the Code Committee must be determined by a majority of the votes of the members present or otherwise.

37.5 The chairperson of the Code Committee has a deliberative vote and, in the case of an equality of votes, a casting vote.

Proposal to expedite development of the first Code of Conduct

38 It is desirable to provide the industry with certainty and guidance as soon as possible about what compliance with the new regime will entail. However, as the Code Committee will be established through statute, it cannot be appointed until after passage of the Bill that gives effect to the new regime. Leaving development of the Code of Conduct until after the Bill is passed and the Code Committee is appointed would both perpetuate industry uncertainty and delay the benefits of the regime being realised.

39 I therefore propose to appoint a Code Working Group in early 2017 (i.e. before the Bill is passed) to feed into the development of the Code of Conduct. The membership of the Code Working Group would reflect the required composition of the Code Committee as outlined in the Bill.

40 The Code Working Group would research and develop options for code standards and content, and prepare a draft Code for recommendation to the Minister. The terms of reference for the Code Working Group would mirror the procedural requirements for the production of the Code, as set out in the Bill.

41 The Minister of Commerce and Consumer Affairs would take the Code Working Group appointments and terms of reference through the APH and EGI Cabinet committees, respectively.

42 Once the Bill is passed, the Minister would approve the first Code of Conduct, based on the recommendations of the Code Working Group.

43 The function of the Code Committee (appointed once the Act has come into force) would be to maintain the Code of Conduct, and recommend to the Minister changes to the Code (rather than to produce the initial draft code).

44 The Act would need to contain transitional provisions to allow the Code Working Group's process to meet the procedural requirements as set out in the Act, even if the processes are undertaken prior to enactment.

45 As outlined in the section on financial implications, the cost of funding the Code Working Group will be met through MBIE baselines.

Proposal for broader membership criteria

46 Whereas the existing Code Committee for AFAs must comprise one consumer representative, and other members who have "knowledge of, and experience and competency in relation to, the financial adviser industry", I propose that under the new regime the representation of consumer interests is increased and the other selection criteria are broadened, to ensure flexibility.

47 I propose that the Code Committee comprise:

47.1 two members qualified for appointment based on their knowledge, skills and experience in relation to, consumer affairs or dispute resolution; and

47.2 other members who are qualified for appointment, having regard to the functions of the Code Committee, by virtue of that person's knowledge, skills and experience in financial services, or any other knowledge, skills and experience deemed relevant.

48 These criteria will ensure that the Code Committee has a membership with the appropriate mix of skills, knowledge and experience to maintain a Code of Conduct for all financial advice. It will also maintain flexibility around the composition of the Code Committee, and allow it to be adapted based on developments in the financial advice market.

Proposal that the Minister approve the draft Code of Conduct on the FMA's advice

49 Currently, the FMA and then the Minister of Commerce and Consumer Affairs must approve the draft Code of Conduct. However, this double-handling is not efficient.

50 I propose that the FMA should not have an approval role for the new Code of Conduct. Rather, the Minister of Commerce and Consumer Affairs should approve the Code of Conduct, and be required to consult with the FMA in doing so.

51 For the Minister to approve the draft Code of Conduct, he or she would have to be satisfied that Code Committee members have reached a majority agreement, that they have met their consultation obligations, and that the draft code is consistent with the purposes and statutory requirements of the new financial advice legislation.

52 This option will make the approval process more efficient and remove the double-handling, while maintaining the FMA's input.

Proposal that the Minister appoint the Code Committee

53 Code Committee appointments are currently the responsibility of the FMA, but there are established protocols for Ministerial appointments, which create checks and balances on the appointment process. The appointment process for the Code Committee should be consistent with best practice for rule-making authorities.

54 I therefore propose that the Minister of Commerce and Consumer Affairs appoint and discharge members of the Code Committee. The Minister would take the appointments through the APH Cabinet committee.

Proposal to bring the proceedings for preparing the Code of Conduct in line with occupational regulation best practice

55 Minor amendments need to be made to ensure the proceedings for producing the Code of Conduct are consistent with occupational regulation best practice for rule making.

56 I propose that the process for preparing the draft Code of Conduct be amended to specify that the Code Committee must have regard to: the main purposes of the FMC Act, any additional purposes of the FMC Act relevant to financial advice, and any international obligations that apply to New Zealand in regards to financial markets or advice.

57 I also propose that when reviewing the Code of Conduct, the Code Committee be required to publish a summary of the submissions received and their response to these submissions, as well as an impact analysis that refers to the purposes of the FMC Act and any other purposes (as specified above).

58 These transparency provisions are good regulatory practice that the government applies to itself, which should be extended to those exercising delegated powers.

Transitional arrangements

59 The new regime for financial advice will, amongst other things, remove the current types of financial advisers (AFA, RFA, and QFE), create a licensing regime that operates at the firm level, and introduce new conduct and competency requirements for all financial advice.

60 These are significant changes, and existing advisers and financial advice firms will need time to transition to and operate under the new regime. For example, they will need sufficient time to get a licence, update disclosure material and ensure that they meet the competency standards (with some advisers likely needing to undertake further training).

61 Officials have considered a range of options to ensure the requirements of the new regime are introduced with regard to these kinds of practicalities. The proposed approach is designed to:

61.1 bring each element of the new regime into effect as soon as practicable;

61.2 ensure existing industry participants can transition to the new regime smoothly and with an appropriate amount of time;

61.3 minimise unnecessary compliance costs; and

61.4 minimise disruption for consumers.

Proposed transitional arrangements

62 I propose to consult on transitional arrangements when I release the exposure draft of the amendment Bill later this year. It is critical that the transitional arrangements are fit for purpose and strike the right balance between giving the industry the time and means to shift to the new regime, while realising the benefits of the new regime as soon as possible.

63 My proposed transitional arrangements are outlined below (except for my proposal regarding expedited development of the Code of Conduct, which is outlined in paragraphs 38–45 in the previous section of this paper). I have also included on page 13 a diagram illustrating indicative timeframes for transition (Figure one: Proposed Transitional Arrangements).

The new regime will take effect and all financial advice will come under a transitional licence by August 2018

64 I propose that all existing industry participants be required to be transitionally licensed within six months of the approval of the Code of Conduct. (Based on the indicative timelines, as depicted on page 13, this is estimated to be August 2018.) The Code of

Conduct would also come into effect on this date. This allows industry up to six months to prepare to comply with the Code of Conduct before it comes into effect.

65 Under the FMC Act, the FMA has discretion as to the licensing process. I envisage transitional licensing will be simple, and will essentially involve notification to the FMA (in contrast to the full licensing process; see below). This would bring existing advisers into the regime (making them subject to the new legislative obligations, Code of Conduct and enforcement mechanisms) without requiring them to satisfy the full licensing requirements, which some firms will need more time to meet.

66 Transitional provisions would make it clear that the existing industry participants could continue to operate under the existing competency and scope of service requirements for a further two years after they become transitionally licensed. In particular, a temporary safe harbour would specify that transitional licence holders would not breach the competency standards in the Code of Conduct if they limit their services to those which the FA Act currently enables them to provide. This recognises it may be difficult for some advisers to comply with the competency standards set out in the Code of Conduct so soon after its approval.

67 Transitional licensing would give the FMA oversight of existing RFAs within a year of the Bill being passed. (Currently the FMA has oversight of AFAs, but not the much larger population of RFAs.) Transitional licensing would also provide the FMA and education providers with a better sense of who is operating in the market, enabling them to commit adequate resources for compliance and training. It would also help advisers to progressively move towards operation under the new regime, making the transition smoother and more manageable, particularly in relation to competency requirements.

Full licences

68 Two years after all industry participants had shifted to transitional licensing, transitional licences would expire and financial advisers would be required to be employed by a financial advice firm operating under a full licence, with the safe harbour provision ceasing to have effect at this point (estimated August 2020).

69 The full licensing process would be more comprehensive than the transitional process, but would also be flexible and depend on factors such as the nature and size of the firm and the services it provides [CAB-16-MIN-0336].

Authorised Financial Advisers deemed to comply with the competency standards

70 AFAs already operate under a regulatory regime which holds them to a Code of Conduct and competency standards. I propose that existing AFAs should be deemed to comply with the competency standards in the new Code of Conduct for the financial advice services which they are currently allowed to provide, with a longstop (such as five years). However, they would not be exempt from the obligation to only provide advice where competent to do so or the continuing professional development requirements.

Registered Financial Advisers able to demonstrate competence through portfolios

71 Unlike AFAs, RFAs will, under the new regime, be operating under substantially greater legislative obligations, including competence requirements. Nevertheless, there are RFAs who have many years' experience, and it may not be appropriate to require them to undertake formal training to demonstrate compliance with the new Code of Conduct standards.

72 I propose that existing RFAs who have worked in the industry for a minimum of ten years be able to prove their competency without undertaking formal training. The exact nature of the assessment is yet to be confirmed, however it could include sitting a test, providing a portfolio of work for review, and interviews.

73 This would enable experienced and competent RFAs to transition to the new regime without undertaking further training which may have been required otherwise, saving time, resource and money.

Diagram for the transitional process

74 Figure one, below, illustrates the various steps to transition from the existing regime to the new regime.

75 The key dates are as follows, assuming the amendment Bill is passed by September 2017:

- August 2018 – the new regime takes effect and all industry participants must be operating under a transitional licence.
- August 2020 – all industry participants must be operating under a full licence. This includes meeting any competency requirements set in the Code of Conduct (apart from existing AFAs, who are deemed to be competent up to the five-year longstop date).

Figure one: Proposed Transitional Arrangements

Timeline – Key Activities	
2017	
Code Working Group appointed	Feb
Bill introduced	Apr
Bill passed	Sept
Licensing and disclosure regulations made Code of Conduct approved (but not yet in force)	Dec
2018	
FMA licensing guidance released Transitional licence applications open	Feb
All existing industry participants must have obtained a transitional licence New regime takes effect (including new Code of Conduct and new adviser designations) with a competency safe harbour Full licence applications open	Aug
2019	
2020	
Transitional licences expire All industry participants must be operating under a full licence Competency safe harbour ceases	Aug

Code of Conduct

- Code Working Group appointed in early 2017 to develop and recommend a Code before the Act comes into force.
- Minister able to approve the Code after enactment.
- Will provide industry with more certainty about the requirements sooner, alleviating anxiety about any changes.
- Will also mean that most elements of the new regime will be able to take effect sooner.

Transitional licensing period

- All existing industry participants must be licensed within six months of the approval of the Code of Conduct.
- Relatively easy process – industry participants will not need to satisfy the full licensing requirements.
- Brings existing industry participants into the new regime quickly – subject to new Code of Conduct and enforcement measures.
- Protected by competency safe harbour but must limit their services to those they are currently able to provide.
- Gives FMA and education providers time to commit resources for training and compliance.
- Will make transition to full licence smoother and more manageable for industry.

Full licensing

- Existing industry participants will have at least two years from transitional licensing taking effect to be operating under a full licence.
- More comprehensive requirements than the transitional period, but will also be flexible and depend on factors such as the nature and size of the firm and the services it provides.
- Competency safe harbour will cease and all industry participants will be required to meet the competency standards in the Code of Conduct, except for existing AFAs, who are deemed to comply until the longstop date.

Code of Conduct
Legislation and regulations
Full licensing
Transitional licensing

Regulation of discretionary investment management services

76 Discretionary investment management services (DIMS) are services in which the provider decides which financial products to acquire or dispose of on behalf of and authorised by their client.

77 DIMS are currently regulated under two separate Acts:

77.1 The regulation of most DIMS is provided under the FMC Act, which introduced a licensing regime for DIMS providers. These providers can offer any sort of DIMS.

77.2 Some providers (AFAs) can provide personalised DIMS (where the service is tailored to the investor's unique personal circumstances) under the FA Act. These providers are exempt from being licensed under the FMC Act.

78 While DIMS providers may currently operate under one of two Acts, the obligations for all DIMS providers are very similar. This is because, when the FMC Act licensing regime for DIMS was introduced, a series of complementary changes were made to the regulation of DIMS under the FA Act to bring the two systems in line with each other.

79 The new regime for regulating financial advice will be brought into effect by repealing the FA Act and incorporating the regulation of financial advice into the FMC Act. This means that, unless changes are made, DIMS will be regulated in two distinct ways under the same Act: under the existing provisions for licensing DIMS providers, and under the new provisions that license firms providing financial advice. This would be confusing and unnecessarily complex.

Proposal to licence all DIMS in the same way

80 To avoid the problem of DIMS being regulated in two distinct ways under the same Act, I propose that all providers of DIMS should be subject to the same requirements and should be regulated in the same way.

81 I propose all DIMS should be regulated under the existing FMC Act DIMS licensing regime.

82 I propose to achieve this by:

82.1 removing DIMS from the definition of 'financial adviser service', so it is not captured under the new provisions; and

82.2 removing the FMC licensing exemption (in section 389(2)(b) of the FMC Act), that allows some providers to provide limited personalised DIMS under the FA Act.

Transitioning DIMS to the new regime

83 These changes will require the ten DIMS providers who currently operate under an exemption from the FMC Act licensing regime to become licensed under the FMC Act.

84 As these providers are already subject to obligations that are similar to those imposed by the FMC Act, I propose that they be granted licenses under the FMC Act, subject to the condition that the service they provide remains limited to that which they can currently provide under the FA Act (i.e. personalised DIMS). Apart from the initial granting of the

licence, the providers will be subject to all requirements that currently apply to FMC Act DIMS providers.

85 This will ensure that providers can continue to provide DIMS with minimal disruption, but will overcome the risk of providers offering DIMS they have not been assessed as fit to provide.

86 If these providers wish to expand their DIMS service beyond personalised DIMS, they can apply for a variation to their licence under the FMC Act.

Regulation of advice provided to wholesale clients

87 Wholesale clients are generally large and/or sophisticated clients such as banks, investment businesses or high-net-worth individuals who do not require or benefit from the same degree of protection as retail clients. For example, wholesale clients include:

87.1 A person who owns a portfolio of specified financial products of a value of at least $1 million (in aggregate).

87.2 A person with net assets of over $5 million.

87.3 A person who is an investment business which in turn includes a registered bank, a licensed insurer, or an entity whose principal business consists of investing in financial products.

88 Because wholesale clients are better able to look after their own interests and less vulnerable to information asymmetries, there is currently a lower entry hurdle for advisers wishing to provide advice to wholesale clients only. Further, some of the regulatory requirements, including disclosure and dispute resolution, do not apply when providing advice to wholesale clients. This reduces transaction costs for both wholesale clients and the advisers they are dealing with.

89 However, the definition of 'wholesale clients' can never perfectly divide those who this regime seeks to protect versus those who are capable and better-off looking after their own interests. There remains a risk that some consumers may meet the definition of wholesale clients who are not truly sophisticated or institutional clients. They may be unaware of their wholesale status or their ability to opt-out of that status.

Cabinet has noted the existing approach to regulating wholesale clients will be retained

90 Cabinet noted that the broad approach to regulating wholesale clients would be retained in the new regime [CAB-16-MIN-0336]. In line with that approach:

90.1 The new regime will retain the FA Act definition of a wholesale client (with any minor or technical amendments needed to incorporate these provisions into the FMC Act).

90.2 The new regime will retain the lower entry hurdle for those who wish to provide advice to wholesale clients only. A firm or individual providing advice to wholesale clients only will need to be registered but will not need to be covered by a financial advice licence – and therefore will not be subject to ongoing monitoring requirements, be required to comply with the Code of Conduct, or be subject to the licensing enforcement tools.

90.3 The current legislative conduct obligations – to exercise care, diligence, and skill and not engage in misleading or deceptive conduct – will continue to apply to all financial advice, including advice to wholesale clients.

91 Two policy questions remain:

91.1 When a firm has both wholesale and retail clients, in which circumstances should a financial advice licence (and associated obligations and enforcement) apply?

91.2 Should the new conduct and disclosure obligations apply when advising wholesale clients?

When a firm has both wholesale and retail clients, in which circumstances should a financial advice licence (and associated obligations and enforcement) apply?

92 I propose that a licence and the associated obligations should apply to any service that meets the FMC Act definition of a 'retail service', irrespective of whether it is being provided to wholesale or retail clients.

93 Under the FMC Act, a 'retail service', is a service supplied to:

93.1 a retail investor, or

93.2 a class of investors where there is at least one retail investor in that class.

94 A financial advice service provided to at least one retail client would be classed as a retail service and would be covered by the financial advice firm's licence (with associated obligations applying). For example, a bank's wealth-banking division would likely involve advice to at least some retail clients and hence would be a retail service. (See below for Figure two: Obligations when providing advice to retail clients).

95 In contrast, a firm could have a purely wholesale advice offering which would not be covered by the licence. For example, a bank's corporate/institutional banking unit will likely only provide services to other businesses.

96 However, the FMA would have the ability to designate a service as retail. They could use this power if, for example, a firm had a wholesale service that was not clearly demarcated from its retail service.

97 This option minimises the risk of consumers who are not truly sophisticated or institutional clients losing all protections, since such consumers are more likely to seek advice from a provider that advises (at least some) retail clients.

98 It also ensures that any service provided to both retail and wholesale clients is regulated in a single consistent way, which will avoid confusion.

Disclosure requirements should apply to both wholesale and retail advisers

99 I propose that all advice (including advice to wholesale clients) be subject to the new legislative obligation to disclose prescribed information.

100 The content, format and timing of disclosure will be detailed in regulations [CAB-16-MIN-0336]. This will allow flexibility to tailor different disclosure requirements for wholesale versus retail clients.

101 For example, the disclosure requirements for wholesale advisers could be to take reasonable steps to ensure the client is aware they are regarded as a wholesale client, the consequences of that status, and that they can opt-out of that status.

The consumer-first obligation should apply when providing advice to wholesale clients

102 I propose that all advice (including advice to wholesale clients) be subject to the new legislative obligation to place the interests of the consumer first. This will create a level playing field whereby all advice is subject to the same broad conduct standard.

103 I propose to consult through the exposure draft on the implications of this proposal. However, my initial view is that these are the new baseline obligations which all advice should be held to. This will decrease complexity and improve investor confidence.

Figure two: Obligations when providing advice to wholesale clients

	Retail service (when provided to a **retail client**)	**Retail service** (when provided to a **wholesale client**)	**Wholesale service** (by definition, can only be provided to a wholesale client)
Service is required to be covered by a **licence**, with associated monitoring and other licence obligations applying.	✓	✓	×
Service is subject to the **Code of Conduct**	✓	✓ (but Code may set different standards for advice to wholesale clients, as per the current AFA Code of Conduct)	×
Service is subject to conduct obligation to place the **interests of the client first**	✓	✓	✓ (consulting through the exposure draft on the potential costs of this obligation applying to a wholesale service)
Service is subject to obligation to **disclose** prescribed information.	✓	✓ (but prescribed disclosure to wholesale clients likely to differ)	✓ (but prescribed disclosure to wholesale clients likely to differ)

Holding-out to wholesale and retail clients

104 Cabinet previously agreed that 'financial adviser' would be a restricted title. Consistent with this decision, and with the proposals above regarding advice to wholesale clients, I propose:

104.1 Holding out to a retail client: A person must not hold themselves out to a retail client as a financial adviser unless they are both registered on the FSPR and engaged as a financial adviser by a licensed financial advice firm.

104.2 Holding out to someone other than a retail client: A person must not hold out to someone who is not a retail client as a financial adviser unless they are registered on the FSPR as a financial adviser.

104.3 Holding out as being able to provide a given service: A person may only hold themselves out as being a financial adviser in respect of the financial advice services that they are competent to provide.

Soft commissions

105 Soft commissions are non-monetary incentives attached to the sale of a certain product. They are used in some parts of the financial advice industry. They can take the form of overseas trips, tickets to sporting events, or software subsidies. They are often a volume-based incentive, and so have the potential to impact the behaviour of advisers. An FMA report published this year on the issue of 'churn'[1] in the life-insurance sector found that overseas trips appear to be an effective sales incentive for advisers. Policies no longer subject to clawbacks[2] were 2.2 times more likely to be replaced if overseas trips were offered as an incentive.

106 In July 2016 Cabinet agreed to direct officials to explore options to require financial product providers to publish an annual register of soft commissions paid to financial advisers and agents.

107 There are a number of features of soft commissions that make them different to other sales incentives, possibly warranting disclosure that is additional to the prescribed disclosure to consumers. These features include:

107.1 Soft commissions can be difficult to attribute to any one sale and therefore disclosure of soft commissions to consumers can be problematic;

107.2 Soft commissions are easier to hide from consumers (as they do not directly affect pricing); and

107.3 Soft commissions can be perceived as more valuable than the retail of that award in cash – and may therefore be more motivating to the recipient.

108 Regular reporting and publication of soft commissions paid could facilitate greater public and media scrutiny of soft commissions, which may in turn result in:

108.1 consumers who are more aware of the incentives that may be influencing the individuals selling them insurance, mortgages or other financial products

108.2 a disincentive for providers to pay soft commissions in the first instance if the volume, number or nature of the reward will not stand up to public scrutiny.

Proposal

109 Officials have explored options that may achieve these outcomes and recommend using the FMA's existing powers without imposing rigid annual reporting requirements.

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[1] 'Churn' describes the practice of an adviser moving a consumer to a new policy based on the commission and incentives payable to an adviser, rather than because it is in the customer's best interest.

[2] A 'clawback period' is the period within which a financial adviser must repay a portion of the commission they received from an insurance provider if the policy is cancelled.

110 Section 25 of the Financial Markets Authority Act 2011 (FMA Act) allows the FMA to gather information on market participants while Section 9 allows the FMA to issue warning reports or make comments about any matter relating to financial markets or financial markets participants.

111 In addition, as the responsible Minister, I have the ability to request the FMA investigate and report on soft commissions. The FMA Act states that the Minister responsible for the administration of the Act may "request that the FMA inquire into, and report on, any matter relating to the financial markets, financial markets participants, or other persons engaged in conduct relating to those markets".

112 Use of these existing powers would allow soft commissions to be reported on in a more targeted and lower cost manner than a formal annual register.

113 I plan to ask the FMA to collect and publish information on soft commissions. This will increase public and media scrutiny of soft commissions and will signal to industry that Government is taking an interest in incentive structures that may be counter to consumers' interests. It will also provide a baseline against which future changes in the payment of soft commissions could be compared.

Risks and Mitigations

114 The shift to firm-level licensing will mean increased obligations and liabilities for firms. The release of the proposed compliance and enforcement mechanisms (in the exposure draft of the Bill) may elicit some concern from firms about their increased responsibilities.

115 Nevertheless, I believe there is a strong justification for the changes, as firms influence the behaviour of their advisers, and increased responsibility for advisers' behaviour will incentivise firms to properly vet, support and monitor the behaviour of their advisers.

116 There may also be broader concerns across the sector about the uncertainties around transitioning to the new regime. I am confident that this is being mitigated as far as possible though my proposed transitional arrangements, including grandfathering the competence of some advisers into the new regime, and the early issuing of the Code of Conduct.

Complementary Measures to Address Misuse of the Financial Service Providers Register

117 The Financial Service Providers Register (FSPR) is a searchable online register of the people, businesses and organisations that offer financial services in New Zealand. It contains important information about financial service providers, including the types of services they are registered for and their dispute resolution scheme. However, registration on the FSPR does not necessarily mean a provider is licensed or regulated in New Zealand or elsewhere.

118 In July 2016 Cabinet noted that some predominantly offshore-controlled entities allegedly involved in fraudulent activities have been registering on the FSPR to create the impression to customers that they are licensed or actively monitored in New Zealand. An underlying issue is that the public often misinterprets "registered" on the FSPR to mean that an entity is actively regulated in New Zealand.

119 Cabinet agreed to address this by amending the FSP Act to require that companies registered on the FSPR have a stronger connection to New Zealand. Cabinet also

directed officials to consider complementary measures which could help address misuse of the FSPR.

120 Complementary measures may help mitigate some of the risks that remain even when the bar for registration is set higher – in particular:

120.1 An applicant may have put forward a business plan when applying for registration showing an intention to provide certain services in order to meet the higher bar for registration. However, they may not give effect to the plan post-registration.

120.2 The circumstances of a provider may change after registration. The FMA and Registrar of Financial Service Providers are aware of instances of persons offering to buy ownership in existing financial service providers, presumably to avoid initial checks as to whether they met the requirements of the FSP Act.

120.3 Providers may find new ways of misusing the FSPR. Some providers may adjust their operations in order to meet the amended registration requirements, for example, by undertaking token transactions with New Zealand customers. Conversely, some New Zealand-based financial service providers that should be registered could adjust their operations in order to avoid registration.

121 To help address these risks, I propose the following measures:

Limitations on advertising of registered status

121.1 I propose that, if an entity is not otherwise licensed in New Zealand, then if it refers to its New Zealand registered status (other than where required by law), it must make clear the limitations of being registered, i.e. that registration does not indicate the entity is licensed or monitored by a regulatory agency in New Zealand. This would prevent offshore-controlled businesses that are already registered on the FSPR from using that status to imply they are regulated in New Zealand. Breach of the limitation would be a ground for deregistration.

Deterring directors from aiding misuse of the FSPR

121.2 The Registrar of Financial Service Providers can currently require a registered provider to supply information to help the Registrar ascertain whether they remain qualified to be registered. I propose to strengthen those powers by granting the Registrar the power to require information or confirmation of information from particular directors of an applicant or registered financial service provider.

121.3 The director would then be personally liable for any false or misleading statements that are given. Failing to comply with a request would also be grounds for de-registration after an appropriate process. This is intended to deter New Zealand individuals from helping to facilitate misuse of the FSPR by agreeing to act as nominee directors of offshore-controlled entities applying to be registered.

Providing mechanisms to ensure the Act captures those that should be registered

121.4 I propose that the FSP Act include a power allowing certain additional groups of providers to be designated as requiring registration under the Act. The power would be subject to certain criteria, including that it must be exercised consistent with the purposes of the Act and be necessary to protect the integrity and reputation of New Zealand's financial markets. This would guard against the risk of providers seeking to avoid the regulatory perimeter.

122 I also propose that officials explore whether regulations should prescribe further information to be contained in the register that may help the public to make decisions about whether they wish to engage with a particular provider. This may include information about the extent to which the provider is regulated offshore.

Further details on the criteria for registration

123 In July 2016 I noted to Cabinet that officials would continue to engage with the FMA, other interested government agencies and industry to refine and test the degree of "stronger connection to New Zealand" required for registration on the FSPR.

124 I propose to consult on the detail of the criteria for registration through the exposure draft of the amendment Bill. Consultation will help to minimise the risk of unintended consequences and uncertainty. I propose to consult on an approach where entities can (and must) register only if they are:

124.1 in the business of providing financial services to New Zealanders; or

124.2 otherwise required to be licensed under any other New Zealand legislation.

125 This proposed approach means a narrower group of entities would be required to register on the FSPR compared to the approach indicated in the July Cabinet paper. Further work since July suggests that it may be desirable not to register entities that are providing services to offshore customers only (regardless of whether they are providing substantive financial services from New Zealand or not). There appears to be little benefit to New Zealand authorities and customers from registering such entities.

126 Officials are continuing to consider the detail of the proposed approach, which will be consulted on alongside the exposure draft Bill.

Next steps

Release of the Exposure Draft and Commentary

127 The Parliamentary Counsel Office has begun preparing an exposure draft of a Bill to give effect to the decisions Cabinet has already made regarding the new regime for regulating financial advice.

128 Once Cabinet has made decisions on the matters outlined in this paper, the drafters will incorporate these decisions into the exposure draft.

129 Officials will prepare a user-friendly document to sit alongside the exposure draft that provides commentary on the exposure draft, to assist individuals unfamiliar with legislation to provide feedback.

130 For expediency, I seek delegated authority from Cabinet to approve and release an exposure draft of the Bill and related commentary, once complete. This would allow consultation on the exposure draft to get underway before Christmas, which in turn would allow the Bill to be finalised and introduced into the House earlier than it otherwise would be.

131 Officials are continuing to analyse the detail of some features of the new regime, so minor policy questions regarding the proposed changes may yet arise. I seek your agreement to delegate authority to me to make decisions on any minor policy issues that

arise, consistent with the policy frameworks agreed by Cabinet. This will allow any minor and technical matters to be dealt with expediently.

132 I also seek approval to make minor amendments to the wording of any provisions being carried over from the FA Act to ensure consistency with the FMC Act.

Other work progressing

133 Officials have begun the detailed work on disclosure requirements and, as directed by Cabinet [CAB-16-MIN-0336], will work with industry and consumer groups to develop the draft content, format and timing of disclosure. As these requirements will be set out in regulations, they do not need to be finalised until late 2017.

134 Officials will work with dispute resolution schemes to identify whether there are options to further promote access to fair and effective redress through aligning scheme rules. Cabinet has invited me to report back to EGI with recommendations on any improvements.

135 Cabinet has already noted that a separate policy process will determine any necessary changes to licensing fees and the FMA's funding (including levy adjustments) [CAB-16-MIN-0336].

Consultation

136 The following Government agencies have been consulted: the Financial Markets Authority, the Treasury, the Commission for Financial Capability, the Reserve Bank of New Zealand, the Department of Internal Affairs, and the Ministry of Justice. The Department of Prime Minister and Cabinet has been informed.

Financial Implications

137 In July 2016 Cabinet noted the broad financial implications of the new financial advice regime, which are:

137.1 Increased licensing and ongoing monitoring and supervision costs for the FMA. (A separate policy process will follow for adjustments to the fees and levies)

137.2 The cost of consequential amendments to the Companies Office Financial Service Providers register (which may be undertaken within baselines)

138 Minor changes to funding and associated adjustments to the FMA levy may be required to meet ongoing costs of the Financial Advisers Disciplinary Committee and the Code Committee arising from the changes outlined in this paper. A separate policy process will follow to address this.

139 In addition, members of the Code Committee Working Group will need to be remunerated. The current Code Committee is funded by the FMA through their existing appropriation, as the new Code Committee will be. As the Code Working Group will be a Minister-appointed non-statutory body, it will be funded from existing MBIE baselines.

Human Rights

140 The proposals outlined in this paper are consistent with the New Zealand Bill of Rights Act 1990 and the Human Rights Act 1993.

Legislative Implications

141 To give effect to Cabinet's July 2016 decisions on the new financial advice regime, the Parliamentary Counsel Office has begun drafting the Financial Services Legislation Amendment Bill, an omnibus Bill, which has a category 6 priority on the 2016 Legislation Programme.

142 The Parliamentary Counsel Office will incorporate decisions on the matters raised in this paper into the draft Bill.

143 Officials are working with the Parliamentary Counsel Office and have consulted the Legislative Design and Advisory Committee to determine the most appropriate legislative design approach. This will involve repealing the FA Act and incorporating the regulation of financial advice into the FMC Act.

Regulatory Impact Analysis

144 The Regulatory Impact Analysis requirements apply to the proposals in this paper. The Ministry of Business, Innovation and Employment has prepared a Regulatory Impact Statement (RIS), which is attached.

145 The Ministry of Business, Innovation and Employment's independent RIS review panel has reviewed the RIS, and considers the information and analysis summarised in the RIS meets the quality assurance criteria.

Publicity

146 Subject to Cabinet's agreement to the recommendations in this paper, I intend to issue a press release announcing Cabinet's decisions.

147 MBIE will also publish a copy of this paper on its website.

Recommendations

The Minister of Commerce and Consumer Affairs recommends that the Committee:

1. **note** that on 11 July 2016 Cabinet agreed to the overarching design of a new regulatory regime for financial advice [CAB-16-MIN-0336];

2. **note** that the changes to the financial advice regulatory regime will be achieved by repealing the Financial Advisers Act 2008 (FA Act) and incorporating the regulation of financial advice into the Financial Markets Conduct Act (FMC Act);

3. **agree** that the FMC Act should be amended where necessary to ensure it provides for the matters dealt with in existing FA Act provisions relating to:

   3.1. the FMA's ability to give directions to financial advisers and financial advice firms in respect of breaches of their obligations;

   3.2. exemptions;

   3.3. information-sharing;

Compliance and Enforcement

4. **note** that Cabinet agreed that financial advice firms must be licensed by the FMA to provide financial advice services, consistent with the licencing regime under Part 6 of the FMC Act [CAB-16-MIN-0336];

5. **agree** that financial advice will be subject, as appropriate, to the compliance and enforcement tools provided under the FMC Act for other licensed services, such as fund managers and discretionary investment management services (DIMS);

6. **note** that Cabinet agreed that all financial advice be subject to the following broad legislative requirements [CAB-16-MIN-0336]:

   6.1. a conduct obligation to place the interests of the consumer first;

   6.2. a competence obligation to only provide financial advice where competent to do so;

   6.3. a disclosure obligation to disclose prescribed information;

   6.4. a client care obligation to ensure that consumers are aware of the limitations of their advice at the point of making a recommendation;

7. **note** that, under the FA Act, all financial advisers must exercise care, diligence and skill;

8. **agree** that, consistent with the obligations and duties of fund managers and DIMS licensed under the FMC Act, licensed financial advice firms who contravene the legislative requirements in paragraphs 6 and 7 will be liable for civil liability orders;

9. **note** that under the FA Act, authorised financial advisers who are found to have breached obligations may have their authorisation removed by FMA or (for breaches of the Code) are subject to a Financial Advisers Disciplinary Committee;

10. **agree** that FMA may recommend to the FSP registrar that the registration of a financial adviser who has breached obligations be suspended, cancelled or and that the person be debarred from registering;

11. **agree** that the FA Act provisions for the Financial Advisers Disciplinary Committee be retained, subject to any amendments required to achieve the following:

    11.1. that the jurisdiction of the Financial Advisers Disciplinary Committee applies to financial advisers who breach obligations;

    11.2. where the FMA investigates a complaint against an adviser and considers that the conduct complained of amounts to a breach, it may, but will no longer be required to, refer that complaint to the Financial Advisers Disciplinary Committee;

    11.3. the Financial Advisers Disciplinary Committee may recommend the FSP registrar suspend, cancel and debar the registration of a financial adviser;

12. **direct** officials to consult on additional options through the exposure draft process to:

    12.1. extend the jurisdiction of the Financial Advisers Disciplinary Committee to financial advice firms;

    12.2. provide that financial advisers, and not financial advice firms, be subject to civil liability where financial advisers fail to meet their obligations and financial advice firms have adequately supported compliance;

13. **agree** that in carrying over obligations from the FA Act into the new regime, or creating any other obligations not referred to in the above paragraphs, liability for breaches should be aligned with Cabinet's decisions on liability in the FMC Act regime [CBC Min (11) 4/3 & (11) 6/9], including:

    13.1. recommending an offer that contravenes financial markets legislation will have civil remedies;

    13.2. failures by brokers to comply with requirements around client money and property will have civil remedies;

    13.3. failure to comply with a disciplinary committee order or a summons to attend a disciplinary committee hearing will be a regulatory offence;

Mechanics of the Code of Conduct and Code Committee

14. **note** that the under the new regime, a Code of Conduct will apply to all financial advice;

15. **agree** that the existing FA Act provisions for the Code of Conduct and Code Committee are carried over into the new regulatory regime, subject to any amendments required to achieve previous Cabinet decisions and the following policy proposals (subject to agreement);

Code Committee

16. **agree** that Code Committee members be appointed:

16.1. for two members, based on their knowledge, skills and experience in relation to consumer affairs or dispute resolution;

16.2. for other members, having regard to the functions of the Code Committee, by virtue of that person's knowledge, skills and experience in the financial services industry, or any other knowledge, skills and experience deemed relevant;

17. **agree** that all roles and responsibilities currently held by the FMA in respect of the Code of Conduct and Code Committee will be held by the Minister, except funding (which will remain the responsibility of the FMA);

18. **agree** that:

18.1. the Minister will approve any draft Code of Conduct;

18.2. the Minister must, prior to approving a draft Code of Conduct, consult with the FMA;

18.3. the FMA will retain the ability to propose changes to the Code of Conduct;

19. **agree** that the Minister will appoint the chair of the Code Committee.

20. **agree** that the process for preparing the draft code specify that the Code Committee:

20.1. must have regard to the purpose of the FMC Act, any additional purposes of the FMC Act relevant to financial advice, and any relevant international obligations that apply to New Zealand;

20.2. be required to publish a summary of the submissions received and their response to these submissions;

20.3. be required to produce and publish an impact analysis that refers to the purposes of the FMC Act and any other purposes (as specified above);

Code Working Group

21. **note** it is desirable for a new Code of Conduct to be developed before the Bill is passed to support the new regulatory regime when it comes into force;

22. **agree** that the Minister of Commerce and Consumer Affairs appoint a Code Working Group (with terms of reference aligned to the requirements of the Code Committee and Code of Conduct specified in the Bill) prior to the introduction of the Bill to prepare a draft Code of Conduct;

23. **agree** that the Bill include transitional provisions that allow the Working Group's process to meet the procedural requirements as set out in the Act, even if the processes are undertaken prior to enactment;

24. **note** that the appointments and terms of reference for the Code Committee will be taken through the APH and EGI Cabinet committees respectively;

Options for Transitioning to the New Regime

25. **note** that existing financial advisers will need time to transition to and operate under the new regime;

26. **agree** that transitional arrangements should seek to:

    26.1. bring each element of the new regime into effect as soon as practicable;

    26.2. ensure existing industry participants can transition to the new regime smoothly;

    26.3. minimise unnecessary compliance costs; and

    26.4. minimise disruption for consumers;

27. **direct** officials to consult on the following proposed transitional arrangements through the exposure draft process:

    27.1. requiring existing financial advisers to transition to the new regime in two stages – first with a transitional licence and then a full licence, with the majority of the new regime taking legal effect upon transitional licensing and the remainder upon full licensing;

    27.2. grandfathering the competency of Authorised Financial Advisers into the new regime with a longstop date (such as five years);

    27.3. enabling some Registered Financial Advisers to demonstrate their competence and compliance with the Code of Conduct requirements through a test and portfolio assessment process;

Personalised DIMS

28. **note** that personalised DIMS are currently regulated in two distinct ways, through the FMC Act and the FA Act;

29. **note** that the requirements applying to FMC DIMS providers and FA Act DIMS providers are largely aligned;

30. **agree** that all providers of DIMS should be subject to the same requirements and should be regulated in the same way;

31. **agree** that DIMS should no longer be treated as a financial advice service and the FMC licensing exemption (in section 389(2)(b) of the FMC Act), that allows some providers to provide limited personalised DIMS under the FA Act should be removed;

32. **agree** that AFAs who are authorised to provide personalised DIMS should be granted DIMS licences under the FMC Act, restricted to the service that they can currently provide under the FA Act;

Obligations for advice to wholesale clients

33. **note** that the FA Act provides the following for wholesale clients, and that these settings will be retained:

    33.1. the current definition of wholesale client (with any minor or technical amendments needed to incorporate these provisions into the FMC Act);

    33.2. the current entry hurdle for those who only wish to provide advice to wholesale clients;

    33.3. the current requirement that all advice (including to wholesale clients) should continue to be subject to the current conduct obligations of due care, diligence, and skill, and not engaging in misleading or deceptive conduct;

34. **agree** that, if a financial advice service is provided only to wholesale clients, that service is exempted from the requirement to be licensed;

35. **agree** that the FMA should have the ability to designate a service as a retail service;

36. **agree** in principle that the following legislative obligations, which will be consulted on, should apply to advice to wholesale clients:

    36.1. to place the interests of the consumer first;

    36.2. to disclose prescribed information;

37. **agree** that a person must not hold themselves out to be a financial adviser to a retail client unless they are:

    37.1. registered on the FSP Register as a financial adviser, and

    37.2. engaged as a financial adviser by a licensed financial advice firm.

38. **agree** that a person must not otherwise hold themselves out to be a financial adviser unless they are:

    38.1. registered on the FSP Register as a financial adviser.

39. **agree** that a person may only hold themselves out as being a financial adviser in respect of the financial advice services that they are competent to provide;

Soft commissions

40. **note** that Cabinet directed officials to explore options to require financial product providers to publish an annual register of soft commissions paid to financial advisers and agents [CAB-16-MIN-0336];

41. **note** that, following consideration of options, the Minister of Commerce and Consumer Affairs intends to ask the FMA to report on soft commissions using existing powers under the Financial Markets Authority Act 2011;

Complementary Measures to Address Misuse of the Financial Service Providers Register (FSPR)

42. **note** that Cabinet agreed to require entities registering on the FSPR to have a stronger connection to New Zealand than is currently required, in order to address misuse of the FSPR by offshore-controlled entities [CAB-16-MIN-0336];

43. **note** that officials have considered complementary measures which could also help address misuse of the FSPR.

44. **agree** that the following measures be introduced to complement the requirements for entities registering on the FSPR to have a stronger relationship to New Zealand:

    44.1. limit registered entities' ability to advertise their status by providing that if an entity is not otherwise licensed in New Zealand, then if it refers to its New Zealand registered status (other than where required by law), it must make clear the limitations of being registered;

    44.2. provide that breach of the limitation referred to in recommendation 44.1 would be a ground for deregistration;

    44.3. provide additional powers for the Registrar of Financial Service Providers to require information or confirmation of information from a director of an applicant or registered financial service provider;

    44.4. provide that the director be liable for any false or misleading statements that are given;

    44.5. provide that failure to comply with a request would, after an appropriate process, be grounds for de-registration;

    44.6. provide a power under which additional groups of providers can be designated as requiring registration under the Act;

45. **direct** officials to explore additional information to be prescribed in the register;

46. **note** that Cabinet agreed to amend the FSP Act so that entities will only be able to register if they are, or will be:

    46.1. in the business of providing financial services, not just back-office administrative services, from a place of business in New Zealand; or

    46.2. in the business of providing financial services to New Zealanders; or

    46.3. otherwise required to be registered or licensed under any other New Zealand legislation;

47. **note** that, as indicated to Cabinet, officials have continued to work on the details of which entities should register on the FSPR and the Minister of Commerce and Consumer Affairs intends to seek feedback on those details in the exposure draft;

48. **note** that officials currently consider that entities should be required to register if they are in the business of providing financial services to New Zealanders or otherwise required to be registered or licensed under other legislation, which is a narrower group compared to the approach indicated to Cabinet in July;

49. **note** that officials are continuing to consider the details of the proposed approach, which will be consulted on in the exposure draft;

Release of the Exposure Draft and Commentary

50. **authorise** the Minister of Commerce and Consumer Affairs to approve and release an exposure draft of the legislation and related commentary;

51. **authorise** the Minister of Commerce and Consumer Affairs to make further decisions, consistent with the policy frameworks for the new financial advice regime agreed by Cabinet, in relation to any other issues that arise while legislation is being drafted;

52. **authorise** the Minister of Commerce and Consumer Affairs to make minor amendments to the wording of any provisions being carried over from the FA Act to ensure consistency with the FMC Act;

Financial Implications

53. **note** that the changes outlined in this paper regarding the Financial Advisers Disciplinary Committee and the Code Committee may have funding implications for the FMA, which will be addressed through a separate policy process;

54. **note** that the Code Working Group will need to be remunerated, and this will come from existing MBIE baselines;

Legislative Implications

55. **note** that the Parliamentary Counsel Office will incorporate decisions on the matters raised in this paper into the amendment Bill they are currently drafting to give effect to the new financial advice regime;

Publicity

56. **note** that I will issue a press release on the aspects of the new financial advice regime outlined in this paper;

57. **note** that MBIE will publish a copy of this paper on its website.

Authorised for lodgement

Hon Paul Goldsmith

Minister of Commerce and Consumer Affairs