**OFFICE OF THE MINISTER OF
COMMERCE AND CONSUMER AFFAIRS**

Chair
Cabinet Economic Growth and Infrastructure Committee

Financial Services Legislation Amendment Bill: Approval for Introduction

Proposal

1 This paper seeks approval to introduce the Financial Services Legislation Amendment Bill (**the Bill**) by early-August 2017.

2 The Bill is an omnibus bill which will create a new regulatory regime for the provision of financial advice and address misuse of the Financial Service Providers Register (**FSPR**). It repeals the Financial Advisers Act 2008 (**the FA Act**) and amends the Financial Markets Conduct Act 2013 (**the FMC Act**) and the Financial Service Providers (Registration and Dispute Resolution) Act 2008 (**the FSP Act**).

3 This paper also seeks agreement to some further policy decisions to finalise the design of the new regime for financial advice, refine the proposals to address misuse of the FSPR, and make some minor changes to the FMC Act to address technical issues that have emerged since industry began operating under it.

4 This paper seeks Cabinet Economic Growth and Infrastructure Committee's approval to introduce the Bill (as well as agreement to policy decisions) to enable earlier introduction of the Bill.

Executive summary

5 This paper seeks approval to introduce the Financial Services Legislation Amendment Bill (**the Bill**) (see Annex 1) which will create a new regulatory regime for financial advice as agreed to by Cabinet in 2016 [CAB-16-MIN-0336 and CAB-16-MIN-0580 refer]. The new regime will:

5.1 Ensure consumers can access the financial advice they need;

5.2 Improve the quality of financial advice;

5.3 Not impose undue compliance costs, complexity or barriers to innovation; and

5.4 Ensure access to redress.

6 Earlier this year I consulted on an exposure draft of the Bill to gather feedback from consumers and industry. While submissions indicated broad support for much of the Bill, submitters also identified some practical concerns with a few previously agreed policy decisions. This paper seeks agreement to policy decisions to address these concerns and finalise the design of the new regime for financial advice.

7 This paper also seeks agreement to further policy decisions to:

7.1 Refine the proposals to address misuse of the Financial Service Providers Register; and

7.2 Make some minor changes to the wider Financial Markets Conduct Act 2013 regime to address technical issues.

Policy – New regulatory regime for financial advice

Background

8 In July and November 2016 Cabinet agreed to the design of a new regulatory regime for financial advice [CAB-16-MIN-0336 and CAB-16-MIN-0580 refer]. The new regime will change the way financial advice on products like mortgages, investments, insurance, KiwiSaver funds and other bank products, is regulated. It will also continue to regulate financial planning services.

9 During February and March of this year I consulted on an exposure draft of the Bill which will create the new regime. This paper seeks approval to introduce the Bill in early-August 2017.

10 The new regime will significantly alter the way financial advice is regulated in New Zealand and contribute to the Government's Business Growth Agenda goal to build a more productive and competitive economy. It will:

10.1 Ensure consumers can access the financial advice they need;

10.2 Improve the quality of financial advice;

10.3 Not impose undue compliance costs, complexity or barriers to innovation; and

10.4 Ensure access to redress.

11 To create the new regime legislative change is required. The Bill (see Annex 1) will:

11.1 Require all firms providing financial advice to retail clients[1] to be licensed as 'financial advice providers' by the Financial Markets Authority (**FMA**). Licensed firms will be able to give financial advice directly (e.g. online) and give financial advice through individual 'financial advisers' and/or 'nominated representatives', who will have less discretion than financial advisers.

11.2 Require all those giving financial advice (firms and individuals) to be held to proportionate conduct and competence requirements. In particular:

11.2.1 All those giving financial advice will need to give priority to the client's interests.

11.2.2 All those giving financial advice to retail clients will only be able to provide advice where competent to do so, and will be subject to a Code

[1] Clients are either retail or wholesale clients. Retail clients are those who are not wholesale clients. Wholesale clients are generally large and/or sophisticated clients such as banks, investment businesses or high-net-worth individuals who do not require or benefit from the same degree of protection as retail clients.

of Conduct that sets standards of competence, knowledge and skill, ethical behaviour and client care.

11.2.3 All those giving financial advice will need to disclose certain information to clients. The content, timing and manner of disclosure will be prescribed in regulations and may vary for retail and wholesale clients.

11.2.4 All those giving financial advice to retail clients will need to ensure their clients understand any limitations on the nature and scope of the advice provided (e.g. how many products or providers they have considered).

11.3 Remove regulatory boundaries (e.g. the definitions of 'class' and 'personalised' financial advice) to make it easier for those giving advice to respond to their clients' needs and wants.

11.4 Remove the requirement for personalised financial advice to be given by a natural person. Technology-neutral legislation will enable the provision of robo (or digital) advice and help future-proof the regime.

11.5 Subject all firms providing financial advice to the FMC Act's compliance and enforcement tools, such as civil liability, and subject licenced firms to licensing actions such as censure and the imposition of action plans.

11.6 Subject all financial advisers to the existing Financial Advisers Disciplinary Committee (**the disciplinary committee**). Financial advisers will be liable to disciplinary consequences if found to have contravened any duty.

12 The majority of these changes (and those proposed below) will be incorporated into the FMC Act. This is due in part to the move to firm-licensing which is already a feature of the FMC Act. Regulating all financial market services, including financial advice, through one piece of legislation also avoids duplication.

Further policy decisions

13 I am also seeking agreement to vary and add to the policy decisions made by Cabinet in 2016 in response to feedback received on the exposure draft of the Bill. While feedback indicated broad support for much of the Bill, submitters also identified some practical concerns with a few previously agreed policy decisions. My proposed variations and additions are outlined below.

<u>Regulation of wholesale clients compared to retail clients</u>

14 Wholesale clients are generally large and/or sophisticated clients who do not require or benefit from the same degree of protection as retail clients. Accordingly, a lighter-touch approach is taken to regulating advice to wholesale clients, reducing transaction costs for wholesale clients and the advisers they are dealing with.

15 However, the current regime does not appropriately demarcate wholesale clients from retail clients, with less sophisticated clients sometimes unsuitably deemed wholesale clients. The exposure draft of the Bill sought to fix this by applying a 'retail service' model whereby all clients would be treated as retail clients if that service was provided to just one retail client. I received a lot of feedback in opposition to the retail service model with

submitters arguing it would be confusing and inefficient. Submitters instead suggested narrowing the definition of wholesale so it would apply to fewer clients.

16 I agree with these concerns and propose:

16.1 Not to apply the 'retail service' model to the new regime for financial advice;

16.2 To align the definitions of wholesale client for financial advice and in the FSP Act with the narrower FMC Act definition of 'wholesale investor' so it applies to fewer clients[2]; and

16.3 To amend the FMA's designation power so that it may declare that clients, who would otherwise be treated as wholesale clients or wholesale investors, should be treated as retail in certain circumstances.

17 These measures will preserve the efficiencies a wholesale regime provides for large, institutional clients, and reduce the harm of clients being classified as wholesale when they do not have the expertise expected of a wholesale client.

18 Other aspects of the new regime will also protect less sophisticated clients who might still be classified as wholesale. This includes the duty to give priority to clients' interests, which will apply to advice to both wholesale and retail clients.

Civil liability for financial advice providers when financial advisers contravene a duty

19 In July 2016 Cabinet agreed that:

19.1 Financial advice providers should be accountable for advice provided by financial advisers and nominated representatives; and

19.2 Financial advisers should have personal accountability for their own advice, because they will have a greater ability to exercise discretion.

20 Submitters expressed a range of views about whether financial advice providers should be civilly liable for contraventions by financial advisers. Some suggested financial advice providers should be able to avoid civil liability if they took reasonable steps to ensure their financial advisers complied with their legislative requirements.

21 I see merit in this idea. Subjecting financial advice providers to civil liability in all cases could encourage financial advice providers to become risk averse (e.g. in order to exercise more control they could opt to provide financial advice through just nominated representatives). I am concerned that this would reduce access to some types of advice and do not think it would be desirable for development of the industry as a whole.

22 I propose that financial advice providers should not be liable for pecuniary penalties when:

[2] Under the existing regime for financial advice, a wholesale client includes any "entity with net assets or turnover exceeding $1 million" – which could capture ordinary New Zealanders who hold their homes in a trust. By contrast, for someone to be considered a wholesale investor by virtue of their assets under the FMC Act definition, the person (and entities associated with the person) must have had net assets or total turnover in excess of $5 million. The FMC Act definition of wholesale investor also captures government agencies, people who have expertise in or have purchased a high value of investment products, and 'investment businesses' such as banks, insurers and entities that provide financial advice.

22.1 A financial adviser has contravened a legislative duty; and

22.2 The financial advice provider took all reasonable steps to ensure that the adviser complied with their duties.

23 This would not create a gap in the liability regime or expose consumers to greater risk as:

23.1 Financial advice providers could still be liable for other civil liability orders set out in the FMC Act for contraventions by a financial adviser, including compensatory orders for losses and damages (therefore this does not create a risk of consumers being left without redress);

23.2 Individual financial advisers would be subject to disciplinary action through the disciplinary committee;

23.3 Consistent with the FMC Act enforcement regime, if a financial adviser (or a nominated representative) is knowingly involved in a contravention (e.g. they intentionally contravene a duty in order to defraud a client) the adviser or representative could still be liable; and

23.4 Financial advice providers would also still be liable for pecuniary penalties for contraventions by the providers themselves and by their nominated representatives. They will also be liable for pecuniary penalties for non-compliance by financial advisers where the provider had *not* taken all reasonable steps to ensure that the financial adviser complied with their duties.

Introducing a limited exclusion for consumer credit

24 The financial advice regime applies to advice in relation to all financial products, including investment, insurance and credit products. Some submitters argued that lenders under consumer credit contracts and credit-related insurance contracts should be excluded from the financial advice regime because:

24.1 Consumer lending and credit-related insurance is already specifically regulated under the Credit Contracts and Consumer Finance Act 2003 (**CCCF Act**). The CCCF Act includes lender responsibility principles that, for example, require lenders to be satisfied that the credit provided will likely meet the borrower's requirements and objectives, and to exercise the care, diligence, and skill of a responsible lender; and

24.2 The additional requirements of the new financial advice regime (particularly requirements to become licensed) would impose significant compliance costs, particularly where advice is given for the purpose of complying with the CCCF Act, and the consumer has not sought advice.

25 I agree and propose a limited exclusion from the financial advice regime for lenders in relation to lenders' consumer credit and credit-related insurance products. As drafted the exclusion would cover the giving of advice for the purpose of complying with the lender responsibility principles in the CCCF Act. However, the scope of the exclusion may require some refinement through select committee, recognising that it was not consulted on as part of the exposure draft of the Bill and it is difficult to perfectly define the scope of the excluded activity.

26 Lenders would be required to take reasonable steps to ensure the borrower understands that they have not received regulated financial advice. In addition, the CCCF Act obligations will provide some protection for consumers.

Minor changes

27 Other changes have also been made to the Bill in response to feedback. These are relatively minor, and will ensure the drafting achieves the policy intent and does not have unintended consequences. The most substantive of these minor changes are outlined in Annex 2.

Transitional arrangements

28 In November 2016 Cabinet agreed to the expedited appointment of a Code Working Group which will enable the Code of Conduct to be prepared sooner than would otherwise be possible. I anticipate the Code of Conduct will be approved by August 2018.

29 I am also seeking agreement to the following transitional arrangements:

29.1 Approximately nine months after the Code of Conduct is approved (with the exact date to be determined by Order in Council), the new regime will take effect, including the new Code of Conduct, legislative duties and enforcement mechanisms.

29.2 At this point a two-year transitional period will commence. During this period:

29.2.1 All firms will need to have a transitional licence to provide financial advice. To enable industry to get a transitional licence quickly, the requirements for transitional licences will be fewer than those required for full licences.

29.2.2 All existing industry participants[3] will be protected by a competence safe harbour. The safe harbour will allow them to continue giving the financial advice that they are currently allowed to provide without needing to meet the new competence standards. This will ensure existing industry participants have time to meet the competence standards in the Code of Conduct.

29.2.3 Until fully licensed (see below), only firms which were QFEs immediately prior to the new regime taking effect will be able to engage nominated representatives to give advice. This is because nominated representatives will not be accountable for their advice and only QFEs have demonstrated that they have systems and processes to take responsibility for their staff.

[3] Existing industry participants are people or firms who were authorised financial advisers, registered financial advisers, qualifying financial entities (QFEs), QFE advisers, or registered entities immediately prior to the new regime taking effect. The safe harbour also covers nominated representatives of firms who were QFEs immediately prior to the new regime taking effect, recognising that QFEs are currently required to support their staff to achieve standards of knowledge, skill and competence.

29.3 Transitional licences will expire at the end of the two-year transitional period (at the latest) and all industry participants (whether new or existing) will be required to be engaged by a firm with a full licence. To manage licensing workflows, the FMA will have the ability to implement a phased approach to full licensing whereby applicants are directed to apply for a full licence within an allocated window of time.

Aspects of the Bill that may be contentious

30 In looking to impose a new regulatory regime on industry there will always be some aspects of contention. The following aspects of the Bill may be contentious:

30.1 *The title 'nominated representative'.* For an industry which provides such a breadth of services I think that 'nominated representative' is a sensible alternative to the title of 'financial advice representative' (this was the title in the draft Bill). That title was the most contentious element of the exposure draft of the Bill. I expect 'nominated representative' will be welcomed and supported; however, given past criticism of different titles, it could still attract some disapproval.

30.2 *The duty to give priority to clients' interests.* Submitters' views on the scope of this duty varied, with some supporting it and others concerned its limitation to conflict management was too narrow. I think the conflict management framing is appropriate, will achieve what is intended, and that the Code of Conduct is the best place for additional standards of ethical behaviour, conduct and client care to be provided.

30.3 *Accountabilities of nominated representatives.* Some submitters were concerned that nominated representatives will not have individual accountability. I do not share this concern and am satisfied that with financial advice providers controlling advice given, and representatives effectively acting as conduits between providers and clients, accountability should rest with providers. But this is not to say nominated representatives will be 'let off the hook' completely. If a nominated representative is knowingly involved in a contravention the representative could still be liable.

30.4 *Delayed access to personalised robo-advice.* Personalised robo-advice will not be enabled until the new regime takes effect (indicative timelines suggest this will be in 2019) and some submitters may think this is not soon enough. The FMA considers it may be possible to enable personalised robo-advice under the current regime using its existing exemption powers and is consulting on this.

FMA implementation of the new regime

31 As advised when the main policy approvals for the new regime for financial advice were sought [CAB-16-MIN-0336 refers], the regime involves significantly increasing the population of advisers who are actively regulated by the FMA and making all advice subject to conduct standards which will require active monitoring. As previously advised, I note that:

31.1 The costs to the FMA to license financial advice providers will be recovered through licence application fees (as is the current situation). A separate policy process will follow for adjustments to the fees to reclassify advisers and to license advice at the firm level.

31.2 Additional funding is likely to also be required to meet the costs to FMA of implementing a wholly new licensing regime and for the ongoing monitoring of financial advisers and financial advice providers. I will revert to Cabinet with an assessment of any further funding requirements as relevant, including analysis of what further costs are required to be incurred that were not provided for in the FMA's recent funding increase.

Policy – Misuse of the Financial Service Providers Register

32 The FSPR is an online register of persons in New Zealand that provide financial services. A number of those registered are not licensed or pre-vetted by the regulator (e.g. foreign exchange traders, creditors under a credit contract and many providers of wholesale financial services). Some predominantly offshore-controlled entities allegedly involved in fraudulent activities have been misusing the FSPR by registering to create the impression to customers that they are actively monitored in New Zealand.

33 To address this misuse, in July and November 2016 Cabinet agreed [CAB-16-MIN-0336 and CAB-16-MIN-0580 refers] to:

33.1 Require entities registering on the FSPR to have a stronger connection to New Zealand than is currently required;

33.2 Limit registered entities' ability to advertise their registered status; and

33.3 Provide additional powers for the Registrar of Financial Service Providers to require information from a director of a registered provider.

34 Officials have consulted on and continued to consider the degree of "stronger connection to New Zealand" required for registration on the FSPR. Following that further consultation, I propose that entities can and must register on the FSPR if they are:

34.1 In the business of providing financial services to New Zealanders; or

34.2 Otherwise required to be licensed or registered under any other New Zealand legislation.

35 Under the proposal, there remains a risk of misuse – entities (particularly overseas-based entities) may register without any intention of genuinely providing services to New Zealanders. To mitigate that risk, I propose to:

35.1 Include regulation-making powers to enable a quicker deregistration process where a relevant provider (e.g. an overseas-based entity) has failed to notify the Registrar that they have commenced providing financial services to New Zealanders;

35.2 Provide that a person is disqualified from being registered, or being a director or senior manager of a registered entity, if they have in the past year been deregistered for breaching a restriction on advertising a registered status; and

35.3 Provide for deregistration where a registered entity has provided false or misleading information in a material particular.

Policy – Other technical changes to the FMC Act

36 The wider FMC Act regime came fully into force on 1 December 2016. It governs a broad range of financial products, many of which are complex. As expected, given the size and complexity of the regime, technical issues emerged as industry began operating under the new requirements.

37 The Bill includes some minor changes to the FMC Act to address some of these technical issues, as follows:

37.1 Currently there is no provision in the FMC Act to cancel the approval of single person retirement schemes (Schedule 3 schemes primarily used by Judges and MPs) upon retirement of the relevant person. The Bill provides for Schedule 3 schemes to be cancelled if the participant applies and the FMA is satisfied that specific circumstances have been met. Circumstances are likely to include: when retirement age is reached, in the event of death or serious illness of the scheme participant, and when the participant's savings will be transferred to a registered superannuation scheme or KiwiSaver scheme.

37.2 Redeemable shares issued by co-operative companies are currently excluded from the definition of debt securities under the FMC Act, and are instead treated as equity securities (shares). The Bill provides a similar carve-out for redeemable shares issued by industrial and provident societies to reflect that these financial products are of a similar nature to co-operative company redeemable shares.

37.3 The FMA is currently required to publish any exemptions granted under the FMC Act 'as soon as practicable'. In contrast, the Takeovers Panel has discretion to defer publication of an exemption in some limited circumstances. I propose the FMA be granted a similar discretion to delay publication where there may be a real commercial prejudice arising in earlier publication (e.g. where an exemption is granted in anticipation of a company merger yet to be publicly announced).

37.4 Schedule 1 of the FMC Act contains a number of exclusions from disclosure requirements that would otherwise apply to offers of financial products, including an exclusion relating to offers of financial products of the same class as quoted financial products. The Bill includes a minor amendment to this same class exclusion, to ensure the exclusion properly reflects market practice for offers by way of sale of financial products.

Regulatory impact analysis

38 Regulatory Impact Statements[4] (**RISs**) were prepared in accordance with the necessary requirements at the time that Cabinet approval for the policy for the new financial advice regime were sought [CAB-16-MIN-0336 and CAB-16-MIN-0580 refers].

39 Treasury has determined that the regulatory policy decisions sought in this paper which relate to financial advice are exempt from the Regulatory Impact Analysis Requirements as they have no or only minor additional impacts and are consistent with the objectives for the new regime for financial advice.

[4] Copies of these RISs can be accessed at: http://www.mbie.govt.nz/info-services/business/business-law/financial-advisers/review-of-financial-advisers-act-2008/cabinet-decisions-july-2013-november-2016

40 The Regulatory Impact Analysis Team at the Treasury has advised that a RIS is not required for the other technical changes to the FMC Act because of their minor or technical nature.

Compliance

41 The Bill complies with:

41.1 The principles of the Treaty of Waitangi;

41.2 The rights and freedoms contained in the New Zealand Bill of Rights Act 1990 and the Human Rights Act 1993;

41.3 The disclosure statement requirements (a Departmental Disclosure Statement has been prepared and is attached to the paper – see Annex 3);

41.4 The principles and guidelines set out in the Privacy Act 1993;

41.5 Relevant international standards and obligations; and

41.6 The *LAC Guidelines on the Process and Content of Legislation (*2014 edition), which are maintained by the Legislation Design and Advisory Committee.

Consultation

42 Cabinet made policy decisions on the design of a new regulatory regime for financial advice in July and November 2016 following two rounds of public consultation with formal submissions processes, online consumer surveys, public workshops and focus groups. Over the past two years officials have also met with various stakeholders on a regular basis to gather further input and feedback.

43 In July 2016 officials met with the Legislation Design and Advisory Committee to discuss the potential legislative design options for the reforms. The Committee supported the approach of repealing the FA Act and amending the FMC Act to incorporate the financial advice regulatory regime.

44 In February 2017 I released a consultation paper which sought feedback on an exposure draft of the Bill as well as proposed arrangements to enable the industry to transition to the new regime. 114 submissions were received with feedback reflected in the Bill.

45 The following agencies have been consulted on this paper: The Treasury, the FMA, the Ministry of Justice, the Commission for Financial Capability, the Commerce Commission, the Reserve Bank of New Zealand and the Department of Internal Affairs. The Department of Prime Minister and Cabinet has been informed of the contents of this paper.

Binding on the Crown

46 The Acts that will be amended are binding on the Crown, and the amendments in the Bill do not alter that.

Creating new agencies or amending law relating to existing agencies

47 The Bill does not create any new agencies or amend the law relating to existing agencies.

48 The Bill does not amend the coverage of the Ombudsmen Act 1975, the Official Information Act 1982, or the Local Government Official Information and Meetings Act 1987.

Allocation of decision making powers

49 The Bill allocates a range of powers to the FMA, consistent with the FMA's existing powers under the FMC Act, but extended to apply to financial advice. Most importantly, the FMA's powers will include:

49.1 Licensing financial advice providers;

49.2 Granting exemptions from the requirements in the Bill;

49.3 Declaring that a service that would otherwise not be a financial advice service is a financial advice service (and vice versa);

49.4 Declaring that clients who would otherwise be deemed wholesale clients or wholesale investors are to be treated as retail clients or retail investors in certain circumstances;

49.5 Issuing frameworks or methodologies to support the application of the Bill and related regulations; and

49.6 Enforcing the provisions of the Bill.

50 The Bill also gives the Minister of Commerce and Consumer Affairs the role of appointing members of the Code Committee (this role is currently held by the FMA under the FA Act). This is to bring the appointment process in line with best practice, and with the established protocols with checks and balances in place for Ministerial appointments.

51 The Bill continues the operation of the disciplinary committee (currently in operation under the FA Act). Minor changes have been made to the provisions relating to the disciplinary committee to provide greater clarity regarding the appointment and removal of members, the appeals process, and procedural requirements for consistency with Ministry of Justice tribunal guidelines.

52 The criteria relating to the qualifications and responsibilities of decision makers and the procedures they follow in the *Legislation Advisory Committee Guidelines: Guidelines on Process and Content of Legislation* have been applied.

Associated regulations

53 Regulations are likely to be needed within six months of the Bill being enacted to give effect to some provisions in the Bill. The regulations will be required to:

53.1 Set out the information that people giving financial advice need to disclose to clients (including the form, timing, and content of disclosure).

53.2 Provide for those providing a client-money service (previously called a ‘broking service’ – see Annex 2) to deposit their own money into client-money accounts in limited circumstances (with that money then deemed to be client-money).

53.3 Prescribe the kinds of financial products that are excluded from certain FMC Act requirements (to replace the current use of ‘Category 2’ financial products currently used throughout the FMC Act).

53.4 Replace any existing regulations made under the FA Act that are required for the ongoing implementation of the new regime.

53.5 Set out the fees and levies that will be payable to the FMA.

53.6 Support measures to address misuse of the FSPR, including by prescribing the details of restrictions on the advertising of a financial advice provider’s registered status and making changes to the information to be supplied by providers and shown on the register.

53.7 Set out categories of financial services under which financial advice providers can register, with the aim of making it clearer for providers as to which categories they should register under, and making it easier for regulators and the public to identify providers that are subject to particular regulatory obligations.

53.8 Align certain aspects of the rules of the different Government-approved dispute resolution schemes.

53.9 Commence certain provisions by Order in Council.

54 In preparing these regulations the drafting task is likely to be medium to large in size and of medium complexity.

Other instruments

55 The Bill includes provisions empowering the making of instruments that are deemed to be legislative instruments or disallowable instruments:

55.1 Designations: the Bill includes provisions for the FMA to declare that a service that would otherwise not be a financial advice service is a financial advice service (and vice versa), and for the FMA to declare that clients who would otherwise be deemed as wholesale clients are to be treated as retail clients in certain circumstances. These are disallowable instruments, and class declarations (i.e. relating to a class of persons or services, rather than a particular person or service) are also legislative instruments. This is consistent with the FMA’s existing designation power under the FMC Act.

55.2 Exemptions and frameworks/methodologies: The Bill does not amend the existing provisions in the FMC Act relating to the FMA’s power to exempt people from requirements of the FMC Act or to issue frameworks or methodologies. However, the proposed Bill would mean these provisions would apply to financial advice. These are disallowable instruments and class exemptions are also legislative instruments.

56 These are consistent with the FMA’s existing powers under the FMC Act.

Definition of Minister/department

57 The Bill does not contain a new definition of Minister, department (or equivalent government agency), or chief executive of a department (or equivalent position) that requires clearance from the Cabinet Office.

Commencement of legislation

58 Some discrete elements of the Bill will come into force the day after the date of Royal assent. These elements include: regulation making powers and the ability for the Minister to approve the Code of Conduct.

59 Most of the new regime for financial advice will come into force on the same date that transitional licences take effect, approximately nine months after the Code of Conduct is approved. Based on the expectation that the Code of Conduct will be approved in August 2018, commencement is estimated to occur in mid-2019. However the specific commencement date will be determined by regulations and made by Order in Council.

60 Commencement by Order in Council is appropriate as it provides flexibility to ensure that commencement does not occur at an impractical time (e.g. over the Christmas period) and that industry has had sufficient time to ensure systems are in place to comply with the Code of Conduct and the rest of the new regime.

61 The explanatory note to the Bill sets out the reasons for commencement by Order in Council.

Parliamentary stages

62 [**WITHHELD**]

63 I propose that the Bill be introduced into the House in early-August 2017, referred to the Commerce Committee and passed by July 2018.

Publicity

64 Subject to Cabinet's agreement to the recommendations in this paper, I propose to issue a press release when the Bill is introduced.

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

Recommendations

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

1 [**WITHHELD**]

2 **note** that the Bill creates a new regulatory regime for the provision of financial advice, introduces measures to address misuse of the Financial Services Providers Register (FSPR) and makes some minor changes to the Financial Markets Conduct Act 2013 (FMC Act) to address technical issues that have emerged since industry began operating under it;

3 **approve** the Bill for introduction, subject to the final approval of the Government caucus and sufficient support in the House of Representatives;

4 **agree** that the Bill be introduced in early-August 2017;

5 **agree** that the Government propose that the Bill be referred to the Commerce Committee for consideration and enacted by July 2018;

Regulation of wholesale clients compared to retail clients

6 **note** that treating some wholesale clients as though they were retail clients (the 'retail service' model) would be confusing and inefficient;

7 **agree** not to apply the 'retail service' model to the new regime for financial advice;

8 **note** that narrowing the definition of wholesale so it applies to fewer clients will better demarcate wholesale clients from retail clients;

9 **agree** to align the definition of wholesale client for financial advice and in the FSP Act with the narrower FMC Act definition of 'wholesale investor';

10 **agree** that the Financial Markets Authority (FMA) should have the ability to declare that clients who would otherwise be treated as wholesale clients or wholesale investors, should be treated as a retail client or retail investor in certain circumstances;

Civil liability for financial advice providers for duties contravened by financial advisers

11 **note** that submitters expressed a range of views about whether civil liability should rest with financial advice providers for contraventions by financial advisers;

12 **agree** that financial advice providers should not be liable for pecuniary penalties when:

12.1 A financial adviser has contravened a legislative duty; and

12.2 The financial advice provider took all reasonable steps to ensure that the adviser complied with their duties;

Introducing a limited exclusion for consumer credit

13 **note** that lenders that provide consumer credit and credit-related insurance products are required to comply with lender responsibility principles under the Credit Contracts and Consumer Finance Act 2003 (CCCF Act);

14 **agree** to provide a limited exclusion from the financial advice regime for advice given by lenders;

15 **note** that, as drafted, the proposed exclusion will apply to advice given by lenders:

15.1 In relation to their consumer credit and credit-related insurance products;

15.2 Where the advice is given for the purpose of complying with the lender responsibility principles under the CCCF Act; and

15.3 Where the lender has taken reasonable steps to ensure the borrower understands that they are not receiving regulated financial advice;

16 **Note** however that the scope of the exclusion may require some refinement through select committee, recognising that it was not consulted on as part of the exposure draft of the Bill and it is difficult to perfectly define the scope of the excluded activity;

Transitional arrangements

17 **agree** to a staged transition whereby firms need a transitional licence before having up to two years to get a full licence;

18 **agree** that the new regime should take effect when the two-year transitional period commences;

19 **agree** that the transitional licensing requirements should be simple in order to enable industry to get a transitional licence quickly;

20 **agree** that some industry participants who do not meet the competence standards in the Code of Conduct be protected by a safe harbour during the transitional licensing period to enable them to continue giving advice (subject to limitations);

21 **agree** that only firms that are QFEs immediately prior to the new regime taking effect be able to engage nominated representatives under a transitional licence;

22 **agree** transitional licences expire two years after they have taken effect (at the latest) at which point all industry participants will be required to be operating under a full licence;

23 **agree** that the FMA have the ability to implement a phased approach to full licensing so it can manage its licensing workflows in a timely manner;

Minor changes

24 **agree** to the minor changes set out in Annex 2 that been made to the Bill to ensure the drafting achieves the policy intent and will not have unintended consequences;

Misuse of the Financial Service Providers Register

25 **note** that Cabinet agreed to measures to help address misuse of the FSPR by offshore-controlled entities, including by requiring that entities have a stronger connection to New Zealand in order to register;

26 **agree** that the required degree of connection to New Zealand for registration be that entities must be either:

26.1 In the business of providing financial services to New Zealanders; or

26.2 Otherwise required to be licensed or registered under any other New Zealand legislation;

27 **agree** to include regulation-making powers to enable deregistration where a relevant provider has failed to notify the Registrar that they have commenced providing financial services to New Zealanders;

28 **agree** that a person is disqualified from registration if they have in the past year been deregistered for breaching a restriction on advertising of registered status;

29 **agree** that providing false or misleading information in a material particular will be a ground for deregistering an entity;

Other technical changes to the FMC Act

30 **note** that minor changes are required to address technical issues that have emerged with the FMC Act since industry has begun operating under the new requirements;

31 **agree** to allow single person retirement schemes to be cancelled upon the scheme participant's application under certain circumstances;

32 **agree** to exclude redeemable shares issued by industrial and provident societies from the definition of debt securities;

33 **agree** to give the FMA the discretion to defer publication of exemptions granted under the FMC Act on the grounds of commercial sensitivity;

34 **agree** to amend the same class exclusion so that it properly reflects market practice in relation to sales of financial products**;**

Publicity

35 **note** that I will issue a press release when the Bill is introduced; and

36 **note** that the Ministry of Business, Innovation and Employment will publish a copy of this paper on its website.

Authorised for lodgement

Hon Jacqui Dean
Minister of Commerce and Consumer Affairs

Annex 1 – Financial Services Legislation Amendment Bill

Annex 2 – Minor changes

Change	Reason for change
The title 'financial advice representative' has been changed to 'nominated representative' (a term which is already in use in the current financial advice regime).	This responds to concerns raised by many submitters that the title financial advice representative was too similar to financial adviser and did not convey the limited nature of advice that representatives would be able to give or their lower level of accountability.
The requirement to agree the nature and scope of advice has been amended.	This responds to feedback that *agreement* to the nature and scope of advice may not always be able to be sought. Some advice does not involve direct contact with a client (e.g. advice sent to multiple clients by email) and it is important that this kind of advice is not discouraged. Instead the Bill requires people giving advice to take reasonable steps to ensure clients understand any limitations on the nature and scope of advice.
The FMA's designation power has been updated to provide greater flexibility.	This responds to feedback that the designation power as drafted was too narrow. The amended provisions will allow the FMA to declare that services are not captured by the regime (as well as declaring that services are captured by the regime).
Directors will no longer be liable for contraventions of financial advice disclosure requirements.	While director liability is appropriate in the context of the FMC Act generally, disclosure requirements for financial advice are more likely to be flexible, and I think it is reasonable that the responsibility of complying with these duties should rest with those giving financial advice.
The disciplinary committee provisions in the Bill have been updated.	The updated provisions provide greater clarity regarding the appointment and removal of disciplinary committee members, clarify the appeals process against decisions made by the disciplinary committee, and include procedural requirements to ensure consistency with Ministry of Justice tribunal guidelines.
The Bill has been amended to require financial dispute resolution schemes to share information with regulators where there has been a material breach of financial markets legislation.	This responds to feedback from many submitters that financial dispute resolution schemes (approved by the Government to consider consumer complaints against financial service providers at no cost to the consumer) should be able to share information about complaints in a wider range of circumstances than is currently the case.
The duty to prioritise the interests of the client has been amended to apply if there is a conflict between the interests of the client and the interests of the person giving advice or *any associated person*.	This responds to feedback that the duty in the draft Bill to prioritise the interests of the client if there is a conflict between the interests of the client and the interests of the person giving advice or *any other person* was too broad.

The term ‘broking service’ has been changed to ‘client money or property service’.	As a ‘broking service’ refers to the holding of client money or client property, the term ‘client money or property service’ better reflects the activities of the service.
The title ‘broker’ has been removed.	As common understanding of the services provided by a broker (e.g. a mortgage broker) does not include the holding of client money or property, removal of this title should avoid confusion about what someone who provides a client money or property service does.
The prohibition on a ‘broker’ depositing their own money into a client account has been amended to clarify that deposits can be made in certain limited circumstances and such deposits are deemed to be client money.	The FMA has granted exemptions under the FA Act allowing client money to be held together with firm money if necessary. This change provides for a permanent solution rather than relying on temporary exemptions. Moreover, by deeming any deposits to be client money, this change overcomes any risk of client money being unprotected in an insolvency event.

Annex 3 – Departmental Disclosure Statement