

In Confidence

OFFICE OF THE MINISTER OF COMMERCE AND CONSUMER AFFAIRS

The Chair
Cabinet Economic Growth and Infrastructure Committee

Release of Options Paper for the Review of the Financial Advisers Act 2008 and the Financial Service Providers (Registration and Dispute Resolution) Act 2008

Proposal

1. This paper seeks Cabinet's approval to publically release the attached Options Paper (see **Annex 1**) for the review of the Financial Advisers Act 2008 (FA Act) and the Financial Service Providers (Registration and Dispute Resolution) Act 2008 (FSP Act).

Executive Summary

2. The Ministry of Business, Innovation and Employment (MBIE) is undertaking a statutory review of the operation of the FA Act and the FSP Act. These Acts regulate the financial advice industry in New Zealand and require all financial service providers to be registered. The review forms part of the Government's financial capability work and is an important element of the Building Investment stream of the Business Growth Agenda.
3. An Issues Paper was released in May this year [EGI Min (15) 10/8 refers] for public consultation and officials have met extensively with consumer and industry stakeholders. This engagement has highlighted a number of barriers that are impeding the better functioning of the two Acts. In particular there is a need to simplify the regime and ensure more consumers can access advice, including those with simple questions and those without large sums to invest.
4. I am seeking Cabinet's approval to release an Options Paper that presents options to overcome the barriers. The options have been developed in consultation with government agencies, key industry stakeholders and consumers. The options include:
 - a. Clarifying elements of the regime that are causing confusion among consumers, such as making the distinction between sales and advice clear and removing misleading terminology.
 - b. Requiring consistent disclosure of any conflicts of interest (including remuneration) that may impede consumers' access to impartial advice.
 - c. Making licensing requirements more consistent across different forms of advisers.
 - d. Facilitating the provision of financial advice through technological channels by removing the requirement that advice be provided by a natural person.
 - e. Making changes to the operation of the FSP Register to prevent its misuse.

In Confidence

5. The Options Paper also includes three potential packages of options to provide high level illustrations of possible future regulatory regimes. Package 1 shows what minor changes could be made while Packages 2 and 3 aim to address all of the barriers through more substantial change.
6. Following the consultation period and review of the submissions on the Options Paper, MBIE is required to report back to me by July 2016 on the operation of the Acts, including recommendations on whether any amendments are necessary or desirable.

Background to the review

7. Access to quality financial advice and information allows New Zealanders to make informed decisions about participating in financial markets. Investor confidence and participation in these markets provides funding for New Zealand businesses and is a vital tool for individuals in achieving their financial goals.
8. The review is an important element of the Business Growth Agenda as the FA Act and the FSP Act contribute to the regulation of New Zealand's capital markets and are integral in promoting sound investor decision-making:
 - a. The FA Act regulates professional providers of financial advice in the investment, insurance, mortgage broking and banking industries. It aims to encourage and promote public confidence in the professionalism and integrity of financial advisers and brokers.
 - b. The FSP Act requires financial service providers to be registered and (where applicable) to belong to a dispute resolution scheme. These requirements are aimed at promoting confident and informed participation of businesses, investors and consumers in fair, efficient and transparent financial markets.
9. MBIE is required by statute to review and provide recommendations to me on the operation of both Acts no later than five years after commencement of the relevant sections of these Acts. Given the extensive inter-relationship between the two Acts, they are being reviewed at the same time.
10. In addition to the statutory requirements to review the two Acts, it is a timely opportunity to analyse the role of financial advice, financial service provider registration and dispute resolution in improving financial outcomes for New Zealanders. The review will test and update the objectives of, and rationale for, government intervention in this area.
11. In February this year, Cabinet approved the publication of the Terms of Reference for the review [CAB Min (15) 6/5 refers]. The Terms of Reference were published on MBIE's website. They outline the scope, objectives and key milestones for the review, including an indication that the Government would release an Options Paper for public consultation before the end of 2015.
12. A steering group of senior officials from MBIE, the Treasury, the Financial Markets Authority (FMA) and the Commission for Financial Capability has been established to oversee the review.

In Confidence

Progress to date

Issues with the FA Act and FSP Act

13. Officials began engaging with stakeholders in late 2014. In May 2015, Cabinet approved the release of an Issues Paper for the review [EGI Min (15) 10/8 refers]. The Issues Paper outlined sought feedback on how the Acts are operating. MBIE received 166 submissions in response to the Issues Paper.
14. Alongside the Issues Paper MBIE produced a simplified consumer brochure. The brochure linked to an anonymous online survey of 16 questions which received 248 responses.
15. Responses to the Issues Paper and consumer brochure as well as other engagement with industry and consumers have clarified elements of the regime that are working well and areas where improvements could be made.

Report on the operation of the registration part of the FSP Act

16. Officials reported to me in August on the operation of the registration part of the FSP Act, being five years after the commencement of the FSP Act. The report found that while the Register provides assurance that financial service providers meet certain requirements and that New Zealand's FATF obligations are being met it is not meeting some of its objectives:
 - a. While the Register provides a single source of information for the public on financial service providers it does not appear to be widely used or understood by consumers, and the information it contains may be of limited value.
 - b. The Register has enabled regulators to identify financial service providers. However the accuracy of the information on the Register cannot be relied upon at an individual level and its usefulness is limited as an enforcement tool.
 - c. The Register is being misused by some firms to gain the appearance of being regulated in New Zealand.
17. Recognising the interdependence between the FA Act and FSP Act, the findings are being fed into the wider review. Potential solutions to the above issues are included in the Options Paper, as discussed below.

Outcomes the regulation should achieve

18. Based on feedback received through consultation the Options Paper sets out three outcomes that the regulatory regime should achieve. These outcomes all form part of the overarching outcome of promoting the confident and informed participation of investors and consumers in financial markets:
 - a. Consumers can access the right kind of advice and assistance to meet their needs and wants. For advice to be accessible it must be available in a variety of ways and easy for consumers to understand.
 - b. Advice improves consumers' financial outcomes. For advice to improve financial outcomes advisers must have the right skills, competencies and ethics to provide good quality advice.

In Confidence

- c. Consumers have access to effective redress. For redress to be effective it must be easy to seek and timely.
19. To date, the Acts have improved professional standards in the industry. Financial advisers are required to exercise care, skill and diligence and are prohibited from engaging in misleading or deceptive conduct. Financial Service Providers must belong to a dispute resolution scheme, ensuring that retail consumers can access redress.

Barriers to achieving the outcomes

20. However, MBIE's analysis has identified areas for improvement. There are a number of barriers that are impeding the better functioning of the regime and preventing the regime from achieving the above outcomes:
- a. It is hard for consumers to know where to seek financial advice from. The structure and terminology used in the regime is seen as preventing consumers from accessing financial advice.
 - b. Certain types of advice are not being provided. Compliance obligations and unclear regulatory requirements have led to some advisers choosing not to provide certain types of advice or not to service clients with smaller sums to invest.
 - c. Consumers may be receiving advice from people without adequate knowledge, skills and competence levels. The regime has introduced some competency requirements but they do not apply to all financial advisers.
 - d. Certain conflicts of interest (such as commissions) may be leading to suboptimal outcomes for consumers. The regime does not require all advisers to manage conflicts, or to disclose conflicts of interest to the client.
 - e. Consumers do not always understand the limitations of different types of advice. For example, consumers may be unaware that they are not receiving personalised advice.

Options Paper

21. The Options Paper identifies a range of potential options to address the barriers that exist within the regulatory regime. It seeks feedback on how the regime could be adjusted to achieve the outcomes and focuses on several key areas.

What is the most effective way for conflicts of interests to be managed?

22. Under the current regime there are various ethical and client care obligations imposed on different types of financial advisers. Some advisers are required to place the interests of the client first and manage any conflicts of interest, while others are not. The Options Paper seeks feedback on whether these requirements should apply to all financial advisers. An alternative option is to clearly distinguish between sales and advice, and require those engaged in sales to notify consumers that they are not required to place the interests of the client first.
23. The Options Paper also seeks feedback on how conflicted remuneration, such as commissions, should be treated in the regime, whether any bans or restrictions should be considered or if there are alternative ways to manage conflicts of interest. The Options Paper does not take a position as to whether any ban or restriction of conflicted remuneration should be imposed.

In Confidence

How should competency obligations apply to financial advisers?

24. Under the current regime competency requirements do not apply to all financial advisers and there is concern that some advisers do not have the skills or knowledge proportionate to the risk or complexity of the advice service being provided. The Options Paper seeks feedback on ways of lifting the competency of some advisers.

How can the regulatory regime assist with meeting compliance obligations?

25. Under the current regime there is a lack of up-front regulatory approval for some advisers, this was a concern raised through submissions. The Options Paper seeks feedback on a number of potential options to provide increased oversight, including whether licensing should be completed at an individual or business level.
26. The Options Paper also seeks feedback what roles different regulatory and industry bodies could play in the future regime. Recognising that any additional compliance could impact on an advisers' ability to provide advice, one option is for industry bodies to have a greater role in assisting their members to meet compliance.

How can disclosure be improved for consumers?

27. Under the current regime disclosure obligations vary for different advisers; some are required to disclose commissions while other advisers are not. MBIE also received strong feedback that the existing disclosure requirements are often too long and confusing for consumers to read or understand. The Options Paper seeks feedback on what information advisers should be required to disclose, whether all advisers should be required to disclose the same information and the potential delivery methods (e.g. verbally, online or hard copy) for disclosure.

How can the regime make it easier for a consumer to find an adviser?

28. The current regime uses some terminology which differs from common use and feedback has indicated that this has been confusing for consumers, made it difficult to find an adviser and may discourage them from seeking advice. The Options Paper seeks feedback on whether the use of consumer-friendly terminology would improve consumers' ability to access financial advice.
29. There is currently no centralised, useful tool for consumers to seek financial advisers. The Options Paper also seeks feedback on whether a 'portal' to provide consumers with information on financial advisers would help them find an adviser and whether this is a role for government.

Should the regime enable consumers to access advice through technological channels?

30. The FA Act requires advice to be provided by a natural person and is therefore a barrier to the provision of online advice. The Options Paper seeks feedback on how the regime could enable innovation in the financial services industry, which could result in financial advice being more accessible.

In Confidence

Packages of options

31. Drawing on a selection of the options explored above, three potential packages of options have been developed to provide high level illustrations of possible future regulatory regimes:
 - a. **Package 1** (refer to page 40 of the Options Paper) represents the least change from the status quo. It retains the current legislative boundaries which determine who is able to provide certain types of advice but would ensure greater consistency of advisers' ethical and disclosure requirements. The terminology would be updated so that it is meaningful to consumers, and licensed entities would be able to provide robo-advice. This package is intended to cause less disruption to the industry, recognising that change imposes costs on businesses, however it would not address all of the barriers.
 - b. **Package 2** (refer to page 43 of the Options Paper), includes the improvements made under Package 1. In addition it reduces the current restrictions on who can provide certain types of advice, thereby ensuring consumers can get advice on simple matters. Instead, it introduces a broad licencing regime in which all businesses engaged in financial advice services are required to be licensed by the FMA. Businesses must ensure their employees are competent and put the consumer's interests first. In addition, a subset of advisers – Expert Financial Advisers – would be individually licenced to provide more complex adviser services, providing them with a recognisable quality mark.
 - c. **Package 3** (refer to page 46 of the Options Paper) also includes the improvements made under Package 1. In addition it distinguishes sales from advice. Anyone providing financial advice services must meet minimum ethical and competency standards unless they provide consumers with a prescribed notification that the transaction is a sale and the salesperson is not required to put the consumer's interests first. A key assumption underpinning this package is that a consumer will understand when they are being sold a product as opposed to being given advice which puts their interests first.

Financial Service Providers Register

32. There is an ongoing concern about misuse of the Register, especially by offshore entities who use the fact that they are registered to gain the appearance that they are being regulated in New Zealand. This poses a potential risk to the integrity of financial markets in New Zealand. The Options Paper seeks feedback on potential changes to prevent this misuse. These include stronger registration requirements, clarifying the de-registration powers of the FMA, adjusting the territorial scope of the FSP Act to require a legitimate connection with New Zealand, and converting the current register to a notification list.
33. Depending on feedback, I am likely to report to Cabinet in early 2016 with proposals to address concerns with misuse of the Register, prior to making any changes to the wider regime.

In Confidence

Risks and mitigations

34. The Options Paper, or particular options within, may be criticised by some parts of the industry. For example:
 - a. Advisers who are currently paid through commissions, either entirely or in part, are likely to oppose any suggestion that conflicted remuneration should be banned or restricted. Banning or restricting conflicted remuneration is one potential option discussed in the Options Paper to overcome the problem of conflicts of interest, along with, extending the ethical obligations and disclosure requirements.
 - b. The regime has been in place for five years and entities have invested considerably by putting systems in place to meet compliance obligations. Any major changes may be opposed by some financial adviser service providers, in particular larger organisations such as banks and insurance providers.
 - c. Increasing competency obligations for advisers, or extending the existing requirements to all financial advisers, could be opposed by some financial advisers who may not currently meet the requirements. This could lead to some advisers leaving the industry, or deter new advisers from entering the industry.
35. Some negative reaction is inevitable by virtue of issuing a paper that considers changes to the operation of the industry. However, the status quo is problematic for much of the industry and the Options Paper is necessary to facilitate a conversation around how to improve industry and consumer outcomes. My press release and officials' engagement will continue to emphasise that a range of options are still being considered and industry input on the costs and benefits of various options will be taken into account when making the final recommendations.

Next steps

36. Subject to Cabinet approval, the Options Paper will be released for public consultation at the end of November and submissions will close at the end of February.
37. I will report to Cabinet on the operation of the FSP Register in early 2016 with recommendations for any interim changes to improve the operation of the Register.

Consultation

38. The Treasury, Financial Markets Authority, Commission for Financial Capability, Ministry of Justice, Reserve Bank of New Zealand and Department of Internal Affairs have been consulted on the attached Options Paper.
39. The Options Paper has been informed by submissions in response to the Issues Paper and meetings with key stakeholders.
40. The Department of Prime Minister and Cabinet has been informed.

Financial Implications

41. There are no fiscal implications from the proposals in this paper.

In Confidence

Human Rights

42. There are no inconsistencies between any of the proposals and the New Zealand Bill of Rights Act 1990 or Human Rights Act 1993. There are no gender or disability perspective implications as a result of the release of the attached Options Paper.

Legislative Implications

43. There are no legislative changes arising out of the release of the Options Paper.

Regulatory Impact Analysis

44. MBIE considers that no Regulatory Impact Analysis is necessary at this stage. The Options Paper aims to elicit comment from stakeholders and this will help to inform a Regulatory Impact Statement and further decision making.

Publicity

45. The Review of the Acts has received a moderate level of media interest and I expect this to increase with the release of the Options Paper. MBIE will publish the Options Paper and consumer brochure on its website and will advise stakeholders by email when the paper is released. I will release a media statement to encourage stakeholders to take the opportunity to continue their engagement in the Review and make a submission.

In Confidence

Recommendations

I recommend that the Cabinet Economic Growth and Infrastructure Committee:

1. **note** that the Financial Advisers Act 2008 and Financial Service Providers (Registration and Dispute Resolution) Act 2008 (the Acts) each include obligations on officials to review the Acts and report to the responsible Minister no later than five years after commencement of the relevant sections of the Acts;
2. **note** that the Ministry of Business, Innovation and Employment, through consultation on an Issues Paper [EGI Min (15) 10/8 refers], has identified a range of barriers to the achieving the identified outcomes for the financial advice regulatory regime;
3. **note** that the attached Options Paper seeks feedback on potential options to remove or reduce the barriers and improve consumer outcomes;
4. **agree** to the release the attached Options Paper subject to any editorial and technical changes that the Minister of Commerce & Consumer Affairs may approve prior to publication;
5. **note** that the Minister of Commerce and Consumer Affairs will issue a press release announcing the release of the Options Paper;
6. **agree** to the Ministry of Business, Innovation and Employment publishing the Cabinet Paper on its website.

Hon Paul Goldsmith
Minister of Commerce and Consumer Affairs

____/____/____