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Office of the Minister of Commerce and Consumer Affairs

Chair, Cabinet Economic Development Committee

### **Release of discussion documents: Regulations to support the Financial Services Legislation Amendment Bill – disclosure by financial advisers and addressing misuse of the Financial Service Providers Register**

#### **Proposal**

- 1 This paper seeks Cabinet agreement to release for public consultation the attached two discussion documents *Disclosure requirements in the new financial advice regime* and *Regulations to support measures to address the misuse of the Financial Service Providers Register*, in order to support the Financial Services Legislation Amendment Bill (**Bill**).

#### **Executive summary**

- 2 The Bill:
  - 2.1 introduces a new regime for the regulation of financial advice, including providing for more meaningful disclosure by financial advice providers;
  - 2.2 also includes measures aimed at addressing misuse of the Financial Service Providers Register (**FSPR**) by predominantly offshore-controlled entities seeking to give the impression that they are actively regulated in New Zealand when that is not the case.
- 3 Regulations need to be developed in order to give effect to those measures in the Bill. As part of developing the regulations, I propose to release the attached two discussion documents for public consultation.
  - 3.1 *Disclosure*: the Bill provides for the content, timing and manner of disclosure information given to clients to be detailed in regulations. The discussion document proposes information that should be disclosed when consumers are searching for a financial advice provider, when deciding whether to obtain advice from a particular provider, and when deciding whether to follow the advice they have been given. The proposals aim to provide consumers with relevant information in a way that they can interpret, while giving providers some flexibility given the broad range of activity covered by the Bill.
  - 3.2 *Misuse of the FSPR*: the Bill also limits registration on the FSPR to those that provide financial services to persons in New Zealand above a certain threshold, and restricts how providers can promote their status as a financial service provider. The discussion document proposes a threshold level and other details to give effect to those measures in the Bill. The proposals aim to address the misuse of the FSPR, while seeking to maintain consumer access to the financial dispute resolution system which is linked to registration on the FSPR.

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### Background

- 4 The Bill introduces a new regime for the regulation of financial advice and includes measures aimed at addressing misuse of the FSPR.
- 5 The Bill was introduced in August 2017, following a comprehensive review of the Financial Advisers Act 2008 (**FA Act**) and the Financial Service Providers (Registration and Dispute Resolution) Act 2008 (**FSP Act**) which began in late-2014.
- 6 The Bill is currently before the Economic Development, Science and Innovation Committee. The Committee is due to report back on the Bill by 7 June 2018.

*Regulations are required to provide the details of the new regime's disclosure requirements*

- 7 The new regime for financial advice aims to:
  - 7.1 ensure consumers can access the financial advice they need;
  - 7.2 improve the quality of financial advice;
  - 7.3 not impose undue compliance costs, complexity or barriers to innovation; and
  - 7.4 ensure access to redress.
- 8 In order for consumers to make confident and informed financial decisions, they require effective disclosure that gives them information that is relevant to them in a way that they can interpret.
- 9 Currently, different types of financial advisers have different disclosure statements that apply in different situations. In some instances, consumers receive long and complicated disclosure statements that are difficult to interpret. In other instances, consumers receive insufficient information about financial advisers which results in them being unable to make informed decisions about who to receive advice from. For example, the majority of financial advisers are not currently required to disclose if they receive commissions, or if they are only able to provide advice on products from a limited number of providers.
- 10 The Bill provides the framework for more meaningful disclosure requirements in relation to the provision of financial advice. This will enable consumers to make better informed decisions when choosing where to receive financial advice and when making financial decisions.
- 11 The content, timing and manner of disclosure information given to clients are to be detailed in regulations.

*Regulations are also required to support measures in the Bill to address misuse of the FSPR*

- 12 The Bill also amends the FSP Act with the aim of addressing misuse of the FSPR by some (predominantly offshore-controlled) entities.
- 13 The FSP Act requires financial service providers to be registered on the FSPR and, if they provide advice to retail clients, to belong to a dispute resolution scheme which those clients can access for free. A number of those registered on the FSPR are not licensed or pre-vetted by the regulator (e.g. foreign exchange traders and many providers of wholesale financial services). Some entities have been misusing the FSPR

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by registering to create the impression to customers that they are actively regulated in New Zealand. Some of those entities have allegedly been involved in fraudulent activities.

- 14 This poses a risk to New Zealand's reputation as a well-regulated jurisdiction and to the reputation of legitimate New Zealand financial service providers.
- 15 To help address this issue, the Bill:
  - 15.1 requires those registered on the FSPR to be in the business of providing financial services to persons in New Zealand above a certain threshold; and
  - 15.2 provides for restrictions around how providers can promote their status as a registered financial service provider, to reduce the likelihood of customers in New Zealand and overseas being misled about what it means to be registered.
- 16 Regulations are needed to provide the details of those new measures.

*Other regulations are being developed separately*

- 17 Other regulations are being developed separately to support the measures in the Bill. Those include regulations prescribing the licensing fees and levies payable by financial advice providers and financial advisers. I will be reporting to Cabinet on those matters later this year.

## Comment

- 18 I propose to release the attached two discussion documents.

### Discussion document one: Disclosure requirements in the new regime for financial advice

- 19 The Bill provides for the detailed disclosure requirements that will apply in the new financial advice regime to be set in regulations.
- 20 The Bill defines someone as giving financial advice if they make a recommendation or give an opinion about acquiring or disposing of a financial product, or if they design an investment plan. In the new regime, consumers will be able to access financial advice through a range of different channels including online via a digital advice tool. Consumers will also be able to receive holistic advice and investment plans, as well as relatively simple advice where only a handful of the consumer's circumstances are considered.
- 21 To improve the effectiveness of disclosure, consumers need to receive accurate information about those they choose to get advice from. Given the broad range of activity covered by the Bill, it is desirable that businesses are provided some flexibility in how they give information to consumers rather than relying on overly-prescriptive statements.
- 22 The discussion document therefore proposes that the regulations will set clear requirements of what information is to be disclosed, and set out when it must be provided to the consumer.

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### *General information to help a consumer searching for a financial advice provider*

- 23 To help consumers when searching for financial advice, the discussion document proposes that financial advice providers be required to make the following information publicly available (or to be provided on request):
- 23.1 details about their licence, the conduct and client care duties that they are subject to, and information about their complaints process and the details of the dispute resolution scheme of which they are a member; and
  - 23.2 a general description of the limitations in the nature and scope of the advice that can be provided, whether they charge a fee for giving financial advice, whether they pay or receive commissions and other incentives, and whether there are any conflicts of interest which could materially influence the advice that they can give.

### *Information to help a consumer decide whether to obtain financial advice from an individual or business*

- 24 To help consumers make decisions about whether to obtain financial advice from a specific individual or business, the discussion document proposes that anyone who gives regulated financial advice (a financial advice provider, a financial adviser or a nominated representative) to a retail client be required to disclose the following when the nature and scope of the service is known:
- 24.1 details about the licence, details of relevant disciplinary history or any insolvency or bankruptcy issues;
  - 24.2 details of the nature and scope of the financial advice that the consumer will receive, including an explanation of the extent of the market that will be considered;
  - 24.3 details of any particular commissions or incentives that the individual or business might receive, and details of any particular conflicts of interest; and
  - 24.4 a reasonable estimate of the fees and the basis on which they will be charged.

### *Information to help a consumer decide whether to follow the advice they have been given*

- 25 Finally, to give consumers the information that they need before deciding whether to follow the advice that is given to them, the discussion document proposes that anyone who gives regulated financial advice to a retail client be required to confirm the following when making a recommendation or giving an option to buy or sell a financial product:
- 25.1 if there have been any material changes to the nature and scope of the financial advice;
  - 25.2 the particular commissions or incentives, and any conflicts of interest, that will apply; and
  - 25.3 the fees that the client will be charged, and extent of any additional expenses that the client might incur.
- 26 The discussion paper also seeks feedback on a number of complementary options that could be included in the regulations. For example, the paper seeks feedback on how

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commissions should be disclosed, whether additional requirements are needed for digital advice, whether existing clients require the same level of disclosure, and whether the regulations should require a warning to be given to retail clients who are advised to replace existing products.

### Discussion document two: Regulations to support measures to address misuse of the FSPR

#### *Threshold for registration*

- 27 The Bill amends the application of the registration and dispute resolution requirements so that they apply to providers in the business of providing financial services *to persons in New Zealand* above a threshold prescribed in regulations, regardless of whether the provider has a place of business in New Zealand or not.
- 28 This change is intended to reduce misuse by requiring that providers have more than a minimal number of New Zealand clients (rather than just a New Zealand place of business as is currently the case) in order to register on the FSPR.
- 29 The discussion document seeks feedback on the threshold to be prescribed in regulations. In particular, the discussion document proposes that a provider need not be registered (or belong to a dispute resolution scheme) if in any one year all of the following applies:
- 29.1 it provides financial services to less than 10 persons in New Zealand (excluding relatives and associates); and
  - 29.2 the total value of the financial services to persons in New Zealand are less than \$10,000; and
  - 29.3 the financial services transactions with persons in New Zealand make up less than 50% of the provider's business by value (ie most of the provider's clients are offshore rather than in New Zealand).
- 30 The above threshold has been proposed with a view to making it difficult to meet for those seeking to misuse the FSPR. However the proposal also needs to:
- 30.1 minimise the extent to which New Zealand consumers would lose access to free dispute resolution due to their provider having a very small amount of New Zealand business; and
  - 30.2 take into account that imposing a threshold will also likely add complexity to the role of the Registrar and other authorities when seeking to ascertain whether a provider should be registered or not.
- 31 The discussion document seeks feedback on the level of the threshold, which is likely to require refinement following feedback.

#### *Restrictions on advertising*

- 32 The Bill also requires that providers must include certain information prescribed in regulations in certain prescribed circumstances when advertising or providing other documents to clients.

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- 33 The intention is that if a provider advertises their status as a registered financial service provider, they must also include prescribed information to reduce the likelihood of any misunderstanding about what it means to be registered.
- 34 The discussion document proposes that if:
- 34.1 a provider refers to its registered status other than as required by law; and
  - 34.2 the provider is not licensed in New Zealand in respect of any of its financial services (i.e. it has not been vetted by a regulator and assessed as capable of effectively providing financial services in New Zealand),
- then:
- 34.3 the provider must explain that it is not licensed by a New Zealand regulator and it is not actively regulated in New Zealand.
- 35 The discussion document also proposes that if the provider does not have a place of business in New Zealand, it must also note that it will be more challenging for New Zealand regulators and/or dispute resolution schemes to obtain redress for clients.
- 36 The discussion document seeks feedback on the proposed information to be prescribed in regulations. It also seeks information about the extent that legitimate providers may wish to refer to their registered status, so that the regulations do not unjustifiably deter consumers from dealing with legitimate providers.

### *Other matters*

- 37 The discussion document also proposes changes to the information to be supplied by registered providers and those applying for registration, in order to help the Registrar assess whether registration requirements are and continue to be met.

### **Consultation**

- 38 The Financial Markets Authority, the Treasury and the Department of the Prime Minister and Cabinet (Policy Advisory Group) have been consulted on this paper. The Ministry of Justice, the Commerce Commission, Department of Internal Affairs and the Police have been consulted on the aspects relating to misuse of the FSPR.
- 39 In developing the disclosure proposals, the Ministry undertook consumer testing, met with key industry stakeholders and consumer advocates, and held a series of workshops with financial advisers from across the sector.
- 40 The discussion document relating to the disclosure regulations proposes that anyone who gives regulated financial advice to retail clients disclose the commissions and other incentives they receive. This may be controversial to some in the industry who do not currently have to disclose these incentives. However, as these incentives may have a negative impact on the advice that consumers receive, I think that it is necessary to improve transparency through disclosure. Further consumer testing will also be completed to ensure that the proposals are robust and that consumers receive sufficient information to make an informed financial decision.

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### Financial Implications

- 41 There are no financial implications from the release of the attached discussion documents.

### Human Rights

- 42 There are no inconsistencies between the proposals in this paper and the New Zealand Bill of Rights Act 1990 or the Human Rights Act 1993. There are no gender or disability perspective implications from the proposals in this paper.

### Legislative Implications

- 43 The release of the discussion document does not raise any legislative implications. Regulations will need to be prepared under the Financial Markets Conduct Act 2013 and the FSP Act (as amended by the Bill) to give effect to the proposals in the discussion documents.

### Regulatory impact analysis

- 44 The Treasury Regulatory Quality Team agrees that no separate Regulatory Impact Assessment is required in support of the proposal to issue discussion documents, in view of the analysis that has already been carried out in support of the Financial Services Legislation Amendment Bill and the analysis contained in the discussion document itself.
- 45 A Regulatory Impact Statement will be prepared prior to final recommendations on these regulations being submitted to Cabinet.

### Publicity

- 46 I intend to issue a media statement announcing the release of the two discussion documents (which may be released separately). The Ministry of Business, Innovation and Employment will post the discussion documents on its website and provide copies to interested parties for consultation. The Ministry will also publish a copy of this paper on its website. The closing dates for submissions on the two discussion documents will be staggered to give the industry sufficient time to consider and make submissions on the proposals.
- 47 The Ministry will also be proactively engaging with consumer and business groups throughout this consultation process to seek feedback.

### Recommendations

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

- 1 **note** that the attached discussion document *Disclosure requirements in the new financial advice regime* requests feedback in relation to proposed regulations which will prescribe the information those giving financial advice will need to provide to consumers;
- 2 **note** that the attached discussion document *Regulations to support measures to address the misuse of the Financial Service Providers Register* requests feedback in relation to proposed regulations which will prescribe:

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- 2.1 the threshold level of financial services below which providers do not need to register on the Financial Service Providers Register; and
- 2.2 information that providers must include in advertising relating to their status as a registered financial service provider;
- 3 **agree** to the Minister of Commerce and Consumer Affairs releasing the attached document *Disclosure requirements in the new financial advice regime* for public consultation, subject to minor amendments consistent with the policy outlined in the paper;
- 4 **agree** to the Minister of Commerce and Consumer Affairs releasing the attached document *Regulations to support measures to address the misuse of the Financial Service Providers Register* for public consultation, subject to minor amendments consistent with the policy outlined in the paper;
- 5 **invite** the Minister of Commerce and Consumer Affairs to report back to Cabinet on the outcome of consultations and submit final recommendations on regulations for Cabinet approval later in 2018;
- 6 **note** the Minister of Commerce and Consumer Affairs will issue a media statement when the discussion documents are released; and
- 7 **note** that the Ministry of Business, Innovation and Employment will publish a copy of this paper on its website.

Authorised for lodgement

Hon Kris Faafoi

Minister of Commerce and Consumer Affairs