MINISTRY OF BUSINESS, INNOVATION & EMPLOYMENT
HIKINA WHAKATUTUKI

Options Paper

Review of the Financial Advisers Act 2008 and the Financial Service Providers (Registration and Dispute Resolution) Act 2008

newzealand.govt.nz

How to have your say

Submissions process

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

- Submissions on the questions in Part 1 and Part 2 of this paper are due by 5pm on **Friday 26 February 2016.**
- As it may be desirable to address the issues relating to the financial service providers register ahead of any other changes to the financial adviser regime, submissions on the questions in Part 3 of this paper are due by 5pm on **Friday 29 January 2016.**

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

Please use the submission template provided at ***www.mbie.govt.nz/what-we-do/faareview*** as this will help us to collate submissions and ensure that your views are fully considered. Please also include your name, or the name of your organisation, and contact details. You can make your submission:

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

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

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

Use of information

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

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

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

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

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

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

The Privacy Act 1993 establishes certain principles with respect to the collection, use and disclosure of information about individuals by various agencies, including MBIE. Any personal information you supply to MBIE in the course of making a submission will only be used for the purpose of assisting in the development of policy advice in relation to this review.

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Contents

List of Acronyms

AFA	Authorised Financial Adviser
CPD	Continued Professional Development
DIMS	Discretionary Investment Management Service
FA Act	Financial Advisers Act 2008
FADC	Financial Advisers Disciplinary Committee
FMA	Financial Markets Authority
FMC Act	Financial Markets Conduct Act 2013
FSP Act	Financial Service Providers (Registration and Dispute Resolution) Act 2008
FSPR	Financial Service Providers Register
MBIE	Ministry of Business, Innovation and Employment
QFE	Qualifying Financial Entity
RFA	Registered Financial Adviser

Foreword

Hon Paul Goldsmith
Minister of Commerce and Consumer Affairs

One of the Government's key priorities is to build a more competitive and productive economy that delivers higher incomes and living standards for New Zealanders. Investment in financial markets provides the opportunity for families to increase their wealth and to deepen New Zealand's capital markets, helping businesses to grow.

Prior to the introduction of the Financial Advisers Act 2008 and the Financial Service Providers Act 2008 investor confidence in financial markets was low. The Acts were introduced to encourage investor confidence and promote informed participation in financial markets.

The new regulatory regime has gone some way to achieving this. It has succeeded in lifting professional standards in the adviser industry as financial advisers are accountable for their advice and must exercise care, skill and diligence in providing services to investors. The regime has also improved consumer protection by requiring anyone providing financial services to retail consumers to belong to a dispute resolution scheme.

But all regulatory systems should be periodically reviewed. Earlier this year the government released an Issues Paper for consultation which took stock of the regime and identified areas where improvements could be made.

We have heard concerns that the regime has had the unintended consequence of making it more difficult for New Zealanders of modest means to gain access to financial advice, because of the costs imposed.

We have also heard that the regime is unnecessarily complex which is making it hard for consumers to know where to seek financial advice from.

We have also heard that the distinction between advice that puts the interest of the customer first, and what is essentially sales activity, remains blurred. There are concerns that consumers may not be receiving advice from people with adequate skills to deliver the best outcomes for them.

This Options Paper has taken this feedback on board. It suggests a number of ways to resolve the core issues preventing New Zealanders from accessing the advice they need.

Three potential packages of options are presented, ranging from minor changes to more fundamental reform.

We also seek feedback on options for ensuring that consumers know when they are getting sales or advice. Other options include strengthening adviser ethical obligations and competency requirements, amendments to help future-proof the regime for technological developments such as robo-advice, and changes to disclosure which should improve consumer experiences and outcomes.

I want the thinking in this paper to be tested in order to ensure any changes to the regime are workable and deliver the right outcomes, and to minimise the likelihood of any unintended consequences.

I encourage you to share your views on the options presented as we take the next step toward developing a regime that is workable and facilitates improved financial outcomes for all New Zealanders.

MINISTRY OF BUSINESS, INNOVATION & EMPLOYMENT
HĪKINA WHAKATUTUKI

Options Paper – a snapshot

Review of the Financial Advisers Act 2008 and Financial Service Providers (Registration and Dispute Resolution) Act 2008

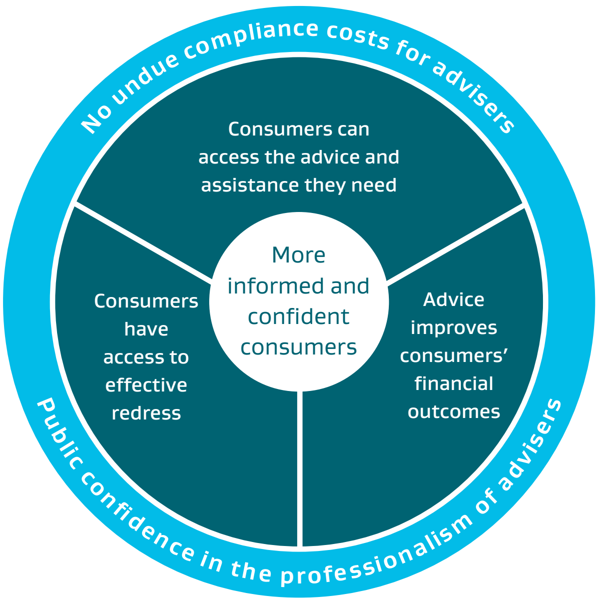
The Ministry of Business, Innovation and Employment (MBIE) is reviewing the Financial Advisers Act 2008 (FA Act) and the Financial Service Providers (Registration and Dispute Resolution) Act 2008 (FSP Act).

MBIE began engaging with stakeholders in late 2014 and released an Issues Paper for consultation in May 2015 alongside a shorter consumer brochure. Responses to these documents and other feedback helped clarify the barriers that appear to be impeding better functioning of the regime.

The Options Paper seeks your feedback on a range of potential policy options to address the barriers identified.

The aim is to promote more confident and informed consumers and investors

As depicted, the long-term outcome we are working towards is more confident and informed participation of consumers in financial markets. To enable this, the review is seeking to achieve the three intermediate outcomes depicted in the middle ring. The outer ring illustrates the importance of providing a fit-for-purpose regulatory environment for advisers to operate in.



The existing regime has brought some positive changes...

The introduction of the FA Act and FSP Act has lifted professional standards in the industry, ensured consumer access to dispute resolution, and helped New Zealand meet international obligations to maintain a register to help identify financial service providers.

...However, there are barriers to achieving the outcomes sought

It is hard for consumers to know where to seek financial advice from: terminology used in the regime is confusing (e.g. "authorised" or "registered") and is preventing consumers from knowing where to seek advice from.

Certain types of advice aren't being provided: compliance obligations mean some advisers choose not to provide certain advice e.g. personalised advice, leaving a gap in the range of advice available.

Consumers may be receiving advice from people without adequate knowledge, skills and competence levels: the regime includes some competency requirements but they do not apply to all advisers.

Certain conflicts of interest (e.g. commissions) may be leading to suboptimal outcomes for consumers: the regime does not require all advisers to manage or disclose conflicts of interest.

Consumers do not always understand the limitations of different types of advice: consumers do not often understand that there are different types of advice and that theirs may not be personalised.

We are seeking feedback on options for addressing these barriers

Amend restrictions on who can provide what advice

e.g. removing the distinction between personalised advice (that takes into account a client's particular financial situation or goals) and class advice; and/or narrowing the number of complex services that only certain advisers can provide; (conversely) removing any distinction based on product complexity.

Amend ethical and client-care obligations

e.g. extending ethical requirements to all advisers; and/or clearly distinguishing between advice and sales so consumers know when an adviser is not required to put the consumer's interests first; and/or restricting conflicted remuneration.

Amend regime for ensuring compliance

e.g. an entity licensing regime where businesses must ensure their employees comply with relevant requirements & greater role for industry bodies to help their members comply; and/or an individual licensing regime supported by a Code.

Allow advice through technological channels

e.g. allowing advice to be provided online by a licenced entity.

Changes to help consumers find advisers

e.g. information to assist consumers to find an adviser; and/or changing terminology to be more consumer-friendly, e.g. renaming 'QFE advisers'.

Improve disclosure requirements

e.g. requiring all advisers to disclose the same information; and/or streamlining disclosure to make it more meaningful for consumers.

Increase competency requirements

e.g. requiring advisers to meet minimum competency standards; and/or requiring Continuing Professional Development.

Increase transparency, consistency and consumer access to dispute resolution

e.g. greater consistency of dispute resolution scheme rules.

We also seek feedback on packages of options of what a new regime might look like

PACKAGE 1: Improved consumer focus through minor change

Intended to cause less disruption to industry

› retain current boundaries about who can provide what type of advice
› all advisers must comply with same ethical obligation to put consumer's interests first
› all advisers must provide simple and common form of disclosure
› terminology updated to be more meaningful for consumers
› licensed entities could provide "robo-advice" online

PACKAGE 2: Competency and ethical obligations for all advisers

All improvements in package 1 and:

› remove distinction between "class" and "personalised" advice – all advisers must provide service that matches consumer's request
› subset of Expert Financial Advisers can advise on complex matters; individually licensed to provide a quality mark
› all financial adviser businesses must be licensed; businesses ensure employees comply with competency & ethical obligations

PACKAGE 3: Distinguishing sales and advice

All the improvements described in Package 1; some of the improvements described in Package 2 (no distinction between class and personalised advice, businesses would be licensed, advisers required to be competent to provide the service they are providing) and:

› "salespeople" not subject to obligation to put the consumer first but would notify consumers of this
› salespeople could only sell their own financial products
› potential increased role for industry associations to help their members to comply

Options to address misuse of the Financial Service Providers Register

We also seek feedback on options to address issues in relation to misuse of the Financial Service Providers Register, particularly by offshore-controlled entities that use their registration to misrepresent that they are licensed or actively regulated in New Zealand.

Options include stronger registration requirements (e.g. require proof that the applicant is licensed in their home jurisdictions); amending the grounds for de-registration; amending requirements on which entities are required to register; converting the register into a non-public list.

We invite you to submit

Submissions on the misuse of the Register issues are due by **29 January 2016**. Submissions on all other aspects are due by **26 February 2016**.

Part 1 – Introduction

Chapter 1 – Introduction

Purpose and context of the review

The Ministry of Business, Innovation and Employment (**MBIE**) with input from the Financial Markets Authority (**FMA**), the Commission for Financial Capability and the Treasury is reviewing the Financial Advisers Act (**FA Act**) and the Financial Service Providers (Registration and Dispute Resolution) Act 2008 (**FSP Act**).

The terms of reference for the review are available at ***www.mbie.govt.nz/info-services/business/business-law/financial-advisers/review-of-financial-advisers-act-2008***

The objectives of this review are to:

- Analyse the role of financial advice and financial service provider registration and dispute resolution in improving financial outcomes for New Zealanders, and to assess and update the objectives of, and rationale for, regulatory intervention in this area.
- Assess the performance of the FA Act and the FSP Act against the updated objectives of, and rationale for, regulatory intervention in this area.
- Meet the statutory review requirements in section 161 of the FA Act by reviewing the operation of the FA Act and preparing a report for the Minister of Commerce and Consumer Affairs by 1 July 2016, including recommendations on whether any amendments to the FA Act are necessary or desirable.
- Meet the statutory review requirements in section 45 of the FSP Act by reviewing the operation of Part 2 of the FSP Act and preparing a report for the Minister by 14 August 2015.

We are reviewing the FA Act and FSP Act together due to the significant cross-over between these two pieces of legislation.

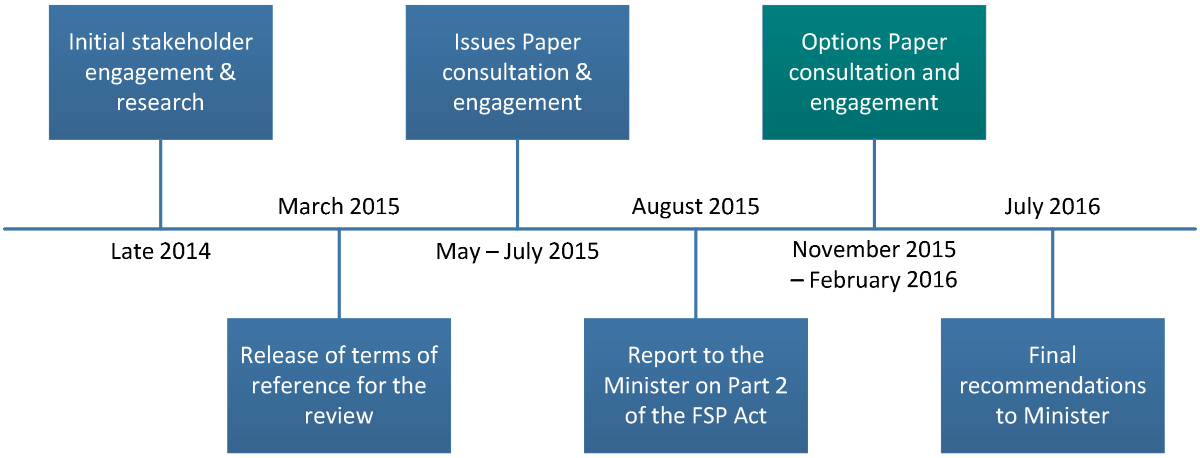
Progress to date and next steps

We (MBIE) began engaging with stakeholders in late 2014 and in May 2015 we released an Issues Paper which outlined our analysis of the role of financial advice, registration and dispute resolution as well as the aims and role of government regulation in this area.

In response to the Issues Paper we received 164 submissions. We also received 248 responses from a shorter consumer brochure and an online questionnaire that were distributed alongside the Issues Paper. The submissions and other feedback have helped us clarify the barriers that appear to be impeding better functioning of the regime.

In August 2015 we delivered a report reviewing the operation of Part 2 of the FSP Act to the Minister for Commerce and Consumer Affairs. The report meets the statutory requirements of section 45 of the FSP Act and is available at ***www.mbie.govt.nz/info-services/business/business-law/financial-advisers/review-of-financial-advisers-act-2008***.

We are now in the process of identifying potential options to address the barriers that are impeding better functioning of the regime. This document seeks your feedback on a range of potential policy options.



Purpose of the document

The purpose of this document is to:

- Refine Government's knowledge and understanding of the issues identified in the Issues Paper and how these are acting as barriers to the outcomes we are seeking to achieve.
- Ensure that the identified options address the barriers.
- Seek input and views on potential options for reform, their likely costs and benefits and effectiveness compared to the current regime.

This document is one means by which we are seeking feedback on possible options to improve the current regulatory regime for financial advisers and financial service providers. We also plan to use other means (such as meetings with advisers, adviser associations and consumer representatives, and focus groups with consumers) to test and refine the options presented in this paper.

How to use this document and dates for submissions

This document is structured in three parts as outlined below. We welcome your feedback in response to specific questions or any other relevant information that you wish to provide.

Part 1: Introduction (Chapters 1 - 3)	Chapter 1 – Purpose and context of the review, progress to date and next steps, purpose of the document Chapter 2 – What the regime has achieved to date and future outcomes sought Chapter 3 – Barriers to achieving the outcomes and questions for feedback
Part 2: Options (Chapters 4 - 5)	Chapter 4 – Discrete options and questions for feedback Chapter 5 – Potential packages of options and questions for feedback
Part 3: Misuse of the FSPR (Chapter 6)	Chapter 6 – Misuse of the FSPR

Submissions on the questions in **Part 1 and Part 2** of this paper are due by 5pm on **Friday 26 February 2016.**

As it may be desirable to address the issues relating to the Financial Service Providers Register ahead of any other changes to the financial adviser regime, submissions on the questions in **Part 3** of this paper are due by 5pm on **Friday 29 January 2016**.

Chapter 2 – Outcomes sought

What the regime has achieved

Regulation of financial advice has been changing worldwide in response to issues brought to light by the Global Financial Crisis. New interventions aim to ensure consumers have adequate information, that advisers are suitably qualified and regulated to provide the advice they say they can, and consumers have fair access to redress.

Prior to 2008, advisers in New Zealand were subject to a regulatory environment which was a mix of generic law relating to financial advisers, consumer protection legislation, sector-specific legislation, and voluntary self-regulation. This regime was failing to ensure that advisers were accountable, that members of the public were able to make informed decisions about their advisers, and that advisers had the necessary experience and expertise to provide financial advice. Consumers also lacked sufficient mechanisms to seek redress and reliance on voluntary ethical standards was insufficient to mitigate the risk of harm from 'bad' financial advice. New Zealand was only partly meeting international regulatory standards for monitoring financial advisers.

The introduction of the FA Act and FSP Act brought some positive changes. Before the introduction of these Acts, consumer confidence in the financial adviser profession was low. There was no comprehensive way to identify or monitor financial service providers, which caused issues for consumers, regulators and policy makers. The new regulatory regime aimed to increase investor confidence, ensure financial advice would only be offered by competent, ethical and accountable individuals, and promote the sound and efficient delivery of financial adviser and broking services.

The FA and FSP Acts have lifted professional standards in the adviser industry, and helped New Zealand meet the international best practice standards set by the *Financial Action Task Force*.

Professional providers of financial advice must now exercise due care, skill and diligence in providing services to investors and consumers and are prohibited from misleading or deceptive conduct. They are now accountable for their advice, and have to disclose information to consumers. Advisers offering "personalised" advice on more complex or risky financial products to retail investors are required to be "authorised", and must reach minimum standards of competency and professionalism and manage conflicts of interest.

Every person providing a financial service in New Zealand must now be registered and (where applicable) belong to a dispute resolution scheme, ensuring all retail consumers can access dispute resolution. We also know more about the make-up of the adviser population through registration, annual return requirements and other information provided by advisers. These changes have all contributed to New Zealand's continued reputation as an efficient and easy place to do business.

Areas for improvement

After five years of operation, we want to consolidate the progress that has been made and continue to ensure New Zealand's financial adviser regime is supporting well-functioning financial markets. We want to reduce the barriers that remain or have emerged and address any unintended boundary issues and anomalies that have arisen. We want to update the FA Act and FSP Act to ensure they can cater for the new ways in which advice will be provided. We want to ensure the FA Act will lift consumer and investor confidence and participation in financial markets, consistent with the objectives of the Financial Markets Conduct Act 2013.

We have heard from advisers and consumers that retaining all elements of the current regime is not the best option, and some change is needed to help us move towards the outcomes described below. The options we think could achieve the outcomes are outlined in this paper for feedback and debate.

Outcomes sought

As depicted below, the long-term outcome is to promote the confident and informed participation of investors and consumers in financial markets.

Figure 1: Outcomes sought

To promote the confident and informed participation of investors and consumers in financial markets, this review is seeking to achieve the three consumer outcomes depicted in the middle ring above. These outcomes have evolved from the three goals outlined in the Issues Paper on the basis of feedback we received. The outer ring illustrates the importance of providing a fit-for-purpose regulatory environment for advisers to operate in, for example by reducing the complexity of regulation and removing barriers to innovation.

Outcome: Consumers can access the advice and assistance they need

All consumers are able to access the right kind of advice to meet their needs and wants. For advice to be accessible it must be offered through different channels, easy to understand and available in a variety of ways (e.g. from simple targeted advice to more detailed comprehensive financial plans).

We would like to see consumers able to access the products and services they need. This requires the removal of any undue barriers to innovation so advisers and entities can provide this advice. This also requires regulatory requirements that are proportionate to the risks they are mitigating so that they do not unduly limit advice. It also requires consumers to be able to judge where to go for financial advice.

Measures to improve the accessibility of advice will be complemented by the Government's current financial capability programme. Both aim to improve consumer understanding of and engagement with their finances so they are better placed to make informed decisions.

Outcome: Advice improves consumers' financial outcomes

When consumers receive advice it is good quality. Advisers have the right skills, competencies and ethics to provide advice that makes consumers better off. In turn, consumers have high levels of satisfaction from their dealings with financial advisers and have confidence that advisers are held to certain standards.

This requires consumers to be able to determine the interests and incentives of advisers and their ethical and competency requirements, so they can place the right amount of trust in their adviser. It requires advisers to have appropriate standards of conduct and competence. This gives advisers the confidence that their peers must meet certain standards, their particular areas of expertise are recognised and overall professionalism of the industry continues to grow.

Outcome: Consumers have access to effective redress

If something goes wrong consumers are easily able to seek effective redress in a timely way.

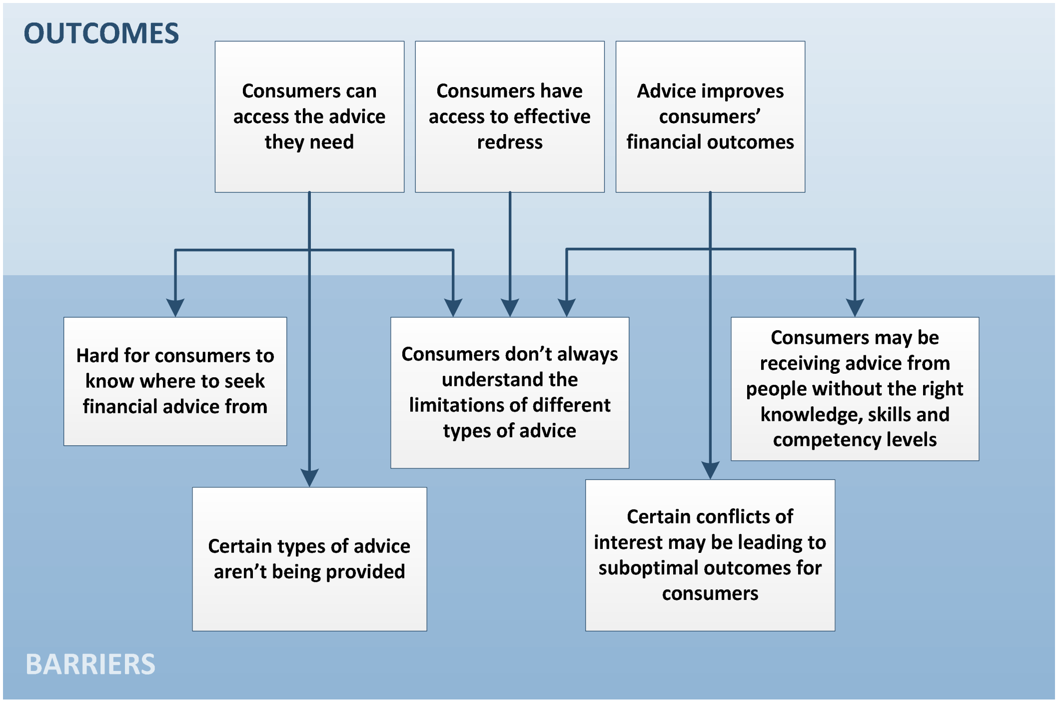
Many measures outlined in this paper are designed to reduce the likelihood of poor advice that can turn into a dispute. However, if something does go wrong, we think there needs to be strong systems for internal and external dispute resolution, and workable consumer protection mechanisms. This requires consumers to understand when and how to seek redress and to have sufficient information to judge the quality of advice they receive. It also requires transparent and fair dispute resolution processes so that both advisers and consumers have confidence that there is an independent forum for disputes to be heard in.

Chapter 3 – Barriers to achieving the outcomes

We think there are five key issues with the regime which are acting as barriers to achieving the stated outcomes. These barriers and their causes are described below.

Questions	
1	Do you agree with the barriers outlined below? If not, why not?
2	Is there evidence of other major barriers not captured here? If so, please explain.

Figure 2: Barriers to achieving the outcomes



Barrier: It is hard for consumers to know where to seek financial advice from

Many consumers would benefit from financial advice as not everyone is equipped with the knowledge and skills to make informed investment and complex financial decisions on their own. Unfortunately it is hard for consumers to know where to seek financial advice from. As a result consumers are more likely to receive financial advice from someone they already know (e.g. from family, friends or an existing provider) which might not be the best place for them to get the advice they need.

- Financial advice is complex by nature but feedback suggests the regulatory regime has compounded this rather than improve it. The regime is thought to be exacerbating confusion about where to go for financial advice. For example, 83% of respondents to the consumer brochure thought that consumers did not know how to find the right type of adviser.

- The legislation sets terminology which is unclear and confusing and prevents consumers from knowing where to seek advice from. Examples include:
    - The differences between adviser distinctions (e.g. "authorised", "registered" and "qualifying financial entity") and the scope of the work they can provide are difficult for consumers to understand.
    - The term "registered" is often seen as superior to "authorised" and may be wrongly interpreted as being associated with particular competencies or active regulation as is the case in other industries (e.g. registered nurse).
    - The definition of "broker" and "broking services" in the FA Act differs from common use. Consumers may be looking for a broker to assist with broking a mortgage or insurance but under this regime that is not the role of a broker.
- Another factor thought to be inhibiting consumers from knowing where to go to for advice is a lack of information. One of the original purposes of the Financial Service Providers Register (**FSPR**) was to provide the public with a searchable tool with useful information on financial service providers. While use of the FSPR has steadily increased, feedback indicates that it is not widely known about or used by consumers.

Barrier: Certain types of advice aren't being provided

Consumers' advice needs and wants vary greatly from person to person. While some types of advice can be accessed with relative ease other types are largely inaccessible. This means some consumers might not be getting the right kind of advice or any advice at all.

- The type of advice consumers need or want varies greatly depending on their life stage and personal circumstances. This can vary from very basic information needed to assist with budgeting and extend to more complex topics such as mortgage or insurance advice, investing, or financial planning to help save for retirement.

- The FA Act has disincentivised the provision of some types of advice. We have heard that the regime, which has created an uneven playing field by imposing different compliance obligations on different types of advice and advisers, is discouraging advisers from becoming Authorised Financial Advisers (**AFA**s). As a result many advisers have made a conscious decision to stick to being Registered Financial Advisers (**RFA**s) and providing RFA services, contributing to an "advice gap" for personalised advice.

- We hear that many consumers want relatively simple "personalised" advice on discrete issues (for example, advice on which KiwiSaver provider or fund is best for them), but some providers think they need to take into account all elements of a consumer's circumstances to do so. As a result personalised advice on discrete issues is either costly or not provided at all.

- Other types of advice which we hear are largely inaccessible include Discretionary Investment Management Services (**DIMS**) and investment advice for consumers looking to invest smaller sums of money. These "advice-gaps" are partly driven by the regulatory regime which places high monitoring and compliance requirements on some advisers and products, thereby incentivising the provision of other types of advice.

- The FA Act requires advice to be provided by a natural person and is therefore a barrier to the provision of online (or "robo") advice. Internationally robo-advice has a rapidly growing market share and is increasing the accessibility of advice for young, internet-savvy investors who may otherwise struggle to access advice due to the smaller size of their investments. The New Zealand regime needs to be able to accommodate technological innovations at the same pace of market change.

Barrier: Consumers may be receiving advice from people without adequate knowledge, skills and competence levels

For consumers to make good financial decisions they must receive advice from people with adequate knowledge, skills and competence levels. While the regime has introduced some competency requirements for some advisers, feedback through the Issues Paper suggests some consumers may still be receiving advice from some people without the right levels of competence.

- The introduction of competency requirements through the regulatory regime is thought to have improved the credibility of financial advisers but there are concerns that these aren't high enough, especially for RFAs.

- There is an imbalance between higher competency requirements for some advisers (AFAs) and low or non-existent competency requirements on other advisers (especially RFAs). We hear that these competency requirements are not always proportionate to the risk or complexity of the financial advice services being provided. This includes the concern that RFAs do not have to meet a competency standard, despite advising on financial products which can have a significant impact on consumers' financial wellbeing (e.g. insurance). For an RFA to practise he or she must simply register as a financial service provider (this involves an application form, criminal record check, annual fee, and joining a dispute resolution scheme).

- As well as potentially impacting the quality of advice there are concerns that the mixed competency requirements are a barrier to a clear career pathway, potentially compromising the future of the industry by not attracting new entrants. This is a particular problem due to New Zealand's ageing and independent small and medium sized adviser sector.

Barrier: Certain conflicts of interest maybe leading to suboptimal outcomes for consumers

For financial advice to facilitate good outcomes for consumers, either advisers should place consumers' interests above their own or consumers should be able to understand where this is not happening. There is currently no across-the-board requirement to put consumers' interests first or to disclose conflicts of interest to consumers, which may be leading to suboptimal outcomes. This includes consumers being churned between insurance policies and sold replacement products, when this is in the interest of the adviser rather than the consumer.

- Remuneration arrangements (such as commissions) and sales targets are incentivising some advisers to provide advice which may not lead to the best outcome for the consumer. While some advisers have ethical obligations that require them to place consumers' interests above their own, mitigating the problem, this obligation is not common to all advisers. Further, there are imbalanced disclosure requirements across advisers, meaning that consumers don't always know what may be driving advisers' recommendations.

Barrier: Consumers don't always understand the limitations of different types of advice

Making good financial decisions is important as it affects quality of life, future opportunities and the overall wellbeing of New Zealanders. To be able to make good financial decisions consumers must be able to understand the limitations of the advice they are receiving.

- The legislation has introduced many distinctions and definitions to differentiate between adviser services (i.e. personalised, class, retail, and wholesale) and types of products (i.e. Category 1 and 2). While this tiered set of regulatory requirements was designed to provide clarity it has unintentionally resulted in a complicated framework that is difficult for industry to communicate and consumers to understand. For example, consumers do not often understand:
    - the limitations of class advice and in receiving advice expect it to be personalised, and
    - that ethical obligations vary across advisers and that some advisers may not be acting in their interest first.
- Disclosure documents should provide consumers with the information they need in a clear, concise and effective way to enable decision-making. Anecdotal evidence suggests they are overly complex and long and are not typically read. There is also concern regarding the adequacy of disclosure requirements for RFAs and Qualifying Financial Entity (**QFE**) advisers who do not need to disclose the nature of remuneration (including commissions), experience, qualifications and any conflicts of interest.

Part 2 – Options for change

This Part outlines a range of options that aim to overcome the barriers outlined in Part 1 of this document. We are seeking feedback on the costs and benefits of the various options that are explored in order to inform our recommendations to the Minister in July 2016. Importantly, even where we express a preference for an option, we are open to feedback on what may and may not work in practice and how effective the options are likely to be.

This Part is divided into two Chapters:

- **Chapter 4: Discrete elements**

  The regulation of financial advisers and financial service providers is made up of several individual elements. Chapter 4 discusses the elements that have been highlighted through the review of the Acts to date. For each element, we describe the current situation and identify potential options for change where issues have arisen.

- **Chapter 5: Potential packages of options.**

  Chapter 5 outlines three potential packages of options. These three packages draw on a selection of the individual options in Chapter 4. They have been developed to provide high level illustrations of possible future regulatory regimes, recognising that changes to individual elements of the regime will have implications elsewhere in the regime.

Chapter 4 – Discrete elements

This Chapter describes the current situation and potential options for change for the individual elements set out below.

Limitations on the provision of advice	4.1 Restrictions on who can provide certain advice, including: • Class and personalised advice • Category 1 and Category 2 products • Wholesale and retail consumers 4.2 Advice through technological channels, including robo-advice
Ethical and competency obligations and how they are enforced	4.3 Ethical and client care obligations, including consideration of: • Requirements to place consumers' interests first • Distinguishing between sales and advice • The treatment of conflicted remuneration, including commissions 4.4 Competency obligations, including consideration of: • Minimum entry requirements • Continuing Professional Development 4.5 Tools for ensuring compliance, including consideration of: • Entity licensing and individual licensing • Registration • Roles of industry and regulatory bodies
Consumer experience	4.6 Disclosure to consumers, including consideration of: • Aligning disclosure requirements • Reviewing disclosure content to ensure it is meaningful to consumers 4.7 Dispute resolution, including consideration of: • Improving the consistency and transparency of dispute resolution 4.8 Finding an adviser, including consideration of: • Search tool for consumers • Consumer-facing terminology
Other elements where no changes are proposed	4.9 Other elements where no changes are proposed: • The definitions of financial adviser and financial adviser service • Exemptions from the application of the FA Act • Territorial scope of the FA Act • The regulation of brokers and custodians

Questions	
3	Which options will be most effective in achieving the desired outcomes and why?
4	What would the costs and benefits of the various options be for different participants (consumers, financial advisers, businesses)?
5	Are there any other viable options? If so, please provide details.

4.1 Restrictions on who can provide certain advice

Introduction

The FA Act restricts who can provide advice on the basis of the type of advice (class versus personalised), different categories of products (Category 1 versus Category 2), and different types of consumers (wholesale versus retail). This section considers options to change these restrictions.

Current situation

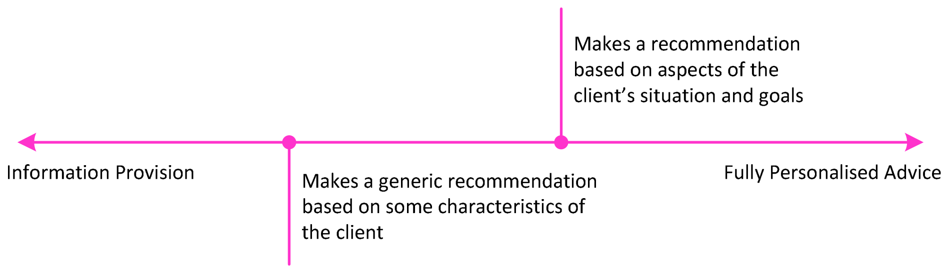
There are tight restrictions on advisers who provide personalised financial advice (i.e. advice that takes into account a client's particular financial situation or goals). The rationale is that someone receiving personalised advice has a reasonable expectation that their circumstances have been properly taken into account and that it usually takes a higher level of skill and competence to make this assessment.

The FA Act divides financial products into Category 1 and Category 2 products. Category 1 products have been assessed as being higher risk or more complex, and therefore advice on these products is subject to higher regulatory requirements. Category 1 includes investment products such as equity securities and KiwiSaver funds. Category 2 includes most insurance products, credit contracts and many savings products.

The FA Act also differentiates between retail and wholesale investors. Wholesale investors are, due to their assets, size or sophistication, assumed to be able to engage financial advisers without much regulatory protection. An adviser has fewer compliance and disclosure obligations than when dealing with a retail investor and a wholesale investor does not have the same access to redress. There is a set of criteria in the Act for determining whether a client is a wholesale client, including individuals investing in excess of $750,000. A client is automatically deemed to be a wholesale investor if they meet the relevant criteria, and must opt-out if they wish to be treated as a retail investor.

Assessment of the current situation

We have concerns about the current distinction between class and personalised advice. In practice the distinction is not clear cut. Rather, as depicted below, there is a spectrum of advice from fully personalised advice to information only.



By restricting who can provide personalised advice, the current regime has created the following perverse outcomes:

- it has provided an avenue for advisers to avoid compliance costs by limiting their services to class-only, thereby contributing to the advice gap for personalised advice, and
- it has led to risk aversion by those providing personalised advice (who believe they must take into account all elements of a client's financial situation and goals), thereby increasing the cost of personalised advice and contributing to the advice gap for limited advice or advice on a discrete issue.

We also heard concerns about the current distinction between Category 1 and 2 products. For example, concerns were raised about imposing lower requirements for advice on insurance products which can be very complex and can cause significant harm to consumers.

We consider that the distinction between wholesale and retail consumers should remain. It has recently been changed to be more closely aligned with the definition in the FMC Act and we do not think that further change to the definition is necessary at this time. However, there is concern that a client is automatically deemed to be a wholesale investor if they meet the relevant criteria, and must opt-out if they wish to be a retail investor.

Options

Option 1: Remove the distinction between class and personalised advice (preferred option, illustrated in Packages 2 and 3 in Chapter 5)

Under this option, the current regulatory distinction between class and personalised advice would be removed. Instead, all advisers would be able to provide either a class or personalised service as long as it matched the consumer's demands. This service may, for example, be information-only or advice based on only some aspects of the consumer's situation and goals, if this matched the consumer's demands.

- ✓ This option would help to overcome the current advice gap for personalised advice.
- ✓ This option would help to decrease compliance costs for those who are currently providing personalised advice, by clarifying that advice need not always take into account all elements of a consumer's situation.
- ✓ This option would remove a layer of complexity and consumer confusion.
- × Unless accompanied by changes to competence and ethical requirements (refer to sections 4.3 and 4.4), this option could bring increased risk to consumers by widening the scope of those who can provide personalised advice.

Option 2: Remove any distinction based on product category (illustrated in Package 3 in Chapter 5)

Under this option, the current restrictions on who can provide advice based on the product's complexity (i.e. Category 1 and 2 products) would be removed. Instead, all advisers would be subject to a broad obligation to only provide advice within their areas of competence. This is akin to the legal profession, whereby lawyers must maintain competence in their fields of practice and only provide services they are competent to provide.

- ✓ This option would remove a layer of complexity and consumer confusion.

- ✗ Unless accompanied by changes to competence and ethical requirements (refer to sections 4.3 and 4.4), this option could bring increased risk to consumers by widening the scope of those who can provide advice on products currently categorised as Category 1.

Option 3: Restrict the provision of certain complex or high-risk services to certain advisers (illustrated in Package 2 in Chapter 5)

Under this option, a set of financial advice services would be designated as complex or high-risk and could only be provided by a subset of advisers. The current requirement that only AFAs can provide personalised advice on Category 1 products is an example of how such a rule could work.

- ✓ This option would decrease the risk of harm to consumers by ensuring that restricted services are only provided by those who have met specific obligations.
- ✓ This option would provide advisers with a higher status to aim for and could increase professionalism of the advice industry.
- ✗ This option would retain a layer of complexity whereby consumers would need to know what type of adviser to see for a particular service.
- ✗ There would be regulatory and compliance costs associated with demonstrating competence to provide the restricted service (potentially leading to an advice gap for the restricted services).

Option 4: Require a client to opt-in before being considered a wholesale client

Under this option, a client would opt-in to being a wholesale client (rather than automatically being treated as a wholesale client if they meet the criteria in the Act). This would ensure that consumers would be afforded the same access to redress as a retail client. Professional or truly sophisticated investors would likely opt-in to facilitate lower compliance costs.

- ✓ This would provide great transparency for consumers. It would ensure that consumers know that they might not have access to redress.
- ✗ This may add another layer of complexity for consumers and may result in additional compliance cost for advisers.

Questions	
6	What implications would removing the distinction between class and personalised advice have on access to advice?
7	Should high-risk services be restricted to certain advisers? Why or why not?
8	Would requiring a client to ‘opt-in’ to being a wholesale investor have negative implications on advisers? If so, how could this be mitigated?

4.2 Advice through technological channels

Introduction

This section discusses options to allow financial advice to be provided through technological channels, such as robo-advice.

Current situation
Under the FA Act personalised advice can only be provided by a natural person. This is intended to ensure that an individual is responsible for advice that meets required standards.

Assessment of the current situation

We think the regulatory regime needs to enable innovation in the financial services industry. The lower cost of robo-advice could appeal to a large spectrum of investors that are not presently catered for; including those who would otherwise be shut out of the market due to insufficient funds for traditional advice. To provide for robo-advice, we consider that a licensing regime of online financial advice platforms is required in order to ensure accountability and consumer redress. Such a regime also provides for flexibility since regulatory conditions could be imposed through the individual licensing process.

Options

Option 1: Allow financial advice to be provided online by a licensed entity (preferred option, illustrated in Packages 1, 2 and 3 in Chapter 5)

Under this option, legislation would be amended to ensure that advice does not have to be provided by a natural person. To ensure accountability and redress for consumers, this option could involve licensing entities to provide advice via a platform with requirements broadly similar to those applying to advisers (where applicable).

- ✓ This option would provide clarity over the legal status of online financial advice platforms.
- ✓ A regulatory barrier would be removed, allowing for innovation in financial advice and increasing access to financial advice for those currently unserved by the regime.
- × The licensing requirements would need to be carefully designed to ensure they are not too onerous (such that the barrier inadvertently remains).

Option 2: Adopt a 'hybrid' regulatory model for financial advice through non-traditional means

Like Option 1, this option would require providers of online financial advice services to be licensed. Additionally, providers would be required to give consumers the option to speak to a person qualified to provide advice to discuss their investment needs.

- ✓ This option would bring greater regulatory certainty and accountability for consumers.
- × This option would increase the costs to provide robo-advice relative to Option 1.

Questions	
9	What ethical and other entry requirements should apply to advice platforms?
10	How, if at all, should requirements differ between traditional and online financial advice?
11	Are the options suggested sufficient to enable innovation in the adviser industry? What other changes might need to be made?

4.3 Ethical and client-care obligations

Introduction

This section discusses options relating to the ethical obligations on advisers, including obligations to manage conflicts of interest and put consumers' interest first. It also discusses the distinction between sales and advice, and the treatment of conflicted remuneration such as commissions.

Current situation:
All advisers are required to meet the conduct obligations in the FA Act to exercise care, diligence, and skill and must not engage in misleading or deceptive conduct.

AFAs are also required to meet minimum standards of ethical behaviour and client care, which are set out in a Code of Conduct. This includes requirements to place the interests of the client first, to not state or imply they are independent if their services are not independent, to manage any conflicts of interest so that the interests of the client are placed first and to ensure there is an appropriate internal process in place for resolving client complaints.

RFAs are not required to put the consumer's interest first and QFE Advisers only have this obligation in certain circumstances.

Assessment of the current situation

We consider the current situation – with different advisers facing different ethical requirements but without clarity to the consumer that this is the case – needs to change. The current situation is confusing to consumers, who may not understand that some advisers are not required to act in their interests first. Consumers therefore cannot tell when they are being sold a product rather than being given unbiased advice and consumers may therefore place undue trust in advice.

Options

Option 1: Extend ethical requirements to all financial advice services (illustrated in Packages 1 and 2 in Chapter 5)

All financial advice services would come with an ethical obligation to put the consumer's interest first and to manage any conflicts of interest that may influence the advice or recommendation provided (akin to the obligations in the current AFA Code of Conduct).

- ✓ This option would provide assurance to consumers that their adviser is acting in their interest.
- ✗ Such obligations can be relatively subjective and therefore difficult to monitor and enforce.

Option 2: Clearly distinguish between sales and advice (illustrated in Package 3 in Chapter 5)

Financial advice services could be provided without an obligation to put the consumer's interest first as long as the consumer was aware that the transaction was a sale and the salesperson was not subject to an obligation to put the consumer's interest first.

- ✓ Relative to the current situation, consumers would be aware when advice was being provided with or without the protection of an ethical obligation (that is, when they are effectively being sold a product). Consumers would therefore have greater ability to place the right amount of trust in advice.

- ✗ This option would rely on consumers knowing how to respond to the information that the adviser may not be acting in their interest (e.g. that it may mean that the product is not the right product for them).
- ✗ This option could limit the availability of advice that is in the consumer's interest if services are only provided by salespeople.

Option 3: Suitability requirement for sales of financial products (illustrated in Package 3 in Chapter 5)

In combination with Option 2, the sale of financial products would come with a suitability obligation whereby a product could not be sold unless deemed suitable for the consumer's needs. This falls short of an ethical obligation to put the consumer's interest first, but requires those providing financial advice services to know the suitable 'target' audience for different products.

- ✓ This option would provide some assurance to consumers that the product they are being sold is suitable for them.
- ✗ It may give consumers undue assurance that the transaction is in their interests.
- ✗ This option does not overcome the concerns about consumers being churned or sold replacement products when it is not in their best interests.
- ✗ It would increase compliance costs for providers selling financial products.

Option 4: Ban or restrict conflicted remuneration

Financial advisers would be banned from receiving certain conflicted remuneration for the sale of financial products. This could include, for example, bans or restrictions on commissions, soft-commissions, and sales targets with bonuses. This is not currently a preferred option.

- ✓ This option would provide some assurance to consumers that the advice is not motivated by conflicted remuneration.
- ✓ This option could improve consumers' perceptions of financial advisers.
- ✓ If limited to a certain set of advisers this could allow those advisers to market themselves as fully independent advisers.
- ✗ This option could limit access to advice to those who are not willing to, or cannot afford to, pay upfront for advice.
- ✗ Relative to a broad ethical obligation, it can be difficult to design a ban or restriction without the possibility of advisers finding a loophole in the requirements.

Questions	
12	If the ethical obligation to put the consumers' interests first was extended, what would the right obligation be? How could this be monitored and enforced?
13	What would be some practical ways of distinguishing 'sales' and 'advice'? What obligations should salespeople have?
14	If there was a ban or restriction on conflicted remuneration who and what should it cover?

4.4 Competency obligations

Introduction

This section discusses competency obligations – such as educational requirements – that could apply to advisers.

Current situation:

- AFAs are required to meet minimum standards of competence, knowledge and skills and undertake continuing professional training. This includes a general obligation to have the competence, knowledge, and skill to provide a financial adviser service before providing it, a requirement to attain the New Zealand Certificate in Financial Services (Financial Advice) with applicable modules for different services, and a requirement to undertake Continuing Professional Development (**CPD**) to maintain competence and keep up to date with relevant developments.
- RFAs do not have to meet minimum competency standards.
- QFEs can set their own standards of competence for QFE advisers.

Assessment of the current situation

As described in Chapter 3, we heard concerns that the competency requirements are, in some situations, not proportionate to the risk or complexity of the financial advice service. This includes RFAs not being required to meet a minimum competency standard despite advising on financial products which can have a significant impact on consumers' financial wellbeing. We also heard concerns that setting a basic minimum standard for AFAs has limited the uptake of higher qualifications by these advisers.

However, a balance will need to be struck between increasing standards for some advisers and ensuring costs are proportionate to the benefit to consumers. To ensure any change in competency is workable, it may require transitional arrangements including grandfathering provisions.

Options

Option 1: Minimum entry requirements (Preferred option in combination with individual licensing (refer section 4.5))

Financial advisers would be required to demonstrate that they have met a minimum competency standard before providing financial advice services. This could be through a minimum qualification requirement or through assessments or examinations.

- ✓ Could result in an overall improvement in the quality of advice consumers receive and better alignment of financial adviser competence with consumer expectations.
- ✗ Would involve higher entry requirements for some advisers, which may cause some to leave the industry and/or increase the cost of advice.

Option 2: Create a stepped pathway to adviser roles

Advisers could commence work under supervision while studying towards a qualification and building up experience.

- ✓ Could help manage the impact of an increase in minimum entry requirements.
- ✓ Could incentivise more people to join the industry.

Option 3: Require mandatory and structured CPD (Preferred option in combination with individual licensing (refer section 4.5))

In combination with Options 1 (minimum entry requirements) advisers could be required to undertake ongoing training to help maintain competence, gain new knowledge and skills, and keep up to date with relevant developments. This could be akin to the requirement in the current AFA Code of Professional Conduct to undertake CPD to maintain competence and keep up to date with relevant developments.

- ✓ Should result in an overall improvement in the quality of advice consumers receive and better alignment of adviser competence with consumer expectations.
- ✗ Would involve increased costs of compliance for some advisers, which may cause some to leave the industry and/or increase the cost of advice.

Option 4: Competency standards set through licensing process (Preferred option in combination with entity licensing (refer section 4.5))

Under this option, there would be a principles-based obligation in legislation for advisers to be competent to provide the advice they are providing. Akin to the current approach to QFE licensing, the specific standards of competence would be set through the licensing process.

- ✓ This option would provide flexibility for businesses to determine how their advisers will be competent in light of the specific products and services they provide.

Questions	
15	How can competency requirements be designed to lift capability, without becoming an undue barrier to entry and continuation in the profession?
16	Should all advisers be subject to minimum entry requirements (Option 1)? What should those requirements include? If not, how should requirements differ for different types of advisers?

4.5 Tools for ensuring compliance with the ethical and competency requirements

Introduction

This section discusses options for ensuring that financial advisers meet their respective obligations, such as licensing, and the roles of different industry and regulatory bodies.

Current situation:
All advisers are required to register on the FSPR. To qualify for registration a person must not be an undischarged bankrupt or convicted of a crime in New Zealand involving dishonesty in the previous five years. In addition:

- AFAs must be licensed (called "authorised" under the FA Act) by the FMA. Through the licensing process they must satisfy the FMA that they have met the competency standards in the Code and are of "good character".
- QFEs are licensed by the FMA at the entity level. They must satisfy the FMA that their governance and compliance arrangements are sufficient to ensure the business and its advisers operate professionally.

There are several industry associations representing the interests of various segments of the financial advice industry. The associations do not hold a formal regulatory role under the current regime, though many provide assistance to their members and some set their own standards that members must meet (over and above those set in law).

Assessment of the current situation

As outlined in Chapter 3, there are currently concerns around the lack of up-front regulatory approval for RFAs. This is exacerbated by concerns that consumers do not understand the different levels of regulatory approvals that apply to different types of advisers. For example, consumers believe that RFAs are subject to rigorous approval processes since the term "Registered" often implies this in other sectors (e.g. Registered Nurse).

Registration alone for any adviser is therefore not our preferred option. We are seeking feedback on the pros and cons of entity licensing and in what circumstances individual licensing should also be considered. We are also seeking feedback on the role for industry bodies if the scope of entity licensing is increased and the role of a Code Committee in the event that individual licensing is retained.

Options

Option 1: Entity licensing (preferred option, illustrated in Packages 1, 2 and 3 in Chapter 5)

Under entity licensing, the business would be responsible for ensuring that their employees or nominated representatives comply with the relevant requirements and for engaging with the regulator (this is akin to the current QFE model).

- ✓ Licensing would provide consumers with confidence that advisers have met the required standards.
- ✓ Through up-front engagement with the regulator, the primary focus would be on getting the right processes in place and preventing harm to consumers, rather than punishing harm after the fact.
- ✓ The licensing process would allow the regulator to impose specific conditions and tailor its monitoring approach in different circumstances.
- × Licensing is a costly process for both businesses and the regulator. This cost may feed through to a higher cost of advice.

Option 1B: Greater role for industry bodies (illustrated in Package 3 in Chapter 5)

In combination with entity licensing (Option 1), industry associations could be given more of a role in assisting their members to comply. This could range from a formal role to a guidance and support role.

- ✓ This option would allow industry associations to work more closely with the FMA to produce best practice guidance for their members.
- × A formal role is not likely to be workable with several different industry associations, as is the current situation in the industry.

Option 2: Individual licensing (possible preferred option in combination with entity licensing, as illustrated in Package 2 in Chapter 5)

Under individual licensing, individual advisers would be licensed and individually responsible for compliance and engaging with the regulator. This option is akin to the current approach for AFAs.

- ✓ This option would provide greatest consumer confidence that the adviser they are dealing with has met the required standards.
- ✓ This option would provide advisers with a higher status to aim for and could increase professionalism of the advice industry.
- × Licensing is a costly process for both businesses and the regulator. This cost would feed through to a higher cost of advice.

Option 2B: Code, Code Committee and Disciplinary Committee in support of individual licensing (illustrated in Package 2 in Chapter 5)

Under this option a Code, akin to the current Code of Professional Conduct for AFAs, would apply to advisers who are individually licensed as per Option 2. The Code would set minimum standards of ethical behaviour and competence that advisers must meet in order to comply with the obligations in the Act. A disciplinary committee, akin to the current Financial Advisers Disciplinary Committee (FADC), would conduct disciplinary proceedings relating to breaches of the Code.

- ✓ This option would provide a relatively flexible means to prescribe minimum standards that advisers must meet (relative to prescribing standards in legislation).
- ✓ This option would provide increased certainty to industry about how to comply.
- ✓ If the Code Committee included industry representatives, this option would be more likely to have industry buy-in to the minimum standards.
- × There would be a risk of the standard setting process being 'captured' by some advisers (relative to the minimum standards being set in law or by the regulator).

Option 3: Registration (Illustrated in Package 1 in Chapter 5)

Individual advisers would be required to register. This could involve meeting some qualification criteria, such as not being an undischarged bankrupt. This option is akin to the current approach for RFAs. For the reasons set out below, this is not currently a preferred option.

- ✓ This option would have low regulatory and compliance costs.
- ✗ This option would not provide assurance to consumers that advisers have met a certain standard.
- ✗ This option could mislead consumers (who may think a “Registered” adviser has met certain standards).
- ✗ This option would create the potential for misuse of the term “Registered” by providers.
- ✗ This option would rely on punishing harm after the fact, rather than preventing it.

Option 4: Align regulatory powers with those in the FMC Act (Preferred option)

The FMC Act took a new approach to enforcement and regulatory powers. For example, it provided for more flexible administrative and non-litigation tools and less reliance on criminal offences. It also introduced a designation tool as a means of future-proofing the regime. These new tools have been favourably received. Under this option, we would explore ways to better align the approach to regulation under the FA Act to the FMC Act.

- ✓ This option would allow the FMA to take a more flexible and proportionate enforcement approach.

Questions	
17	What are the benefits and costs of shifting to an entity licensing model whereby the business is accountable for meeting obligations (Option 1)? If some individual advisers are also licensed (Option 2), what specific obligations should these advisers be accountable for?
18	What suggestions do you have for the roles of different industry and regulatory bodies?

4.6 Disclosure

Introduction

This section discusses the disclosure of information to consumers, including what information is likely to assist consumers to make decisions and in what form.

Current situation

- AFAs are required to provide disclosure statements before providing personalised advice, investment planning services or personalised DIMS. The first, 'primary' disclosure statement outlines the adviser's contact details, the services they offer, a general description of how they are paid, their disciplinary history (if any), and their complaint procedure. One or more 'secondary' disclosure statements are provided to describe the specific nature of the service that the adviser will provide, what it will cost and how the adviser will be paid (including detail of any commission and any other conflicts of interest).
- RFAs are required to provide retail clients with a prescribed disclosure statement before providing personalised advice. This disclosure statement sets out the adviser's name and contact details, the types of services the adviser provides and the adviser's dispute resolution processes and scheme membership. RFAs are not obliged to actively disclose how they are remunerated.
- QFE advisers are required to disclose, if requested by the client: the name and contact details of the QFE, the QFE's dispute resolution procedures, information about the business (including a general description of how the QFE and its advisers are remunerated for the advice on category 1 products), information about the service being provided (including the fees charged for the advice on category 1 products), and any relevant commissions or other incentives.

Assessment of the current situation

We have heard concerns that the current situation – where different advisers have different disclosure obligations – can be misleading to consumers. For example, a consumer could interpret the fact that an RFA did not disclose a commission as evidence that the adviser must not earn a commission. We also heard concerns that the information being disclosed is not meaningful to consumers and often is too long to read. Current disclosure requirements are therefore imposing compliance costs on advisers without bringing benefits to consumers.

Options

Option 1: All advisers have the same disclosure requirements (preferred option, illustrated in Packages 1, 2 and 3 in Chapter 5)

All advisers could be required to disclose the same information in the same, shortened (potentially standardised) format.

- ✓ This option would provide greater clarity and easier comparability for consumers.
- ✓ It would involve consistent disclosure obligations for all advisers.
- ✓ It would respond to concerns that current disclosure documents are too long and confusing for consumers to absorb and make decisions on.

- ✗ This option does not address concerns that some consumers would still not read disclosure documents.
- ✗ This option would bring some cost associated with redrafting current disclosure documents.

Option 2: Review the information disclosed and form of disclosure to make it more meaningful for consumers (preferred option)

In addition to requiring more consistent disclosure (option 1) the content of disclosure statements could be streamlined to make it easier to read and more meaningful for consumers, and reflect the information they would like to know when meeting an adviser. Feedback we have received from advisers and consumers suggests the following information would be the most useful (we intend to test disclosure information in consumer focus groups):

- The range of products they are able to offer/advise on including any limitations of their advice (advisers would need to clearly note any limitations on the advice they are offering).
- The nature of their remuneration - commission (e.g. 'tied' arrangements), fees (e.g. 'insurer-neutral' arrangements).
- Any other conflicts of interest.
- Relevant experience and qualifications.

Under this option, the form and timing of disclosure would also be reviewed including when and how the consumer would receive the disclosure.

- ✓ This option would ensure the information disclosed is relevant for consumers (which may make them more likely to read and absorb it).
- ✓ This option would likely streamline disclosure documents, resulting in decreased costs of disclosure over time.
- ✗ This option would bring some cost associated with redrafting current disclosure documents.

Option 3: Make further information available on the Financial Service Providers Register or other portal/website

In addition to a standard disclosure document containing core information, further information could be made available to consumers on the Financial Service Providers Register or some other suitable portal/website.

- ✓ This option would allow consumers to search a publicly available website to source further information outside of the standard disclosure document, should they want to access it.
- ✗ The cost of establishing or amending a portal that will meet consumers' needs.

Questions	
19	What do you think is the most effective way to disclose information to consumers (e.g. written, verbal, online) to help them make more effective decisions?
20	Would a common disclosure document for all advisers work in practice?
21	How could remuneration details be disclosed in a way that would be meaningful to consumers yet relatively simple for advisers to produce?

4.7 Dispute resolution

Introduction

This section discusses options relating to the dispute resolution regime with a view to improving transparency, consistency and greater consumer access to dispute resolution.

Current situation

Under the FSP Act, all financial service providers who provide services to retail clients are required to be members of one of four approved dispute resolution schemes. The purpose of the schemes is to provide an avenue for consumers who have a dispute with their financial service provider to seek redress in a quick, efficient and cost-effective manner. Without dispute resolution, consumers' primary recourse for redress would be through the courts. The particular procedures and jurisdiction of each scheme are set out in their individual scheme rules, which are approved by the Minister of Commerce and Consumer Affairs. All of the schemes have a $200,000 monetary limit set out in their rules.

Assessment of the current situation

The Issues Paper sought submissions on the effects (both positive and negative) of competition between the schemes. Submissions were largely divided on the issue, with some arguing the existence of multiple schemes increases efficiency and enhances quality, while others expressed concern that inconsistencies in scheme rules may lead to arbitrage (for instance, where financial service providers end up selecting a scheme with a reputation for leniency). Others considered that the existence of multiple schemes prevented economies of scale being reached.

Given the current lack of evidence of negative impacts of competition (including "scheme hopping" by members to the detriment of the consumer), and recognising the collaborative and positive relationship between the schemes, we have not proposed an option in which the current multiple scheme model would be replaced with a single scheme. MBIE will continue to seek feedback on the performance of the multiple scheme model.

Even if no changes to the multiple scheme model are made, there are opportunities to promote access to fair and effective redress by ensuring all schemes are subject to consistent rules and level of scrutiny and that low public awareness of the schemes is addressed.

In March 2015 MBIE released a consultation document to test whether the $200,000 maximum compensation cap applied by the dispute resolution schemes is acting as a barrier to the efficient resolution of real property insurance disputes. The Issues Paper also asked whether or not the minimum compensation cap should be raised in relation to disputes regarding other financial services.

Some submitters argued that the cap should be raised on the basis of general inflation, and the fact that some general household claims sit above the $200,000 threshold. However, others argued that there is little evidence to suggest that the existing cap is acting as a barrier to the effective resolution of disputes by the dispute resolution schemes. We also heard that any increase in the cap could result in dispute resolution schemes being required to assess technical evidence beyond their current resourcing levels, and that the Courts may be the more appropriate forum for such disputes.

Overall there is insufficient evidence at this stage to warrant a change to the cap. MBIE will continue to closely monitor this issue and work with the schemes to identify any barriers to the efficient resolution of disputes, complementing the wider goal of improving overall access to and awareness of the schemes.

Options

Option 1: Changes to improve the transparency and consistency of dispute resolution schemes, and promote greater access for consumers (preferred option, common to all packages in Chapter 5)

Several changes could be made to improve consumer outcomes. Changes could include one or a combination of the following:

- Requiring financial service providers to inform consumers at the time of complaint which dispute resolution scheme they belong to and how to access it, and indicate an expected timeframe for acknowledging and responding to a complaint.
  - ✓ Increased awareness of schemes, with flow-on effects of increased consumer confidence.
- Greater consistency of scheme rules. For example, while we are not proposing to amend the $200,000 jurisdictional limit at this stage, there could be greater consistency in how this is applied by different schemes.
- Greater transparency and monitoring of dispute resolution. For example, this could include clearer reporting requirements and standardised reporting and publication of case summaries.
  - ✓ Improved transparency and consistency.
  - ✓ Comparability for consumers across the schemes.
- Mandatory professional indemnity insurance for financial service providers.
  - ✓ Increased likelihood of consumers receiving compensation for loss.
  - ✗ Increased costs for providers, ultimately passed on to consumers.
- Gathering information from consumers on their experience with dispute resolution after a dispute.
  - ✓ Keep abreast of potential issues in the market.
  - ✓ Greater evidence base in relation to benefits of schemes, and areas for improvement.
  - ✗ Cost to schemes in survey execution.

Questions	
22	Is there any evidence that the existence of multiple schemes is leading to poor outcomes for consumers?
23	Assuming that the multiple scheme model is retained, should there be greater consistency between scheme rules and processes? If so, what particular elements should be consistent?
24	Should professional indemnity insurance apply to all financial service providers?

4.8 Finding an adviser

Introduction

This section outlines options to assist consumers to find a financial adviser.

Current situation

- Consumers can use the FSPR to check their adviser is registered. They can also access a number of sources (e.g. the FMA, Sorted and adviser association websites) to find information on types of financial advisers, how to choose an adviser, what to ask advisers and where they are located.
- Advisers often use language from the Acts when describing what they do. This includes reference to (as relevant) AFAs, RFAs, QFEs and QFE Advisers, class and personalised advice, wholesale and retail clients, and category 1 and category 2 products.

Assessment of the current situation

As discussed in Chapter 3, there are currently barriers to consumers knowing where to seek advice from. The FSP Register allows consumers to check their provider is registered and has a dispute resolution scheme but does not provide useful information to help consumers find an adviser and can be inaccurate. The terminology in the Act is also unclear and confusing to consumers. We are seeking feedback as to whether a better searchable tool for consumers should be provided (and who is best placed to provide this) and whether advisers should be required to use more consumer friendly language. If terminology is to change, we would work with consumers to find out what changes would improve their ability to find financial advisers and understand what they do.

Options

Option 1: Establish a portal with information for consumers on financial advisers

Information to assist the public in finding the right adviser that suits their needs would be consolidated into a central repository. This could take a number of forms (e.g. a new website, the current FSPR, an 0800 number), depending on what information and form consumers would find most useful. This could include the ability to search for advisers and view comparable information.

- ✓ This option would create a 'one stop shop' for consumers, increasing consumers' access to and understanding of financial advice.
- ✗ A portal with extensive information would be costly to establish and maintain.

Option 2: Work with consumers and advisers to identify useful terminology

Financial advisers would be required to use different and more consumer-friendly language when engaging with consumers. Specific changes would be determined through consultation with consumers and advisers, but the following changes could be made, depending on the overall 'package' of options that is preferred:

- Renaming 'QFE advisers' to make it more explicit to consumers that they are a linked adviser (e.g. 'ANZ adviser').

- Removing the term ‘registered’ financial adviser as this title has been subject to misuse and has created confusion between ‘registered’ and ‘authorised’.
- An appropriate name for people providing sales only under a separation of sales and advice model.
- Renaming ‘wholesale’ and ‘retail’ advice and ‘class’ and ‘personalised’ advice and ‘broker’ to more meaningful terms.

  ✓ Ability to test with consumers to see which terminology changes are helpful.

  ✗ Compliance cost for advisers as a result of any required changes to terminology.

Questions	
25	What is the best way to get information to consumers? Who is best placed to provide this information (e.g. Government, industry, consumer groups)?
26	What terminology do you think would be more meaningful to consumers?

4.9 Other elements where no changes are proposed

The definitions of 'financial adviser' and 'financial adviser service'

Current Situation

A financial adviser is defined in the FA Act as a person who provides a financial adviser service. Financial adviser services are defined as the provision of:

- Financial advice, which is making a recommendation or opinion relating to acquiring or disposing of a financial product. This does not include providing information or recommendations and opinions relating to a particular class of product.
- An investment planning service, which is designing a plan for an individual that is based on an analysis of the individual's overall financial situation and goals, and includes a recommendation or opinion on how to realise those goals.
- A discretionary investment service, which is deciding which FMC Act financial products to acquire or dispose on behalf of a client (when acting under an authority to do so).

The regulation of financial advice needs to adequately cover financial advice services where consumers would benefit from advice but where consumers cannot judge the quality of advice and there is risk of harm from 'bad' advice. On the other hand, the regulatory regime needs to be sufficiently narrow that it does not impact on services where consumers do not require regulatory intervention.

We consider the existing definitions achieve this balance. Importantly, the definitions make allowances for the provision of information or recommendations relating to a particular class of product. This exclusion ensures that regulation does not hinder the provision of general information. Similarly, execution-only services (where a consumer has requested to buy a specific product and does not wish to receive advice) are not advice services and therefore outside the scope of the regime.

Note that specific exemptions from the regime and the provision of advice through technological channels are discussed elsewhere in this Chapter.

Questions	
27	Do you have any comments on the proposal to retain the current definitions of financial adviser and financial adviser service?

Exemptions from the application of the FA Act

Current Situation

Some professions, including lawyers and accountants, are exempt from the application of the FA Act to the extent that they provide a financial advice or broking service in the ordinary course of their business. The basis for these exemptions is that these professions are already subject to regulatory oversight, and that any potential benefits that may arise from having to meet additional compliance through the FA Act are not justified.

Concerns were raised in submissions that some of those who are exempt from the regime are putting consumers at risk by 'crossing the line' from financial advice in the ordinary course of business. In particular, lawyers, accountants and real estate agents were singled out by submitters as posing undue risk to consumers from unqualified financial advice. A common response through submissions was that any individual providing financial advice should be required to meet the same professional standards including registration, accreditation and disclosure.

However, there does not appear to be any evidence that these exemptions are having a detrimental impact on consumers' financial outcomes, or on the professionalism or consumer confidence in the financial advice industry.

Given the lack of evidence of consumer harm and consumers being at risk as a result of these settings we do not propose any changes to the exemptions regime.

Questions	
28	Are those currently exempt from the regime posing undue risk to consumers through the provision of financial advice in the normal course of their business? If possible, please provide evidence.

Territorial scope

Current situation

The FA Act applies to a financial advice or brokering service received by a client in New Zealand, regardless of where the person providing the service is resident, incorporated, or carries on business. This means that overseas providers need to consider their obligations under the FA Act if their services are "received by a client in New Zealand".

Certain provisions of the FA Act also apply to New Zealand-based financial and brokering services provided to an overseas client. These include basic conduct obligations to exercise due care, diligence and skill and not to engage in false or misleading conduct.

Given the increasing internationalisation of financial advice and services we are not considering limiting the territorial scope of the FA Act to providers who are resident, incorporated or carry on business in New Zealand. (For options around the territorial scope of the FSP Act see Chapter 6).

Nevertheless there is an inherent difficulty in monitoring and enforcing compliance with New Zealand laws by overseas providers, and concerns have been expressed that a lack of access to financial advice domestically means that New Zealanders are exposing themselves to undue risk in the utilisation of overseas financial advice.

This risk to consumers may be partially addressed by increasing consumer awareness of any undue risk arising from financial advice from an overseas source, and by ensuring the regulatory regime does not act as a barrier to the availability of advice locally.

Questions	
29	How can the FA Act better facilitate the provision of international financial advice to New Zealanders, without compromising consumer protection? Are there other changes that may be needed to aid this, beyond the technological options outlined in Chapter 4.2?
30	How can we better facilitate the export of New Zealand financial advice?

The regulation of brokers and custodians

Current situation

The FA Act regulates 'broking' and 'custodial' services. A broking service is defined as the receipt of client money or property in relation to a financial product by a person and the holding, payment or transfer of that client money or property.

A 'custodial service' is a subset of broking service, where the client money or property is held by a person on behalf of its beneficial owner. Additional requirements are placed on custodians under the Financial Advisers (Custodians of FMCA Financial Products) Regulations 2014.

The requirements placed on brokers and custodians were seen by the majority of submitters as being adequate and effective at protecting client interests. It was noted that it is probably too early to assess the effectiveness of the reporting requirements placed on custodians under the above Regulations.

Section 4.8 discusses the use of the word 'broker' in the Act, which differs from common usage.

Questions	
31	Do you have any comments on the proposal to retain the current approach to regulating broking and custodial services?

Chapter 5 – Potential packages of options

Drawing on the individual elements outlined in Chapter 4, three packages of options of changes to the regime have been developed. Each package illustrates a possible future regulatory regime at a high-level, recognising that changes to individual elements should not be considered in isolation as they will have implications for the wider regime.

Importantly, while we are seeking feedback on which, if any, of the three packages are preferred, none are set in stone. They are intended as a basis for discussion with stakeholders about the pros and cons of each and what may or may not work in practice. We are also seeking feedback on whether there are other packages that could work better than the three permutations presented here.

Package 1 proposes relatively minor changes to the current regime. Recognising that minor changes might not be sufficient to address the barriers, Packages 2 and 3 propose more significant changes to the current regime.

Annex 1 presents case studies to illustrate how each package would work in practice for three typical scenarios – a consumer wanting to find out if they are in the right KiwiSaver fund, a consumer wanting advice for investing $50,000 and a consumer wondering whether they need life insurance.

Questions	
32	What are the costs and benefits of the packages of options described below?
33	How effective is each package in addressing the barriers described in Chapter 3?
34	What changes could be made to any of the packages to improve how its elements work together?
35	Can you suggest any alternative packages of options that might work more effectively?

5.1 Package 1 (improved consumer focus through minor change)

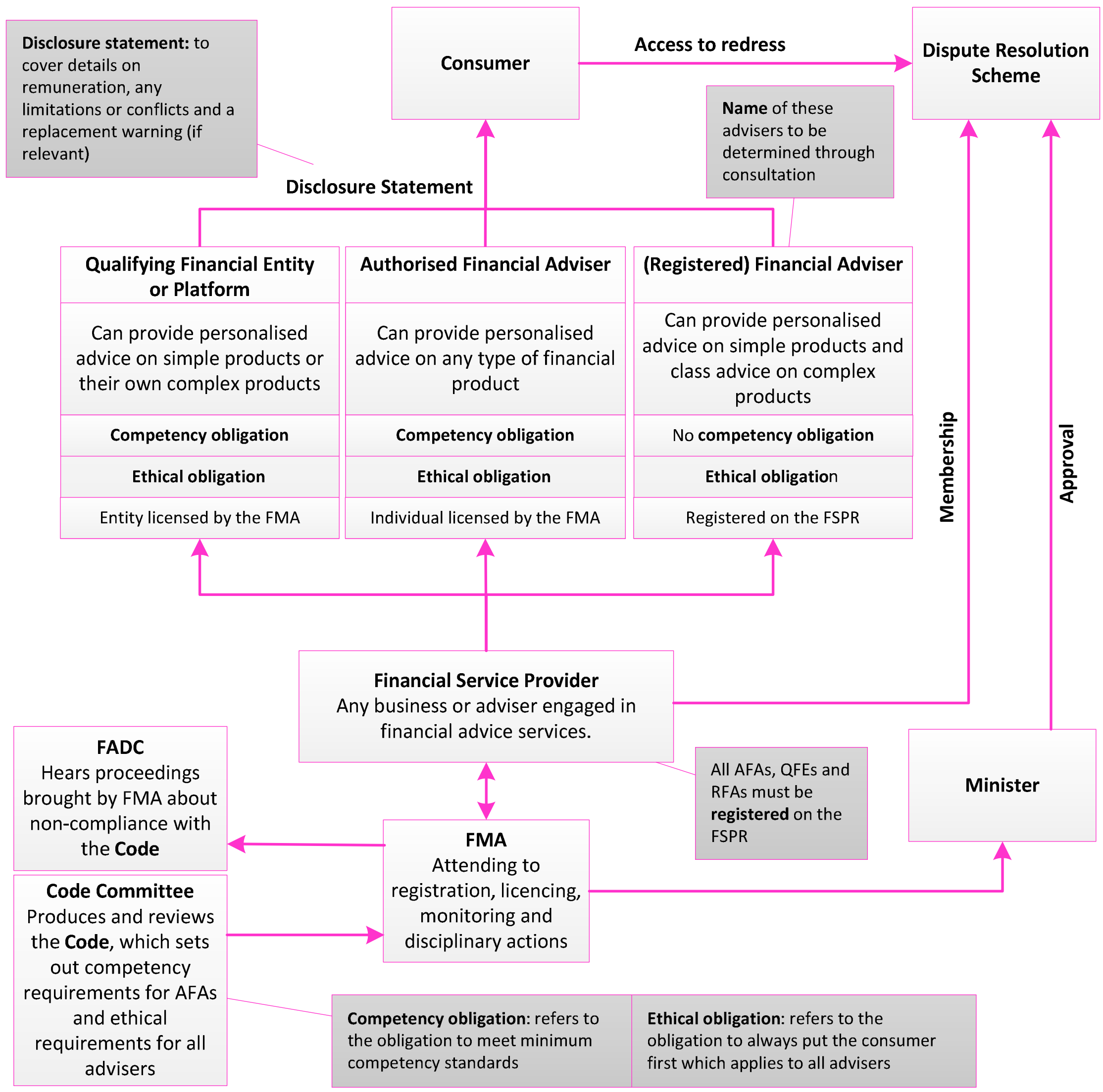
Overview

Package 1 aims to make financial advice more accessible for consumers through relatively minor changes. Limiting the degree of change is a key principle of this package, recognising that change imposes costs on businesses (and consumers) due to the need to change processes and systems.

Misleading jargon would be replaced with clearer terminology to enable consumers to more easily understand the regime. Consumers would have increased access to robo-advice which could be provided by licensed entities. Conflicts of interest would be dealt with by improving disclosure requirements and requiring all financial advisers to place the consumer's interests first.

Some advice gaps would likely remain because the current legislative boundaries that determine who can provide what advice would remain. It is also likely that some consumers would continue to receive advice from people without adequate knowledge, skills or competence levels.

Figure 3: Package 1



Summary of how Package 1 differs from the current regime

Ethical obligations	All advisers would be required to adhere to the same ethical obligation "to always put the consumer's interests first". This would include a requirement to manage any conflicts of interest such that the consumer's interest would be placed ahead of the adviser's interest. This ethical requirement would not preclude advisers from earning commissions or being aligned with a provider/s, however an adviser could not recommend a financial product unless the adviser considered the transaction was in the consumer's best interest. An adviser could not imply or state they are independent if they were aligned to a particular product provider/s.
Disclosure requirements	All advisers would be required to provide a simple and common form of disclosure to consumers. What the disclosure would look like and contain would need to be developed but would likely include: • A statement confirming that the adviser is required to act in the consumer's interests. • Detail on any conflicts of interest, including commissions, sales targets and soft commissions. • An explanation of any limitations to the service being provided, such as limitations on the range of products or product providers considered. • If relevant, a notification that the advice includes a recommendation to replace an existing product (e.g. switching KiwiSaver schemes) and that the advice is not based on an assessment of whether the replacement product will make the consumer better off than their current product.
Consumer experience	Adviser designations could be changed to be more meaningful for consumers.
Provision of robo-advice	The provision of robo-advice would be enabled by amending the legislation to be technologically neutral – meaning that advice could be provided by a platform or an individual. Any robo-advice platform would have to have a licenced entity behind it.

Impact of Package 1 on different industry participants compared to the current regime

QFEs and QFE advisers	• Able to provide robo-advice. • New ethical obligations would apply and advice processes would need to be modified to reflect this. • Disclosure obligations would increase (e.g. QFE advisers would have to disclose how they are remunerated).
AFAs	• Disclosure obligations would be streamlined which could reduce compliance costs.
RFAs	• New ethical obligations would apply and advice processes would need to be modified to reflect this. • Disclosure obligations would increase (e.g. RFAs would have to disclose how they are remunerated).
Consumers	• Advisers would be required to act in consumers' best interests. • Consumers would receive more meaningful disclosure. • Adviser designations would be clearer. • Potential for greater access to advice through online financial advice platforms.

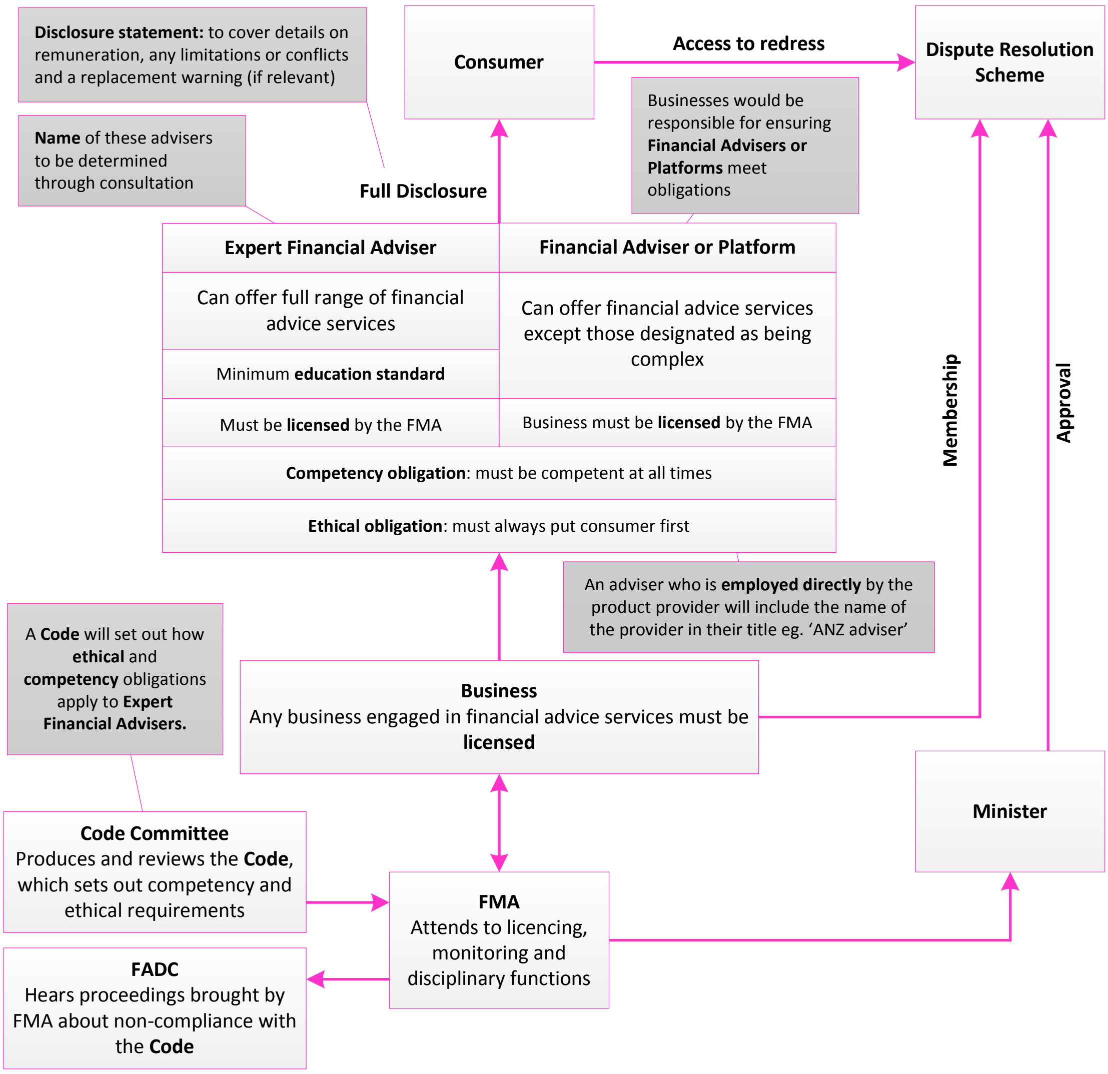
5.2 Package 2 (competency and ethical obligations for all advisers)

Overview

Package 2 includes all of the improvements described in Package 1. It also aims to increase the standard of advice that consumers receive by requiring all financial advisers to be competent and put the consumer's interests first. Under this package more consistent obligations would apply to all advisers and some of the current boundaries which determine who can provide what advice (e.g. Categories 1 and 2, class and personalised advice) would be removed. This would create a simpler regime and overcome the current advice gaps that have been caused by complexity and an uneven playing field.

Package 2 includes an entity licensing regime which looks to extend the efficiencies of the current QFE model. All businesses and sole traders would be licensed by the FMA and would be responsible for ensuring their advisers adhere to the relevant ethical and competency obligations. A sub-set of advisers (Expert Financial Advisers) would be individually licensed to provide more complex adviser services (the services that would fall into this complex category are yet to be defined). This individual licensing would provide them with a recognisable quality mark.

Figure 4: Package 2



Summary of Package 2

Types of advice services	There would be one type of financial advice service. The current regulatory distinction between "class" and "personalised" advice would not exist. Instead, all advisers would be required to provide a service that matched the consumer's request – which may be for advice on a discrete matter or a full financial plan – subject to sticking within the adviser's areas of competence. Execution-only services (where a consumer has requested a specific product and does not wish to receive advice) are not advice services and are therefore outside the scope of the regime.
Types of advisers	There would be two types of advisers – Expert Financial Advisers and Financial Advisers. • Expert Financial Advisers would be those who could provide the most complex or high-risk financial advice services. • Financial Advisers would be those who could provide advice services, except those designated as being most complex.
Types of products	The current distinction between Category 1 and Category 2 products would not exist. However, there would be a set of complex or high-risk financial advice services that only Expert Financial Advisers could provide. This set could include advice on certain financial products that are considered particularly complex or high-risk. This would be a narrower list than the current Category 1 list, recognising that all advisers would be subject to ethical obligations and competency requirements.
Competency requirements	All advisers would be subject to legislative principles-based competency requirements to ensure they are competent at all times to provide their services. Detail on the specific requirements for Expert Financial Advisers would be set out in a Code of Conduct which would be akin to the current Code of Professional Conduct for AFAs.
Licensing model	1. Any business engaged in a financial advice service would be licensed by the FMA. Licensing would involve businesses proactively engaging with the FMA to ensure they have the right processes in place to comply. It is similar to the current process for licensing QFEs. A business wishing to provide advice via a platform (robo-advice) would also be required to be licensed. 2. All Expert Financial Advisers would be individually licensed to provide more complex adviser services. The individual licensing of Expert Financial Advisers should provide them with a recognisable quality mark.
Roles of regulatory and industry bodies	Detailed ethical, client-care, and competency obligations for Expert Financial Advisers would be set by a Code Committee.

Impact of Package 2 on different industry participants compared to the status quo

QFEs and QFE advisers	• Able to provide robo-advice.
	• Most QFE advisers would become "Financial Advisers" and therefore:
	  o New ethical obligations would apply and advice processes would need to be modified to reflect this.
	  o Disclosure obligations would increase (e.g. to disclose how they are remunerated).

AFAs	• Some AFAs would become "Expert Financial Advisers" and therefore:
	  o Disclosure obligations would be streamlined which should reduce compliance costs.
	  o They would have a more recognisable quality mark.

RFAs	• RFAs would become "Financial Advisers" and therefore:
	  o New ethical obligations would apply and advice processes would need to be modified to reflect this.
	  o Disclosure obligations would increase (e.g. to disclose how they are remunerated).
	  o Competency obligations would apply.
	  o There would be additional compliance costs due to business licensing requirements.
	  o They could provide robo-advice.

Consumers	• Advisers would be required to act in consumers' best interests. • Consumers would receive more meaningful disclosure. • Adviser designations would be clearer. • Potential for greater access to advice through online financial advice platforms and the advisers being required to provide a service that matches the consumer's request. • More certainty that advisers have the competencies required to provide their advice.

5.3 Package 3 (distinction between sales and advice)

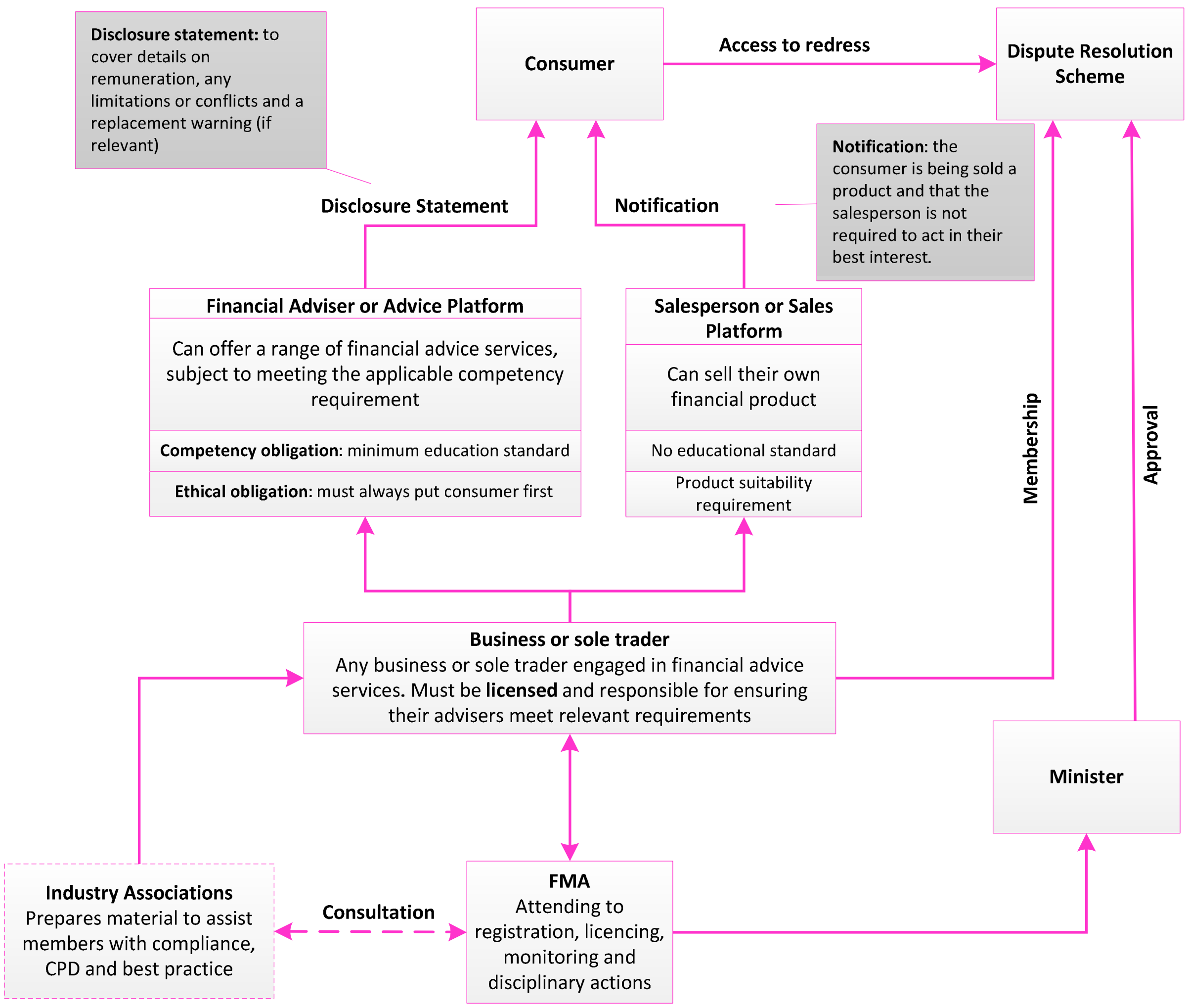
Overview

Package 3 includes some of the improvements made in Packages 1 and 2 (improved terminology and disclosure, the ability for licensed entities to provide robo-advice, and an entity licensing regime).

Package 3 also aims to clearly distinguish sales from advice. While Packages 1 and 2 require all people providing financial advice services to place consumer's interests first, Package 3 allows "salespeople" to avoid this obligation with the condition that consumers are made aware that they are not receiving advice that puts their interests first.

To this end, anyone providing financial advice services would need to meet competency and ethical obligations unless they notified consumers that the transaction is a sale. Salespeople would only be able to sell their own financial products (as a result, advisers who are not directly aligned to a product provider would be required to meet the competency and ethical obligations).

Figure 5: Package 3



Summary of Package 3

Types of advice services	There would be one type of financial advice service. The current regulatory distinction between "class" and "personalised" advice would not exist. Rather, all advisers would be required to provide a service that matched the consumer's request – which may, for example, be for advice on a discrete matter or for a full financial plan – subject to staying within the adviser's areas of competence. Execution-only services (where a consumer has requested a specific product and does not wish to receive advice) are not advice services and are therefore outside the scope of the regime.
Types of advisers	There would be one type of financial adviser and one type of salesperson. • A Financial Adviser would be able to offer the full range of financial advice services, from advice on a discrete matter to full financial plans. Advisers would only be able to provide advice within their areas of competence. This is akin to the legal profession, whereby lawyers must maintain competence in their fields of practice and only provide services they are competent to provide. • Salespeople would be required to provide consumers with a prescribed notice and would be subject to an obligation to ensure the product being sold is suitable for the consumer. Salespeople could only sell their own financial products and as a result, only salespeople aligned to a single financial product provider could be salespeople.
Types of products	There would be no distinction between product types.
Competency requirements	All advisers would be subject to a principles-based competency requirement to ensure they are competent at all times to provide their services. Akin to the current QFE model, these requirements would be principles-based rather than prescriptive minimum standards. The detail on how to comply would be determined through a licensing process (see below).
Licensing model	All businesses and sole traders would be required to be licensed by the FMA. There would be a strong focus on engagement with the FMA to ensure each business had the right processes in place – given the services they provide – to comply with the ethical and competency requirements.
Roles of regulatory and industry bodies	Recognising that some of the entities captured by the regime will be small, there would be an increased role for industry associations in providing best practice guidance to their members to assist them in becoming licensed and meeting their obligations on an ongoing basis. Associations could work with the FMA to produce guidance for their members that, if followed, would likely meet the licensing requirements. For example, an industry association representing insurance brokers could work with the FMA to produce guidance for its members around qualifications and CPD appropriate for insurance brokers. Industry bodies could also play a role in assisting consumers to find an adviser.

Impact of Package 3 on different industry participants compared to the status quo

QFEs and QFE advisers	• QFEs would be able to provide robo-advice. • Some QFE advisers would become "Financial Advisers" and some would become "Salespeople". For QFE "Financial Advisers": o New ethical obligations would apply and advice processes would need to be modified to reflect this. o Disclosure obligations would increase (e.g. to disclose how they are remunerated). o New and potentially higher competency obligations would apply. For QFE "Salespeople": o Required to provide consumers with a prescribed notification. o Would be subject to a product suitability obligation.
AFAs	• AFAs would become "Financial Advisers" and therefore: o Disclosure obligations would be streamlined which should reduce compliance costs. o They could provide robo-advice. o There would be little differentiation between them and other types of advisers.
RFAs	• There would be additional compliance costs due to business licensing requirements. • RFAs who are aligned to a product provider would likely become "Salespeople": o Required to provide consumers with a prescribed notice o Would be subject to a product suitability obligation. • RFAs not aligned to a single product provider would become "Financial Advisers": o New ethical obligations would apply and advice processes would need to be modified to reflect this. o They could provide robo-advice. o Disclosure obligations would increase (e.g. to disclose how they are remunerated). o Competency obligations would apply.
Consumers	• Advisers would be required to act in consumers' best interests. • Consumers would receive more meaningful disclosure. • Adviser designations would be clearer. • Potential for greater access to advice through online platforms and the advisers being required to provide a service that matches the consumer's request. • More certainty that advisers have the competence required to provide their advice. • Clarity when being sold something compared to receiving advice.

Part 3 –Misuse of the FSPR

Chapter 6 – Misuse of the FSPR

Introduction

This section outlines concerns around the misuse of the FSPR and potential options to overcome these concerns. These options are separated from those discussed in Part 2 recognising that it may be desirable to address this issue ahead of any other changes to the financial adviser regime. Accordingly, MBIE seeks submissions on the questions in this part of the paper by 5pm on **Friday 29 January 2016.**

Current situation

- Anyone who is in the business of providing a financial service (such as a financial adviser, bank, lender or insurer) is required to be registered on the FSPR.
- The requirement applies only to a person who is ordinarily resident in New Zealand or has a place of business in New Zealand, regardless of where the financial service is provided.
- As outlined in the report on the *Financial Service Providers (Registration and Dispute Resolution) Act 2008 – Part 2: Registration,* some offshore-controlled firms have sought to register on the FSPR in order to take advantage of New Zealand's reputation as a well-regulated jurisdiction. These firms then misrepresent that they are licensed or actively regulated in New Zealand.
- The FMA has powers to direct the Registrar to decline a registration or de-register an entity. The FMA can do so if it considers that registration creates a misleading impression about the extent the provider is regulated in New Zealand or will damage the integrity or reputation of New Zealand's financial markets or New Zealand's regulatory arrangements for those markets. However, dealing with misuse issues in this way requires considerable resources.

Assessment of the current situation

As outlined in the Financial Service Providers (Registration and Dispute Resolution) Act 2008 – Part 2: Registration report, we recommend changes to address misuse of the FSPR particularly by offshore-controlled providers.

Steps have been taken to reduce misuse of the FSPR (including use of the de-registration powers), but misuse remains an ongoing challenge and the de-registration powers have not proven to be fully effective. Interim solutions are already being worked on to reduce misuse and better alert consumers to the limitations of information on the FSPR. This includes clearer messaging and notices to consumers about what it means to be registered.

We have developed options for further changes to address these issues. Given the risk of damage to New Zealand's reputation as a well-regulated jurisdiction and the reputation of legitimate New

Zealand-based financial service providers, we will explore making changes ahead of any other changes to the financial adviser regime as discussed in the rest of this paper.

We will also be working with the Ministry of Justice to consider how the preferred option would work alongside anti-money laundering and countering financing of terrorism legislation, and whether any changes to that legislation would assist with resolving the misuse issues.

Options

Option 1: Include stronger registration requirements

More stringent requirements would be imposed prior to registration. Regulations could be made requiring applicants to confirm and provide proof that they are licensed and/or supervised in their home jurisdiction and in any jurisdiction that they are proposing to provide services to. Other changes could include requiring a level of indemnity cover or bonding for offshore-controlled entities providing services to New Zealand retail consumers to ensure compensation funds are available in the event of a dispute.

- ✓ This option would enable the Registrar/FMA to more easily identify potentially fraudulent firms.
- ✓ It would be unlikely to add material compliance costs to legitimate financial service providers, who are likely to have relevant documents readily available (depending on the nature of the requirements).
- ✗ Time and resources would be required to verify documentation provided.
- ✗ On its own, implementing this requirement may not enable the Registrar/FMA to refuse registration or de-register in all cases of misuse.

Option 2: Amend the grounds for de-registration

Legislative changes would be made to clarify or provide additional circumstances under which the FMA may direct the Registrar to decline a registration or de-register an entity. The grounds could include where an entity does not provide a substantive amount of services from a place of business in New Zealand, or are a 'repeat offender' that has previously been de-registered.

The legislation could also prohibit firms from referring to their registered status in any offshore advertising, or it could provide that if firms wish to refer to their registered status, they must accurately describe that status and its limitations (and could provide standard wording, such as "registered in New Zealand but not licensed or subject to active supervision or oversight"). Failure to comply could then be a ground for de-registration.

- ✓ Compared to the current situation, this option more clearly outlines the circumstances under which a firm can be de-registered and the evidence required to establish sufficient grounds for de-registration. It would likely better enable the FMA/Registrar to de-register fraudulent firms.
- ✓ De-registration is at the FMA's discretion, so this would be a more flexible means of addressing the misuses issue compared to amending the territorial scope of the legislation. It reduces the risk of unintended consequences.

- ✗ It would be reasonably resource-intensive to gather the evidence required to establish sufficient grounds for de-registration (though less so compared to the current situation).

Option 3: Amend the territorial scope of the legislation to require a legitimate connection to New Zealand

Legislative changes would be made to the territorial scope in the FSP Act so that the requirement to register applies only to entities with a stronger connection to New Zealand than is currently the case. Instead of simply requiring a place of business in New Zealand, the legislation could apply either to entities that are providing services to clients in New Zealand, or to entities carrying on business of providing a financial service in New Zealand.

- ✓ It would preclude overseas-controlled entities that are not providing financial services in New Zealand from registering.
- ✗ It could create other potential loopholes, uncertainty or unintended consequences. For example, if the territorial scope was entities providing services to New Zealand clients, it may impose compliance costs on overseas entities that could be required to register if they have one or two New Zealand clients. Conversely, an entity seeking to misuse the FSPR could potentially still do so by undertaking one or two transactions in New Zealand.

Option 4: Require trust and company service providers to register

Regulations would be made to prescribe trust and company service providers subject to Anti-Money Laundering legislation as financial service providers required to register on the FSPR. The services of trust and company service providers can include acting as a director or nominee shareholder in order to provide anonymous registration for offshore interests.

- ✓ It would assist the FMA to address misleading conduct by company agents. It would also align the registration obligations with anti-money laundering legislation, which includes trust and company service providers as "reporting entities".

Option 5: Limit public access to all or parts of the FSP Register

Under this option, certain parts of the FSPR would be available only to regulators and policy-makers. Those non-public parts could include entities that are not licensed or those not proposing to provide retail services in New Zealand.

- ✓ It would reduce the likelihood of the FSPR creating or reinforcing a false impression that a firm was licensed or regulated in New Zealand.
- ✗ An offshore-controlled firm could still claim (in a potentially misleading, but strictly true manner) that it was a New Zealand registered financial service provider.
- ✗ It may reduce the usefulness of the FSPR as a consumer tool.

Option 6: Convert the current FSP Register into a non-public notification list

Under this option, the current register would be converted into a non-public notification list. Legislative change would be made so that entities that are currently required to register would instead be required to notify a government agency of their intention to provide financial services. The agency would maintain a non-public list of notifications received. Existing registered entities could be deemed to have made a notification. All entities still must not be disqualified e.g. its directors must not be undischarged bankrupt. (If necessary, a separate publically-accessible register could be established to provide information for consumers. The public register could contain information of only those entities that provide financial services to New Zealand retail consumers.)

- ✓ This option would reduce the benefit of registration for overseas-controlled firms that do not provide services in New Zealand. (Appears to be little benefit to a firm claiming “notified [New Zealand Companies Office] of intention to provide financial services” compared to “registered as financial service provider in New Zealand”).
- ✓ This option likely still meets New Zealand’s international obligations under the Financial Action Task Force Recommendations to maintain a register of financial institutions to assist with anti-money laundering monitoring purposes.
- ✗ Significant changes to legislation, the registration system and processes would be required.

Questions	
36	Do you agree with our assessment of the pros and cons of the options to overcome misuse of the FSPR?
37	What option or combination of options do you prefer and why? What are the costs and benefits?
38	What are the potential risks and unintended consequences of the options above? How could these be mitigated?
39	Would limiting public access to parts of the FSPR help reduce misuse?

Annex 1 – Case studies

Scenario 1 – A client contacts their KiwiSaver provider as they notice their balance drop overnight and they want to find out if they're in the correct fund.

Existing regime	The QFE adviser may prefer to keep the transaction to general 'class' advice, to avoid a more onerous advice process. In providing class advice, they can determine if the client is in an appropriate fund for their age bracket but may avoid investigating other aspects of the client's situation. The client can be transferred into the 'advice' stream to discuss their options with an AFA who will need to undertake a more thorough analysis of the consumer's wider situation.
Package 1 ('Improved consumer focus through minor change')	The QFE adviser may prefer to keep the transaction to general 'class' advice, to avoid a more onerous advice process. The client can be transferred into the 'advice' stream or they can utilise the bank's online offering to compare funds.
Package 2 ('Competency and ethical obligations for all advisers')	The financial adviser they speak to can discuss the client's needs and ascertain whether they are in the correct fund. The adviser must put the client's interests first when providing the advice and must disclose whether they will receive any conflicted remuneration or bonus for transferring the client into a different fund.
Package 3 ('Distinction between sales and advice')	The client initially speaks to a salesperson who can discuss the provider's KiwiSaver funds but must notify the client that they are a salesperson. If the client wants to receive professional advice, they can speak to a financial adviser. The salesperson also suggests that the client can utilise the bank's robo-advice service.

Scenario 2 - A client has a $50,000 term deposit approaching maturity. They would like financial advice to ensure they receive additional income during retirement.

Existing regime	They contact a local advisory firm who chooses not to assist since they limit their services to consumers with larger sums to invest (due to the time and cost of a full advice process). They contact their bank and the QFE adviser can provide financial advice relating to the bank's products. The client can be transferred into the 'advice' stream to discuss their options with an AFA who will need to undertake a more thorough analysis of the consumer's wider situation.
Package 1 ('Improved consumer focus through minor change')	They contact a local advisory firm who chooses not to assist since they limit their services to consumers with larger sums to invest (due to the time and cost of a full advice process). They contact their bank and the QFE adviser can provide financial advice relating to the bank's products. The client can be transferred into the 'advice' stream to discuss their options with an AFA who will need to undertake a more time consuming analysis of the consumer's wider situation. Alternatively, the client may choose to utilise the bank's robo-advice service.
Package 2 ('Competency and ethical obligations for all advisers')	They contact a local advisory firm whose financial advisers can discuss a range of products that are available to the client. They decide to also contact their existing bank to see what then can offer. The bank's adviser can provide advice on the bank's products and suggests that the client may choose to utilise the bank's robo-advice service.
Package 3 ('Distinction between sales and advice')	They contact a local advisory firm whose financial advisers can discuss a range of products that are available to the client. They decide to also contact their existing bank for a second opinion. The salesperson can sell one of the bank's products, but needs to notify the client that the transaction is a sale and can recommend that the client can meet with the bank's financial adviser. Alternatively, the client may choose to utilise the bank's robo-advice service.

Scenario 3 – Having recently purchased a house a client chooses a life insurance product recommended by their financial adviser.

Existing regime	The client is unaware that as the financial adviser is an RFA they have no obligation to place their client's interests first. The client is also unaware that the RFA receives commission from the product provider and that recommendation is limited to a number of products.
Package 1 ('Improved consumer focus through minor change')	The financial adviser has ethical obligations, including the need to place their client's interests first. The client is made aware that the financial adviser will receive commission for completing the sale and that their recommendation was limited to the three insurance providers whose products they offer.
Package 2 ('Competency and ethical obligations for all advisers')	Their financial adviser has ethical obligations, including the need to place their client's interests first. The client is made aware that the financial adviser will receive commission for completing the sale and that their recommendation was limited to the three insurance providers whose products they offer.
Package 3 ('Distinction between sales and advice')	The financial adviser has ethical obligations, including the need to place their client's interests first. The client is made aware that the financial adviser will receive commission for completing the sale and that their recommendation was limited to the three insurance providers whose products they offer.