Baseline Review of

Financial Advisers in New Zealand

(undertaken as part of the introduction of the Financial Advisers Act 2008)

Baseline period: 1 December 2010 – 1 July 2011

Ministry of Business, Innovation & Employment

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Abbreviations

ABS	Adviser Business Statement
AFA	Authorised Financial Advisers
CMD	Capital Market Development Taskforce
CO	Companies Office
CPD	Continuing Professional Development
ETITO	Electrotechnology Industry Training Organisation [1]
FAA	Financial Advisers Act
FMA	Financial Markets Authority
FSP	Financial service providers
FSPA	Financial Services Providers (Registration and Dispute Resolution) Act
IMF	International Monetary Fund
ITO	Industry Training Organisation
MBIE	Ministry of Business, Innovation & Employment
MCA	Ministry of Consumer Affairs
MED	Ministry of Economic Development[2]
NQF	National Qualifications Framework
NZQA	New Zealand Qualifications Authority
QFE	Qualifying Financial Entities
RFA	Registered Financial Advisers
SC	Securities Commission[3]
TTMRA	Trans-Tasman Mutual Recognition Agreement

[1] Now called The Skills Organisation
[2] Ministry of Business, Innovation and Employment (MBIE) integrates the functions of the former Ministry of Economic Development (MED), Department of Building and Housing, Department of Labour and the Ministry of Science and Innovation.
[3] Securities Commission was replaced by the Financial Market Authority (FMA) on 1 May 2011.

Executive summary

The financial adviser industry

Financial advisers are individuals or firms who render investment advice and financial planning services to assist clients in the arrangement of their financial affairs. Financial advisers can encompass a wide area of professions like chartered accountants, investment representatives, insurance consultants, tax agents, financial planners, etc. Financial advisers perform an important economic function. For many people finance can be complicated and financial advisers can help them to maintain a desired balance of investment income and acceptable level of risk.

Financial advisers and consumers can have different interests: financial advisers can have direct incentives (via commissions from issuers of financial products) to sell products rather than give strategic advice in the interest of their clients. In addition, financial advisers and consumers can have asymmetric information – the financial adviser having more information than its client. In this situation the client cannot directly ensure that the financial adviser is always acting in its best interests. In addition, consumers who use financial advisers can be poorly informed about the level of expertise of their financial adviser and therefore are unable to judge the quality of financial advice.

A new regulatory regime

A new regulatory regime for the financial adviser industry was introduced in 2011. The goal of the new regulation is to increase investor confidence in the financial services industry and to promote the sound and efficient delivery of financial adviser and broking services. Financial advisers must 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, have to disclose information. To be authorised, financial advisers must reach high standards of competency and professionalism. The FAA was passed in September 2008, and came fully into effect on 1st July 2011.

In this baseline review of financial advisers in New Zealand we seek to describe the financial advisers industry at the time of implementation of the new regime and the rationale for government intervention. We also establish a framework for future evaluation of the new regulatory regime.

Baseline review

This report is in four parts. In Part One the purpose and scope of the baseline review is presented. Government policy parameters around the financial adviser industry and the reasons for government intervening are also discussed. Government regulation can reduce financial market transaction costs and increase the efficiency of savings and investments.

In Part Two the new regulatory regime for financial advisers (categories, exemptions and requirements) and the other key pieces of legislation are outlined. The legislation regulates the provision of financial adviser services, including broking services, to clients in New Zealand.

One of the core principles of the FAA is that financial advice should only be offered by competent, ethical and accountable individuals. To achieve this there are three branches to the FAA:

1) disclosure: to ensure that consumers can make informed decisions about whether to use a financial adviser or broker

2) competency: to ensure that there are certain financial advisers who have the experience, expertise and integrity to effectively match a retail client to a financial product that best meets that person’s need and risk profile

3) accountability: to ensure that financial advisers are held accountable for any financial advice that they give and that there are incentives for financial advisers to appropriately manage conflicts of interest

Baseline numbers

In Part Three New Zealand's financial adviser industry is examined at both the time the new regulatory regime came into effect on 1 December 2010 and immediately after its implementation on 1 July 2011.

The number of registered financial advisers at the end 2011 was approximately 9,900. 1,936 of all registered financial advisers were AFAs. 62 entity groups had Qualifying Financial Entity status by the end of 2011 Whether the number of financial service providers in New Zealand has decreased due to the implementation of the FAA is however unclear.

The majority of financial advisers are male (82%), within the 40 to 59 age range, and almost half of the survey respondents have been in the financial industry for 20 years or more. Half of all survey participants had a school level or vocational qualification on entering the business, which in part may reflect their age. Almost half of the financial advisers are sole traders or employed in companies with five or fewer employees. On the other hand, more than 25% work for companies with more than 100 employees.

Half of all financial advisers spent up to 30 hours per year on structured training and up to 50 hours in unstructured education such as reading industry magazines. Financial advisers belong to a wide range of different professional associations.

More than half of all financial advisers (55%) give advice on a broad range of investments as opposed to a specific product such as life insurance. Financial advisers provide advice mainly on:

- Insurance needs (67%)
- Investment review and planning (48%)
- KiwiSaver schemes and funds (46%)
- Managed investment funds (45%)
- Retirement planning (45%)

Three quarters of all financial advisers (76%) work with retail clients (one fifth with wholesale clients) and almost half give advice on investment products from several companies.

Financial advisers sometimes work with their clients for a long time and guide them through some very important decisions. The number of clients is therefore an interesting indicator of how the financial adviser business is structured. Most financial advisers have a client base of 200 to 499.

Evaluation framework

There is a requirement that the new regulatory regime has to be reviewed five years after its implementation. Part Four outlines a framework for the future evaluation. We propose to look at expected outcomes and the policy objectives, how they translate into outcomes and impacts, and what success of the new regime looks like.

To ensure that the future evaluation is a helpful input to further policy development, the government agencies involved in the design and implementation of the new regime need to have an agreement on the evaluation framework. This includes:

- a common view about what success of the new financial advisers looks like;
- a common methodology for the evaluation;

- relevant data gathering from a number of sources as input in the evaluation, in particular from monitoring and surveillance of market participants;
- feedback mechanisms to further understand the policy environment of the financial adviser industry and to identify issues associated with financial advisers

PART ONE
BACKGROUND

1. Introduction

The purpose of this report is to present the findings and recommendations from the baseline review of financial advisers in New Zealand. The baseline review was undertaken between December 2010 and July 2011 as part of the introduction of the Financial Advisers Act 2008 and its amendments (together the FAA).

1.1 What is a financial adviser?

A general definition of a financial adviser is someone who gives investment advice and financial planning services to assist clients in the planning and arrangement of their financial affairs. However, there are variations as to whom the term ‘financial adviser’ applies to, what financial products they represent, and how financial advisers earn an income.

Depending on how ‘financial adviser’ is interpreted the vocation could encompass such professions as chartered accountants, investment representatives, insurance consultants, lawyers whose practice relates to personal financial or estate matters, real estate agents, tax agents, valuers and financial planners. Some financial advisers are generalists and offer advice on a wide range of financial products, while others specialise in a specific type of investment such as insurance, savings, retirement, real estate, or tax.

Ideally, a financial adviser will help their clients maintain a desired balance of investment income, capital gains, and acceptable level of risk, by using asset allocation techniques to better a client’s financial situation. Financial advisers may use a combination of financial products such as stocks, bonds, mutual funds, trusts, options, futures, and insurance products to address specific long and short term goals of their clients. A financial adviser seeks to understand a client’s financial goals and risk tolerance and recommend appropriate investments based on these.

A financial adviser may collect commissions or referral fees on the financial products that they recommend, directly charge clients for their services (fee-only advisers), or do a combination of both. Financial advisers who collect commissions or referral fees from product or service providers potentially face conflicts of interest. Fee-only financial advisers may charge clients a fixed fee or a percentage fee of the assets managed.

In this baseline review the Ministry of Business, Innovation and Employment[4] (MBIE) adopts the definition of a financial adviser in the FAA.

> *a financial adviser is an individual who performs a financial adviser service, i.e. in the course of business they:*
>
> *(a) give financial advice*
> *(b) provide a discretionary investment management service; or*
> *(c) provide an investment planning service.*

Under the FAA a person gives financial advice (and so performs a financial adviser service) if they make a recommendation or give an opinion or guidance in relation to acquiring or disposing of (including refraining from acquiring or disposing of) a financial product. However a person does not give financial advice merely by providing information, making a recommendation or giving an

[4] Ministry of Business, Innovation and Employment (MBIE) integrates the functions of the former Ministry of Economic Development (MED) from 1 July 2012. This report makes reference to MED if publications or policies before that date are mentioned.

opinion on a class of financial products or about the procedure for acquiring or disposing of a product, transmitting financial advice of another person or recommending a person consult a financial adviser.

A discretionary investment management service is deciding which financial products to acquire or dispose of on behalf of a client, with their granted authority.

An investment planning service is designing or offering to design a plan that analyses an individual's current and future financial situation (including his or her investment needs), identifies his or her investment goals, and includes recommendations or opinions for realising those goals.

Under the FAA a person does not provide a financial adviser service if that person is exempt under that Act or its regulations.[5] Exemptions include providing or making available anything contained in a prospectus, an investment statement, an advertisement under the meaning of the Section 2A of the Securities Act 1978, and a document or information required by law. Other exemptions are incidental services and occupational exemptions.

1.2 Purpose and scope of the baseline review

The purpose of the baseline review is threefold:

i. to describe New Zealand's financial adviser industry at the time of implementation of the FAA, i.e. establish a baseline;
ii. to comment on government policy parameters around the financial adviser industry; and
iii. to establish a framework for future evaluation of the FAA.

To determine the impact of the FAA it is important to start with a clear understanding of the financial adviser industry at the inception of policy. A baseline of the industry provides a reference point for future comparison and thereby will aid in determining how New Zealand's financial adviser industry has developed over time.

To fully understand the financial adviser industry it is also important to consider the underlying rationale for government intervention and the factors that will contribute to the effective implementation of policy.

The FAA will undergo a formal evaluation five years after its implementation.

With the above objectives in mind the Ministry of Business, Innovation and Employment (MBIE) set out to answer the following questions in the baseline review:

1. What was the landscape of financial advisers in New Zealand at the time the FAA was implemented?
2. What are the key performance drivers for New Zealand's financial adviser industry?
3. What is the policy rationale for the FAA?
4. What outcomes are expected from the FAA, are the policy objectives relevant and are they clearly elaborated?
5. What are the interdependencies for the success of the FAA?
6. What performance measures would determine success of the FAA and how will the FAA be evaluated in the future?

This MBIE review is a joint project between the Evaluation Team which resides in the Executive and Governance Group and the Corporate Law and Governance Team which resides in the Labour and Commercial Environment Group of MBIE.

[5] See sections 13, 14 and 148of FAA and the FMA Guidance Note on Financial Advisers Act Exemptions.

1.3 Methodology

Existing data

Existing data drawn upon for the review included:

- a file review of policy documents and legislation;
- an international literature review of government policy for financial advisers and the evaluation of such;
- the public Register of Financial Service Providers (introduced as part of the Financial Services Providers (Registration and Dispute Resolution) Act 2008);
- the report of the New Zealand's Capital Markets Development Taskforce;
- the Ministry of Consumer Affairs National Consumer Survey;
- private sector research: RaboDirect's Financial Confidence Index; and
- research and tests by consumer organisation "Consumer NZ"

Survey and interviews of financial advisers

MED commissioned Andrew Fletcher Consulting to conduct an online quantitative electronic survey of financial advisers. Invitations to participate in the survey were sent to a cross section of people within the financial services industry, using a database compiled from multiple sources to ensure an adequately diverse representation of the audience of interest. Lists of named individuals and contact details were provided from the Register of Financial Service Providers and also obtained from industry associations' websites. In addition, several participants asked to be included in the survey as a result of viewing information about the survey on MED's website.

The target sample size for the survey was 300 and a final response of 325 was achieved. A copy of the questionnaire is appended to this report. Andrew Fletcher Consulting also conducted 23 qualitative interviews with financial advisers during the period 1st April to 31st May 2011.

Other information

The evaluation team also had discussions with key personnel in the following organisations to gain insight into the proposed implementation of FAA, explore expected outcomes, and/or to help understand the current landscape of financial advisers in New Zealand:

- the Financial Markets Authority (previously the Securities Commission)
- the Ministry of Consumer Affairs;
- the Companies Office (who administer the Register of Financial Service Providers);
- industry training association ETITO (now called The Skills Organisation);
- Consumer NZ (an independent, non-profit organisation researching activities relating to consumer protection and information); and
- industry groups and Qualifying Financial Entities[6] (QFE): qualitative interviews mentioned above

The data obtained for the baseline is limited by the number of financial advisers, QFEs and consumers surveyed and the number of industry stakeholders consulted. Data is also limited by self-reporting of respondents.

To address these limitations, where possible, multiple sources of data were used to test for accuracy and consistency.

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[6] A Qualifying Financial Entity (QFE) is a financial services organisation (bank, insurer, finance company, etc.) that meets the professional standards set out in the FAA and that has been accepted for QFE status by the Financial Markets Authority.

2. Why should the government consider intervening in the financial adviser industry?

With any policy it is important to understand the rationale for government intervention. The material for this section is based upon a review of the international literature of government policy for financial advisers and findings of the Capital Market Development (CMD) Taskforce.[7]

2.1 Importance of financial advisers and consumer welfare

Financial advisers play an important role by advising their clients on their financial and investment decisions. However, information problems - either through product disclosure or the provision of financial advice - can make it difficult for interested consumers to make fully informed financial decisions, even when they make use of financial advisers.

According to the CMD Taskforce the issuer of a financial product will always know more about their product than those purchasing it. As a result investors cannot evaluate the characteristics of a financial product nor 'test drive' it until they have invested in it. Yet the weaknesses in financial products may take time to become apparent and the costs of investment mistakes can be considerable. A financial adviser, who develops knowledge of financial products, and can pass this knowledge on to investors, can help to bridge the information asymmetry between issuers and investors.[8]

However, herein lies another information problem. Unless financial advisers can capture the benefit of information disclosure, they have limited incentives to fully disclose information about financial products and their own relationship with an issuer. Such a situation could occur when financial advisers have direct incentives (via commissions from issuers) to sell products rather than give strategic advice, even if this advice is in the best interests of their client. Product commissions also provide an incentive for financial advisers to recommend higher-risk products that may not be in a client investors' interests (i.e. products which do not pay a commission would not be recommended, even if they were better for a client).

Information problems also exist in the provision of financial advice itself. Consumers who use financial advisers can be poorly informed about the level of expertise of their financial adviser and therefore are unable to judge the quality of financial advice that they receive.

As a result of the above information problems, it can be difficult for inexperienced investors to find and understand the key information that they need, let alone compare financial products and services in order to make a discerning choice.[9] The resulting lack of confidence to invest increases the cost of capital because a higher price is required to compensate for the level of risk perceived by investors and to achieve investor participation.

[7] The Capital Market Development Taskforce in an industry-led taskforce established in July 2008 to develop a blueprint and action plan to develop New Zealand's capital markets.
[8] Most consumers will make only a limited number of large investment decisions over their lifetime and so it is both unlikely and unnecessary for them to invest time and effort in developing expertise themselves in this area.
[9] Bounded rationality is the term used to describe the situation when market participants (typically retail investors) lack understanding or are unable to fully process complex information and therefore make suboptimal decisions. Typical approaches to this problem are requirements that information is clear and explicit, or the substitution of consumer choice for regulatory standards (such as setting competency standards for financial advisers).

Mandatory disclosure – of conflicts of interest, financial adviser fees and the levels of financial adviser competency – can help to reduce information asymmetries and contribute to a better functioning market for both investors and firms.[10]

2.2 Market power

In theory, if only a handful of financial advisers existed in the market, they could use their market position to charge excessively high prices for their services. This situation would likely limit consumers' use of financial advisers.

However, in MBIE's view, a more likely scenario for New Zealand is one in which good and honest financial advisers are driven from the market. If consumers are not able to judge the quality of advice they receive, nor understand the motivations behind recommendations of their financial adviser, they may mistrust their advice. As a result they may not be prepared either to pay an adequate price for the advice or to seek it in the first place. This situation can lead to good and honest financial advisers leaving the market. In turn, this would drive down the average quality of financial advice and further spread mistrust amongst consumers.

The flipside is that poorly performing financial advisers may be able to stay in the market, leading to deficiencies in the quality of advice some consumers get. The poor quality of advice will negatively impact on individual or household savings and investment decisions.

Ultimately, if the public do not trust the advice of their financial advisers, they will reduce use of their services – potentially leading to a collapse in the market for financial advisers.

2.3 Negative externalities

A negative externality, or spillover, occurs in the financial adviser industry when the poor performance or behaviour of a financial adviser adversely affects others in the market. Such a negative externality is more likely to exist in an unregulated market, or one in which there are low entry requirements and a lack of transparency amongst financial advisers.

The CMD Taskforce notes that, in New Zealand, financial advisers have varying degrees of expertise and independence and an associated low reputation.[11] As a result, the behaviour of poor quality financial advisers in the market could adversely affect the reputation of other (high quality) financial advisers and reduce consumer confidence in the market, more generally.

2.4 International best practice

The Financial Sector Assessment Programme (FSAP) is a joint International Monetary Fund (IMF) and World Bank effort, introduced in May 1999, whose aim is to increase the effectiveness of efforts to promote the soundness of financial systems in member countries. The International Organisation of Securities Commissions (IOSCO) Objectives and Principles of Securities Regulations form an essential part of the standards and codes undertaken in the FSAP. The Principles set a standard against which a country's practice of regulation (including that of financial advisers) and supervision of securities markets is assessed.

In a 2004 report the IMF Financial Sector Assessment Program assessed New Zealand's compliance with the IOSCO Objectives and Principles of Securities Regulation as only partial, with some financial advisers not subject to comprehensive standards. Although there were informal

[10] Much information has public-good characteristics (non-rivalry and non-excludability), and therefore may be under-produced relative to the socially optimal level. Regulations that require disclosure often aim to increase the amount of information available to all market participants and improve capital allocation and the efficiency of capital markets.
[11] Refer to "Capital Markets Matter: Report of the Capital Market Development Taskforce", December 2009.

incentives at the time on financial advisers to give good advice to protect their reputation, it was difficult for consumers to evaluate the advice that they received. This led some to argue that bad financial advisers managed to stay in the market as the lack of useful information available to consumers prevented competition from flushing those advisers out of the market.

A concrete and related issue was that there was also no basis for mutual recognition of financial advisers under the Trans-Tasman Mutual Recognition Agreement (TTMRA) with Australia. The lack of mutual recognition meant that New Zealand based financial advisers could not enter the Australian market without undergoing separate accreditation and vice versa. This might have adversely impacted on levels of competition and the spread of best practice in the financial adviser industry.

One of the findings of the CMD Taskforce was that New Zealand markets do not provide retail investors with the range of good-quality investment products that are seen in other countries. In their view, the limited range of quality products is likely to have been a factor in encouraging investment in New Zealand finance companies and other products offered to the public that had fewer on-going market disciplines than, for example, exchange-listed companies.

Other countries have reviewed their financial regulations. In Australia, the Corporations Act restricts the use of certain words, such as ‘independent’, ‘impartial’ and ‘unbiased’. For example, adviser entities cannot call themselves ‘independent’ unless any commissions they receive are rebated in full to their clients.

The Australian Securities and Investments Commission (ASIC) has recently recommended that in order to strengthen and clarify the duties owed to investors by advisers, a legislative fiduciary duty should be introduced. Investment advisers in the United States also owe a fiduciary duty to clients. In the United Kingdom, institutions have a duty of care to investors that imposes similar obligations.

2.5 Risks and incentive problems

In a 2006 study by Oxera[12] it is asserted that it is the combination of market failures, risks, and the problem of incentive misalignment between participants in an industry that lead to potentially detrimental outcomes in a market. Using this argument, the existence of the above problems is not, in itself, a reason for regulatory intervention.

For example, a lack of information about a financial product would not be associated with investor detriment if there was no risk that the investor could lose funds or otherwise be adversely affected in the event of firm default. Similarly, it is the presence of negative externalities, combined with the risk of default, that give rise to concerns about systemic failures.

Conversely, the existence of risks per se is not a problem that may call for regulatory intervention. If consumers were able to correctly anticipate that their investments were threatened by default, they would be able to incorporate the risk in their decision-making and adjust the charges that they would be willing to pay for a financial product. Similarly, if consumers understood the risk characteristics of investment products, risks would be priced in terms of the anticipated returns.

Market failures are also inextricably linked with the incentives of participants in the financial services industry. For example, even if an investor was not able to observe or monitor fully the activities of a financial adviser, there would be no detrimental impact if the incentives of the investor could be aligned with that of the adviser (e.g. by means of a completely specified contract). It is the problem of incentive misalignment that gives rise to, or exacerbates the negative impact of, a market failure.

[12] Refer to “*A framework for assessing the benefits of financial regulation*”, Report prepared for Financial Services Authority.

In December 2009 the CMD Taskforce noted that a shortcoming of the financial adviser industry in New Zealand was that investors were concerned that the regulatory regime may not adequately protect them. According to the CMD Taskforce, some financial advisers were able to take advantage of confusing and misleading disclosures of risks and inadequate supervision by trustees and statutory regulators to exploit uninformed and ill-advised investors.

Many financial advisers receive commissions and other incentives from providers that give rise to serious conflicts of interest. This is a substantial problem for investors, as they may believe they are paying for advice that is solely in their best interest, when, in fact, they are not. It was also a significant contributor to investor losses from finance company failures.

PART TWO

GOVERNMENT POLICY
FOR FINANCIAL ADVISERS

3. The Financial Advisers Act (FAA)

In Part Two of this report government policy for financial advisers is discussed. The key pieces of legislation for financial advisers include the FAA, the Financial Services Providers (Registration and Dispute Resolution) Act 2008. The FAA was substantially amended in 2010 by the Financial Service Providers (Pre-Implementation Adjustments) Bill.

3.1 Purpose and key objectives

> *promote the sound and efficient delivery of financial adviser and broking services, and to encourage public confidence in the professionalism and integrity of financial advisers and brokers.*

To achieve the above there are three branches, or objectives, to the FAA:

1) disclosure by financial advisers and brokers:
    - o to ensure that retail clients can make informed decisions about whether to use a financial adviser or broker and, in the case of an adviser, whether to follow a financial adviser's advice

2) competency of financial advisers:
    - o to ensure that there are certain financial advisers (AFA) who have the experience, expertise and integrity to effectively match a retail client to a financial product that best meets that person's need and risk profile

3) accountability of financial advisers:
    - o to ensure that financial advisers are held accountable for any financial advice that they give and that there are incentives for financial advisers to appropriately manage conflicts of interest

A core principle of the FAA is that financial advice should only be offered by competent (AFA), ethical and accountable individuals [13].

The FAA was passed in September 2008, and came fully into effect on 1st July 2011.

3.2 A tiered approach to regulation

The FAA increases regulatory oversight of those who provide financial services, in particular, financial advice. The new regulatory regime sets up a tiered approach to regulation. Persons that provide "financial services" are required to register their business on a public register, and if those services are provided to "retail clients" be a member of an approved alternative dispute resolution scheme. These requirements are relatively straightforward.

In addition to these basic requirements, specific types of financial service providers are subject to additional regulatory requirements, e.g. the FAA imposes additional regulatory requirements on persons providing "financial adviser services". Providers of financial adviser services ("financial advisers") are subject to registration and licensing, conduct, and disclosure obligations. The FAA is more tailored to specific circumstances, rather than a "one-size-fits-all" approach. The exact obligations depend on the nature of the financial adviser service provided, the types of financial products, the type of client, and (in certain cases) the status of the financial adviser's employer. In

[13] Although only individuals can provide personalised financial advice to retail clients an entity can provide a class service or a service to wholesale clients. While a financial adviser can give advice on behalf of an entity, any such advice is to be given in their own name

addition to a range of categories, there are exemptions and requirements. These are discussed in detail in appendix 10.1.

3.3 Policy implementation

The following agencies and government departments are involved in the implementation of the FAA as a new regulatory regime for the financial industry.

The Financial Markets Authority (FMA)

FMA is responsible for the authorisation and supervision of financial advisers; investigating potential breaches of financial markets conduct legislation and taking appropriate enforcement action under the FAA. FMA also (with a code committee) established a Code of Professional Conduct and monitors its compliance and other obligations of AFAs and QFEs to ensure they exercise the standard of care, diligence and skill required. FMA is responsible for granting QFE status and the terms and conditions that will be placed on QFEs, including disclosure obligations.

FMA is tasked with:

- appointing members to a code committee, reviewing the code and proposing changes (via the code committee);
- enforcing the FAA: FMA also deals with matters relating to fees, charges, and costs payable to FMA. These fees and charges will meet the ongoing costs of FMA, the Code Committee and the Disciplinary Committee in performing their duties and functions under the FAA; and
- investigating potential breaches of the FAA: breaches of the Code are referred to a Disciplinary Committee and FMA can prevent authorised financial advisers from operating.

In terms of disciplinary action, FMA looks after issues around the Code (remedial action and breaking the law) whilst the industry dispute schemes cover dispute resolution between a financial adviser and their client. The outcome of a dispute resolution service is to help resolve a problem with a financial adviser. However, a complaint to FMA may lead to disciplinary action against an adviser for breach of the Code or the law.

Companies office

The Companies Office is responsible for implementing and maintaining the Financial Service Providers Register (FSPR) which includes a list of financial advisers.[14] The FSPR aims to provide greater accountability and transparency. The provisions of the Financial Services Providers Act are discussed in more detail in section 4.1.

Ministry of Consumer Affairs

Financial advisers who provide services to retail clients have to belong to a dispute resolution scheme. The purpose of these schemes is to offer the consumer a greater level of confidence and protection when dealing with financial service providers. The Ministry of Consumer Affairs has responsibility for approving industry directed dispute schemes and has established a default scheme. The provisions of the dispute resolution schemes are discussed in more detail in Section 4.1.

Electrotechnology Industry Training Organisation Incorporated (ETITO)[15]

In accordance with the Code of Professional Conduct, ETITO[16] was tasked with establishing a nationally consistent standard for authorised financial advisers. The qualification process is

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[14] Exempt providers are not registered and some Australian advisers coming under the Australian Licensees exemption are not registered.
[15] Now called The Skills Organisation

detailed in box 1.

The industry training system was formed around Industry Training Organisations that were representative of industry and whose functions were to set national standards and qualifications, purchase off-job training on behalf of trainees, and arrange assessment for trainees. Qualifications can be made up of unit standards gained in the workplace as well as those gained at tertiary providers. This system is voluntary for employers and industries. The system is industry-led and competency-based and provides flexibility for employers and unions.[17]

Box 1: Authorised Financial Advisor qualification process

There are a multitude of paths that advisers have taken to arrive at their chosen vocation within the general field of financial advice. As a result there is varying competence, knowledge and skills within the financial adviser industry. To some degree professional industry bodies have addressed this. However, what was notable before the implementation of the FAA was the absence of a consistent nationwide entry level qualification. This is one of the areas which the FAA and the Code of Professional Conduct address.

The Industry Training Act requires ETITO to be responsible for:

- setting national skill standards for their industry
- providing information and advice to trainees and their employers
- arranging for the delivery of on and off-job training (including developing training packages for employers)
- arranging for the assessment of trainees and
- arranging the monitoring of quality training.

To establish the minimum national standard ETITO worked with and supported the Code Committee to define a set of national standards within the National Certificate in Financial Services (Financial Advice) (Level 5). This included reviewing unit standards and creating set B within the certificate (targeted at demonstrating an understanding of the legislative framework for financial advisers) and creating a competence alternatives schedule.

The Code sets out the minimum standards of competence, knowledge and skills required to provide financial adviser services. AFAs are required to attain the Unit Standard Sets within the National Certificate in Financial services that are relevant to the financial adviser services provided by the AFA. However, an AFA is deemed to have attained a particular Unit Standard Set where the AFA has attained an alternative qualification or designation to that Unit Standard Set listed in Schedule G of the Code. The unit standard sets are:

- A - core knowledge including knowledge of the industry, financial markets, the advice process and products
- B (Compulsory) - knowledge of the Code and the legislative framework for financial advisers including consumer protection laws
- C - professional practice including applying the six step advice process and complying with legislation
- D - investment specialist standards
- E - insurance specialist standards or residential property lending specialist standards.

Training and assessment

Similar to other national standards, training providers need to be NZQA registered and accredited. These registered and accredited training providers will be able to provide training for all unit standards contained in Standard Sets A, B, C, D and E. They will also be able to provide assessment against Standard Sets A, D and E.

To become registered and accredited, providers must meet general NZQA requirements for being a provider and must demonstrate to ETITO that they have the ability and capability to provide the training.

Assessment of Set B can is undertaken by ETITO through a supervised online examination. While assessment of Set C can be carried out by ETITO or through a DAO, and will be assessed through the submission of a portfolio of evidence that will be the subject of a competency discussion between the adviser and an assessor.

ETITO ensures consistency of assessment through a national external comparison – random assessment.

ETITO have no control over fees for training or assessment except where ETITO provide assessment.

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[16] ETITO was recognised as the national standards setting body and appointed as Industry Training Organisation (ITO) for the financial services industry under the Industry Training Act.

[17] For detailed information on the training system, the Industry Training Act 1992, and a description of the current institutional arrangements refer to the Ministry of Education. There is currently a review of the industry training system.

3.4 Policy rationale

In Chapter 2 we discussed the rationale for government intervention in the area of financial services and advice. The general case for regulating financial advisers is to bridge the information asymmetry between advisers and consumers. At a minimum regulation would signal to consumers that they can expect a certain level of quality from financial advisers through minimum standards. As a result quality of financial advice should be boosted, confidence in financial advisers improved and better investment decisions made by consumers.

The rationale for the FAA arose from the recommendations of The Taskforce on Regulation of Financial Intermediaries[18]. The Taskforce identified the presence of significant information asymmetries in the financial intermediaries sector. In particular, the Taskforce noted that most intermediaries were subject to only informal incentives to credibly vouch for the quality of information they provided. Conversely, consumers were found to have a limited ability to evaluate the quality of services provided by their financial intermediaries, thereby allowing some intermediaries to do the minimum necessary to keep their client satisfied. This situation appeared to indicate a lack of sufficient incentives for intermediaries to act ethically or to manage conflicts of interests appropriately. In addition most consumers were found to lack experience and expertise when investing in the financial sector. Whilst engaging in public consultation on these issues the Taskforce noted a high degree of convergence in the submissions from the public, industry, and other interested parties indicating that some change in the regulatory regime was necessary and justified.

Reporting in 2006, the Taskforce recommended that the government institute a new regulatory regime to regulate financial intermediaries in New Zealand. The regime would address the information asymmetries regarding the intermediaries themselves by providing the investor with confidence in the competency and integrity of their intermediary. This required ensuring that:

- investors have intermediaries available that have the experience, expertise and integrity to effectively match an investor consumer with products that best meet their needs and risk profile;
- intermediaries are held accountable for any advice given and that there are incentives for intermediaries to manage appropriately conflicts of interest; and
- adequate disclosure of intermediaries' conflicts of interests, fees and competency are provided so that investors/consumers can make informed decisions about whether to use an intermediary and whether to take their advice.

Before the introduction of the FAA, financial advisers were subject to a regulatory environment which involved a mix of generic law relating to financial advisers, relevant legislation with a consumer protection focus, sector-specific legislation, and voluntary sector-specific regulation.[19] Some advisers chose to belong to voluntary self-regulatory organisations which had codes of conducts and disciplinary procedures.

The voluntary regulation of financial advisers failed to ensure that all advisers were accountable to the public. Consumers lacked sufficient mechanisms to seek redress or deal with conflicts (for

[18] The Taskforce was appointed in 2004 by the Minister of Commerce to review and report on the possible regulation of financial intermediaries.
The sustained decline in securities prices and other assets following the global financial crisis was not foreseen by most advisers, and the value of their counsel has been questioned by many investors who have invested in collapsed finance companies. In particular after the failure of finance companies, trust in financial institutions and advisers collapsed. A survey by Fairfax NZ among 1200 people showed that 71% of those surveyed thought financial advisers were untrustworthy. However, not all losses by investing in finance companies can be blamed on bad advice.
[19] Formerly, investment advisers and brokers were regulated by Part 4 of the Securities Markets Act 1988 and the Securities Markets (Investment Advisers and Brokers) Regulations 2007.

example, consumers were not aware of the voluntary dispute resolution methods or that there was a limit to the matters with which the Banking Ombudsman and Insurance Ombudsman could deal). It was difficult to stop negligent or unethical financial advisers practising or to rely on voluntary standards to ensure that advisers were acting ethically or managing conflicts of interests appropriately.

In addition, the voluntary regulation of financial advisers failed to ensure that clients were able to make informed decisions about their advisers. Low entry requirements may have allowed advisers to operate off the reputations of other advisers. Informal incentives on advisers did not provide a sufficient guarantee to mitigate the risk of inappropriate financial advice.

The voluntary regulation of financial advisers also failed to ensure that advisers had the necessary experience and expertise. Consumers who used financial advisers were often imperfectly informed (information asymmetry) about the level of expertise of their financial adviser and therefore were unable to judge the quality of financial advice that they received.

New Zealand only partly met international regulatory standards for the monitoring of financial advisers[20]. There was insufficient information, monitoring and compliance to provide a basis for trans-Tasman mutual recognition. Voluntary standards were not sufficient to allow a NZ adviser to practice in Australia.

Financial advisers are expected to be one of the faster-growing occupations over the next decade. The impending retirement of an increasing number of New Zealanders is expected to create strong demand for advisory services.

3.5 Intervention logic

The following logic model (Figure 3-1) for the FAA represents the view of MBIE as to how the Act is designed to address identified needs and lead to desired outcomes. The bolded boxes in the logic model indicate the areas where a future evaluation will be focussed.

The contribution to macroeconomic growth that a well-functioning financial adviser industry can make is taken as given.

[20] See chapter 2.4 and International Monetary Fund (IMF) Financial Sector Assessment Program.

Figure 3-1: FAA logic model

Issues in the Financial Adviser industry

Imperfect information makes it difficult for consumers to:

- make informed investment decisions (there are many and complex investment opportunities);
- judge the quality of financial advice; and
- determine the interests and incentives of financial advisers.

Consumer mistrust and reduced revenues may drive good/ honest advisers from the market.

Low entry requirements and lack of transparency of financial advisers.

Insufficient mechanisms to seek redress or deal with conflicts of interest.

NZ's regulation of financial advisers lags international best practice and there is no mutual recognition under TTMRA.

Implementation of the FAA

Financial Markets Authority:

- Accredit and authorise applicable financial advisers and QFEs.
- Establish a Commissioner for financial advisers (since repealed).
- Code Committee established to write new code of conduct for financial advisers. Code approved by FMA and Minister of Commerce.
- Establish a disciplinary committee.
- Monitor compliance with the FAA and prosecute breaches of the code.
- Perform other functions, as assigned by legislation.

Consumer Affairs:

- Oversee dispute resolution scheme for breaches of statutory standards and resolve disputes.

Companies Office:

- Establish a register of financial service providers to register financial advisers and applicable entities

Industry Training Organisation ETITO:

- Manages training arrangements and provides skills leadership.

Efficiency of implementation:

- Keep monetary costs of authorisation /entry low.
- Minimise barriers to entry.

Intermediate Outcomes

Competency of financial advisers (certain financial advisers have the experience, expertise and integrity to effectively match a retail client to a financial product that best meets their need and risk profile).

Minimum conduct and disclosure standards for financial advisers (different tiers according to complexity and risk posed by financial advice).

Financial advisers are held accountable for their advice and conflicts of interest are appropriately managed.

A competitive financial adviser industry exists.

Assumption: ceteris paribus the intermediate outcomes will result in the final outcomes.

Final Outcomes

Better and informed investment decisions by consumers.

Consumers can judge the quality of financial advisers and can determine their interests and incentives.

Consumers have greater confidence in financial advisers.

Consumers increase their use of financial advisers (i.e. there is increased financial savings).

NZ's financial adviser regime in line with international best practice and trans-Tasman coordination improves.

4. Other Influences on the Financial Adviser Industry

In this chapter we discuss influences on the financial adviser industry, besides the FAA. These areas of work aim to further promote confidence in financial advisers and encourage professionalism in the sector.

4.1 The Financial Services Providers (Registration and Dispute Resolution) Act 2008

The provision of financial services is regulated by the Financial Service Providers (Registration and Dispute Resolution) Act 2008 ("FSPA"). The FSPA was passed in September 2008, and came fully into effect on 1st April 2011.

The goals of the FSPA are to:

a) Provide clear general information on financial service providers for consumers and regulators;

b) Achieve minimum standards for directors and senior management of financial service providers;

c) Conform with New Zealand's international obligations imposed by the Financial Action Taskforce; and

d) Ensure that low cost dispute resolution facilities will be available to consumers

To achieve these goals the FSPA contains two groups of provisions. The first group of provisions requires all businesses providing financial services, including financial advice, to register as "financial service providers". The second set of provisions requires financial service providers that offer services to the retail customers to belong to an approved dispute resolution scheme.

Register of Financial Service Providers

Under the FSPA an online compulsory register of financial service providers has been established. The register is publicly searchable, allowing consumers and regulators to identify and access information on persons (including entities) in the business of providing financial services. Information on the register includes the services offered by the financial service provider. By the end of 2011 around 9,800 financial advisers were registered (8,600 individuals; 980 entities).[21]

During the registration process individuals and companies need to select all the activities for which they wish to be registered. The FSPR website contains guidance on the definitions of various financial services. The registration process also includes a criminal history check (for all individuals and directors/senior managers of entities seeking to be registered), and payment of a fee.

In order to register, financial service providers must be resident or have place of business in New Zealand or be or be required to be a licensed provider under certain legislation, be a member of a dispute resolution scheme if they will advise retail clients and not be disqualified. A person will be disqualified from registering if, among other things, he or she is an undischarged bankrupt, has been convicted of offences relating to dishonesty, or is subject to a management ban. Where the provider is an entity, it will be disqualified if any controlling owners, directors or senior management fail the checks. Breaches of the FSAP in terms of registration are subject to prosecution and/or fines. Financial service providers are required to file an annual confirmation after registration.

[21] In addition, the FMA lists 1936 Authorised Financial Advisers (AFA) as at 23 December 2011 and 62 entity groups have Qualifying Financial Entity (QFE) status.

Dispute resolution schemes

As a mandatory requirement of registration the FSPA requires those offering financial services to retail clients to be part of an approved dispute resolution scheme. Such schemes aim to improve consumer access to redress in the financial sector.

Financial service providers can be either a member of an industry-based dispute resolution schemes or a reserve dispute resolution scheme. The Minister of Consumer Affairs is responsible for approving both the industry-directed dispute resolution schemes and establishing the default scheme, all of which must adhere to rules set out in the FSPA and associated regulations.

Currently, there are four schemes providing financial dispute resolution services, including the default scheme:

- Financial Services Complaints Limited
- Insurance & Savings Ombudsman
- Banking Ombudsman
- Financial Dispute Resolution

While dispute resolution schemes are free to consumers, there is a cost of membership to the financial service provider. Each scheme has its own processes and rules regarding time frames for disputes. However, most disputes are resolved within two months.

Complaints handled by the dispute resolution schemes relate to alleged breach of contract between financial advisers and their clients. They also include statutory obligations, industry codes, or any other legal obligation or an unfair practice by financial advisers. They do not cover complaints about investment performance, fees (other than how these have been applied) and general policies and practices of financial advisers (other than how income has been applied). Dispute resolutions schemes can award compensation to clients of up to $200,000.

Financial dispute resolution schemes aim to cut down on the time, expense and effort of going through the legal system and are much more informal than a court process.

4.2 The Securities Act 1978

The issuing of securities is currently regulated by the Securities Act 1978. Under the Act, subject to exemptions, offers of securities to the public must have disclosure in the form of a prospectus and investment statement. Failure to comply with the Act's requirements can result in enforcement by FMA in the form of civil penalties and compensation orders, criminal fines and imprisonment, and management bans, as well as powers for investors to seek compensation and avoid certain transactions made in breach of requirements.

While the Securities Act 1978 does not directly govern the provision of financial advice, it remains important in defining the nature of financial products which are securities, as specified by the FAA. There are implications for what types of products may come within the FAA's category one definition of a "security".

The Securities Act 1978 is currently under review. The Financial Markets Conduct Bill 2011 was introduced into the house in 12 October 2011 and is under consideration. The Bill aims to reform the current capital markets regulation, and introduce some fundamental changes in regulatory design. Key amongst the new changes will be a shift to regulating products according to their economic substance rather than, as now, their legal form, with capacity for the FMA to allocate a product to a category. This is consistent with the approach taken under the FAA.

Other changes will include:

- a shift from regulating only those securities offered to the public to a system in which all offerings are regulated unless they are specifically exempt;
- prescribing a single product disclosure statement to replace prospectuses and investment statements; and
- simplified securities advertising rules.

These changes will have indirect implications for advisers who advise in respect of category one financial products, in terms of any compliance obligations attached to specific products.

The Financial Markets Conduct Bill proposes some amendments to the Financial Services Providers (Registration and Dispute Resolution) Act 2008.

4.3 The Capital Market Development Taskforce

On 16 December 2009 the Capital Market Development (CMD) Taskforce released its final report, making 60 recommendations to improve the performance of New Zealand's capital markets.[22] In forming these recommendations the taskforce looked at the current state of our capital markets, the international context, future risks and opportunities, and key changes necessary to deliver the best possible financial system for New Zealand.

Priority responses for the government are strengthening the financial adviser regime and completing the review of New Zealand securities law.

The recommendations of the CMD Taskforce were broadly in agreement with the FAA. However, as the FAA legislation pre-dated the CMD Taskforce report, work in implementing the FAA regime was not accelerated by the CMD Taskforce recommendations.

The main change to the FAA that derived from the CMD Taskforce report was the decision by Cabinet to significantly reduce the FAA's application to wholesale financial advice.

4.4 International integration

The regulation of financial intermediaries is largely jurisdictionally based. New Zealand maintains a two pronged approach - following international standards whilst also pursuing more focused, cross-border integration, with Australia

International standards

New Zealand has resolved to promote high standards of regulation to maintain just, efficient and sound markets under the IOSCO Objectives and Principles of Securities Regulation in relation to how we regulate financial advisers. As noted in chapter 2, in 2004, New Zealand's compliance with these "best practice" principles was assessed as only "partial" by the IMF Financial Sector Assessment Program. The resulting IMF report recommended more comprehensive regulatory oversight of financial advisers in New Zealand, on the basis that not all financial advisers in New Zealand are subject to comprehensive standards for internal organisation and operational conduct.

For financial intermediaries, the IOSCO focus is on areas where capital, client money, and public confidence in the market may most be put at risk. This may lead to on-going implications for financial advisers, particularly those who deal in securities on behalf of customers.

[22] Refer to http://www.med.govt.nz/business/economic-development/pdf-docs-library/cmd-capital-markets-matter-full-report.pdf for the December 2009 report.

Trans-Tasman mutual recognition

Mutual recognition of individual financial advisers with Australia has been established under the Trans-Tasman Mutual Recognition Agreement (TTMRA). The primary benefit of the TTMRA is that people registered to practice an occupation in New Zealand or Australia, can register to practice in their “non-home” jurisdiction. At present, individually registered financial advisers are able to apply for licence from Australian regulators.

Licenced entities in both New Zealand and Australia are currently excluded from recognition under the TTMRA. Work towards mutual recognition for such licences ‘in the spirit of TTMRA’ is on-going.

Australian advisers who provide financial adviser services to clients in New Zealand are subject to the New Zealand financial adviser regime. However there are two exemptions which have been granted by FMA that Australian advisers may be able to utilise.

1. Under the Australian Licensees Exemption Notice an Australian licensed financial adviser firm which meets certain conditions will be able to provide certain financial adviser services to New Zealand retail clients without its specified representatives being registered or authorised.
2. Under the Australian Qualified Advisers Exemption advisers who have certain Australian qualifications and who are applying to be Authorised Financial Advisers (AFA) are exempted from the Code's educational qualification requirements.

The applicants will remain subject to all other authorisation eligibility requirements and as AFAs will be subject to all applicable laws.

4.5 Other influences

Financial service providers, including financial adviser services, are also covered by the Fair Trading Act 1986 and the Consumer Guarantees Act 1993.

Under the Fair Trading Act 1986 service providers must not mislead consumers, give them false information, or use unfair trading practices. According to the Consumer Guarantees Act 1993 services must be provided with reasonable care and skill, must be fit for the purpose, and provided within a reasonable time, for a reasonable price.

Complaints under both these Acts can be taken to a free dispute resolution scheme, to the Disputes Tribunal, or through the Courts.

In addition to the requirements of the FAA, specific types of financial service providers will be subject to additional regulatory requirements set out in other legislation.

These include:

- Registered banks and non-bank deposit takers: requirements set out in the Reserve Bank of New Zealand Act 1989
- Securities trustees and statutory supervisors: requirements set out in the Securities Trustees and Statutory Supervisors Act
- Insurers: requirements set out in the Insurance (Prudential Supervision) Act

PART THREE

EVALUATION BASELINE:

FINANCIAL ADVISERS IN NEW ZEALAND

5. New Zealand's Financial Adviser Landscape (as in 2011)

In this chapter we describe New Zealand's financial adviser industry and report some market perceptions of financial advisers around the time the FAA was implemented (December 2010 – July 2011). Most of the data in this section is derived from MED's commissioned research on financial advisers. This research included an online electronic survey of 325 financial advisers and interviews with 23 financial advisers (9 to 30 May 2011).

Other information for this chapter was obtained from stakeholders in the industry, the financial adviser register which became operational in August 2010, RaboDirect's Financial Confidence Index (constructed from a random sample of 1,000 New Zealanders), and the Ministry of Consumer Affairs National Consumer Survey of 1,000 New Zealanders. The methodology for each of these data sources is detailed in Appendix, 10.3, 10.4, and 10.5.

According to the CMD Taskforce, prior to the FAA being passed New Zealand's financial adviser industry consisted of a range of people with varying levels of competency and independence. Some were able to give completely unbiased advice, whereas others were restricted to certain products and providers. Many received commissions and other incentives from providers that gave rise to serious conflicts of interest.

5.1 Numbers of financial advisers

According to feedback received from financial sector participants, staff papers released by the Securities Commission (now replaced by FMA) and the Ministry of Consumer Affairs, prior to the implementation of the FAA it was estimated that in October 2009 there were around 11,300 financial service providers (advisers, banks and other financial institutions, insurance companies, superannuation scheme individual trustees).[23]

These estimates can be compared to the numbers of members in industry associations. Many financial advisers are members of an industry association or professional body. While the purpose of these associations is to serve the business interests of financial advisers, many associations have a broader focus than just financial advisers (including e.g. accountants). Some are also organised as New Zealand and Australian associations. Membership criteria can differ between firms and individuals and many associations do not publish their member numbers. According to self-reported and published membership of relevant industry associations and professional bodies, in February 2011 around 3,500 people were noted as being individual financial advisers.

As part of the introduction of the FAA and the FSPA, companies and individuals in the business of providing financial services were required to register on the financial service providers register. By the end of May 2011 (just prior to implementation of the FAA) more than 5,000 financial service providers were registered as a financial service provider (FSP). The majority (more than 3,700) registered as individual financial advisers. By the end of December 2011 (6 months after the FAA implementation) more than 9,900 financial service providers (of which 8,675 were individual financial advisers) were registered and the number of registered financial service providers had risen to 10,900 in June 2012. These numbers are summarised in Table 5-1.

The original estimate was fairly close to the number of registered providers one year past implementation.

[23] MED (2009)

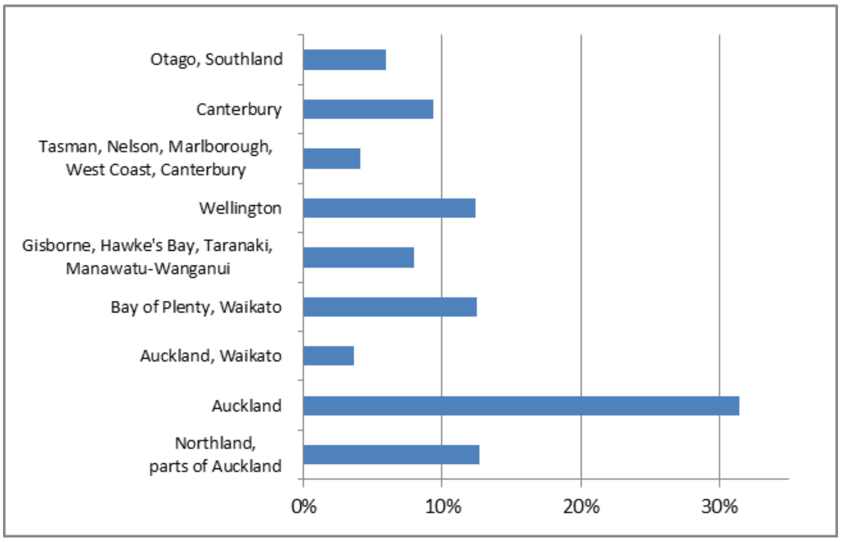
Table 5-1: Number of financial service providers

Source	Date	Number of financial service providers
MED	October 2009	11,300 (estimate)
Industry associations	February 2011	3,500 (voluntary membership)
Companies Office	May 2011	5,000 (registered)
	December 2011	9,900 (registered)
	June 2012	10,900 (registered)

Whether the number of financial service providers in New Zealand has decreased due to the implementation of the FAA is unclear. In addition, the higher entry requirements (competency, disclosure, accountability) for financial advisers under FAA could have led to a lower inflow of new advisers or even an outflow of existing advisers. Registration of financial advisers was still on-going and some of these might be "late registers". Also, the MED figures from 2009 were only "best estimates" of financial service providers carrying on business.

In Figure 5-1 the geographic distribution of registered financial service providers as at December 2011 is shown, based on an analysis of their business address via postal codes.

Figure 5-1: Distribution of registered financial service providers



Source: FSPA register

Not surprisingly, most providers are located in urban centres. At the end April 2012 around 100 financial service providers were registered with an address outside of New Zealand. Most of them (82) were registered under a business address in Australia. The number of financial advisers active across the Tasman appeared to be low and likely indicates high entry and operation costs.

5.2 Types of financial advisers

Most service providers were individuals that a registered financial advisers. The FMA licenses and monitors authorised financial advisers (AFA). By mid-2011 1,823 advisers had become an AFA. By the end of December 2011, 1,936 or 22% of all individual advisers were AFAs.[24]

[24] It is too early to assess whether there is a trend to become an authorised financial adviser. The MEDs survey showed that more advisers (56%) intended to become an authorised financial adviser.

In the MED survey on financial advisers respondents were asked their reasons for choosing a particular status, i.e. registered or authorised financial adviser and QFE. Respondents' comments are summarised below:

Registered financial adviser:
Apart from the mandatory requirement to register, participants noted that the registered status is the best fit for a company's business model and the work undertaken on a day-to-day basis. It is a potential first stage before going to an authorised level in the future and less expensive in terms of time and cost in becoming an authorised financial adviser.

Authorised financial adviser:
Participants in the MED survey chose to become authorised financial advisor because it is a mandatory requirement to perform certain activities, e.g. providing KiwiSaver advice, and it is the best fit for the company's business model. Some companies encouraged employees to become authorised financial advisors and paid for the costs of authorisation. These companies and individuals were of the opinion that the more stringent requirements to become an authorised are necessary to step up the industry.

Qualifying Financial Entity:
62 entity groups had Qualifying Financial Entity status by the end of 2011. Participants in the MED survey and interviews indicated that QFE status is more pragmatic and cost effective for larger organisations in terms of time, money and administrative work than registering individual staff members. In addition, there may be brand advantages. The QFE model provides the ability to take responsibility for the entity's own staff (less ambiguity around responsibility) and could potentially encourage increased confidence in the provider.

As part of the MED survey of financial advisers a number of qualitative interviews with industry associations were conducted. The interviews helped to identify potential participants that choose not to register and/or had left the industry. The main reason for financial advisers not registering under the new regime was that increased costs and compliance requirements made it difficult for small one and two person band practitioners to survive. As a result, most of these financial advisers had sold off their client bases and retired early (if close to retirement).

5.3 Key statistics on financial advisers

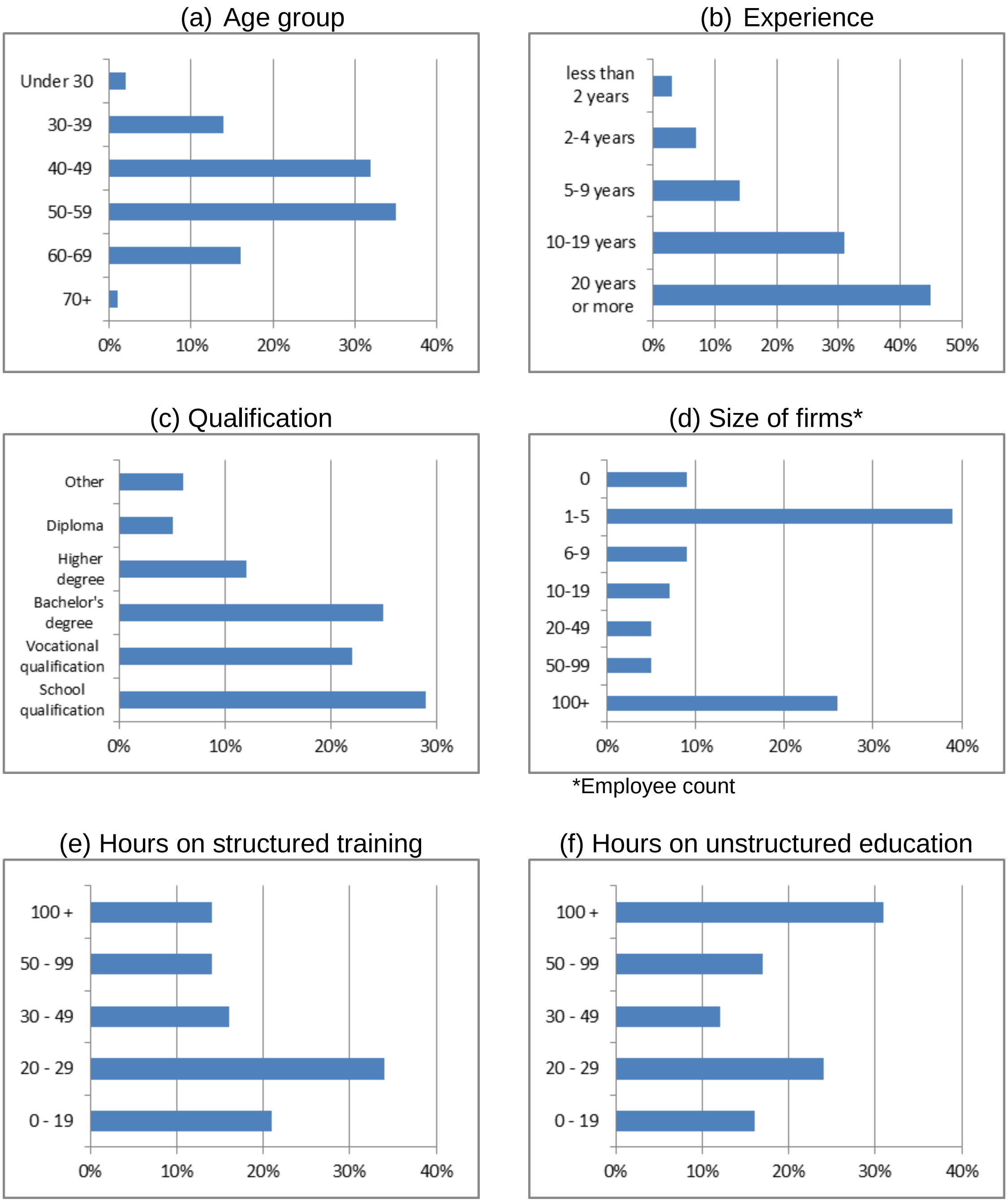
In the MED survey financial advisers were asked about their age, qualification, experience and training. These results are shown in Figure 5-2 below. At the time of the survey in May 2011 the majority of financial advisers surveyed were male (82%), were within the 40 to 59 years age range (67%) and almost half had been in the financial industry for 20 years or more.

Half of all survey participants had a school level qualification or vocational qualification on entering the business.

The sample profile shows that almost half the participants were sole traders or employed in companies with five or fewer employees. On the other hand, more than 25% worked for companies with more than 100 employees.

Financial advisers surveyed tended to spend less time on structured training vis a vis unstructured education such as reading industry magazines. Half of all survey participants spent up to 30 hours on structured training and up to 50 hours on unstructured education.

Figure 5-2: Financial advisers statistics



Source: MED survey (2011), n=325

5.4 Business activity of financial advisers

Before the introduction of the FAA the financial adviser industry was only lightly regulated and the business activities of advisers could range from advice on specific investment products or insurance needs to cash flow management or advice to help the client protect and build assets.

The FAA defines the business activity and service of financial advisers. According to the FAA financial advisers are people who give advice about investing and other financial services and products as part of their job or business. The FAA applies also to “brokers” and the term has a specific meaning in FAA legislation. A broker is an intermediary who provides a 'broker service', that is they hold, pay or transfer clients' money or property.[25]

MED survey participants were asked what their ‘principal economic activity’ was. More than 50% of respondents said that their principal economic activity is giving financial advice, while around 30% provide a broking service (under the FAA). If their principal economic activity was neither giving financial advice nor broking service (around 20% of respondents) they were involved in providing insurance related services.

Those financial advisers providing mainly broking service appeared to have lower levels of qualification on entry: 32% had a bachelor’s degree or a higher degree versus 43% financial advisers whose principal economic activity is giving financial advice.[26] More than half of all financial advisers (55%) gave advice on a broad range of investments as opposed to a specific product such as life insurance. Financial advisers provided advice mainly on:

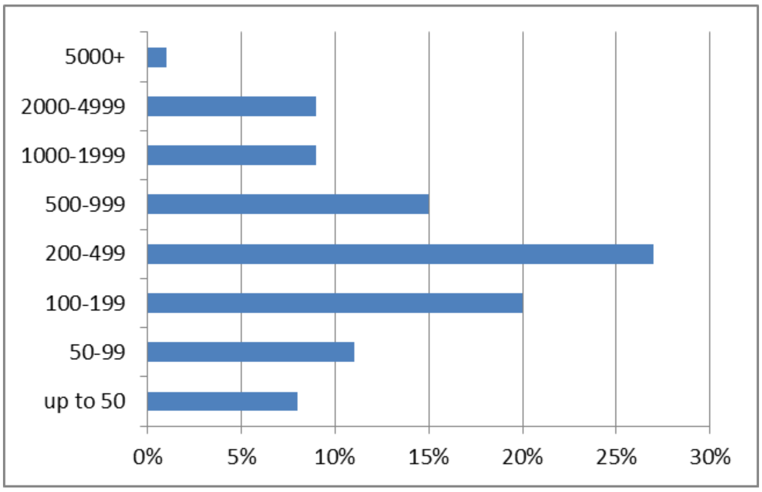
Table 1: Types of advice

Insurance needs	67%
Investment review and planning	48%
KiwiSaver schemes and funds	46%
Managed investment funds	45%
Retirement planning	45%
Education funding	16%
Supply/clarification of products information only	15%
Tax planning	7%

Source: MED survey (2011), n=325

Approximately three quarters of all financial advisers (76%) worked with retail clients (20% with wholesale clients) and almost half gave advice on investment products from several companies. Financial advisers sometimes worked with their clients for a long time and guided them through some very important decisions. The number of clients that financial advisers worked with is therefore an interesting indicator of how the financial adviser business was structured. According to the MED survey of financial advisers most respondents had a client base of 200 to 499 (Figure 5-3).

Figure 5-3: Number of clients financial advisers work with



Source: MED Survey, n=325

[25] Mortgage brokers or insurance brokers will not be ' brokers' under the legislation, if they do not provide 'broking services' as defined, but they will often be financial advisers. All brokers need to be registered and must also comply with the brokers' conduct and disclosure obligations in the FAA. These provisions apply to anyone providing broking services, whether they are a financial adviser or not.

[26] Further comparisons between financial advisers and broker are listed in appendix 10.

According to the MED survey just half of all financial advisers provided a comprehensive written analysis and recommendation of their client's financial situation and 40% of financial advisers undertook activities to improve consumer trust.

Financial advisers used their own knowledge and expertise in preparing suitable financial plans and/or investment plans for clients. 62% of financial advisers of the sample undertook in-house research and analysis and a third purchased information to deliver advice. 34% of financial advisers specialised in a specific area, e.g. insurance or risk management, and 80% refered their clients to an appropriate professional when they asked for advice outside of their core competencies.

5.5 Market dynamics

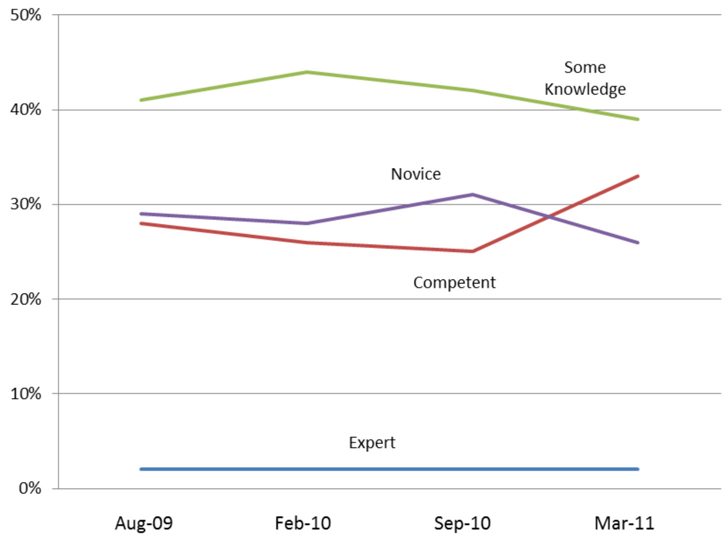
In this section we use consumer and industry data to describe how New Zealanders rated their own financial expertise, how confident they were in the financial system, how many made use of financial advice and who they consulted before and around the time the FAA was implemented (December 2010 – July 2011). The data revealed that some New Zealanders had low financial understanding and did not have the expertise to filter poor financial advice using their own knowledge about sensible investing. Appropriate financial advice could, therefore, play an important role in improving the financial situation of inexperienced customers.

The situation is similar to Australia. An inquiry by the Australian Parliamentary Joint Committee on Corporations and Financial Services (2009) found that many investors rely on third parties to steer them in the right direction and seek financial advice for the very reason that they have minimal financial literacy and therefore place more faith in the investment advice they receive.

5.5.1 Use of financial advisers

In the RaboDirect survey 1,000 randomly sampled New Zealanders were asked to rate their own expertise with respect to choosing financial products and investments. In September 2010, less than one years before the FAA was implemented, 31% of New Zealanders rated themselves as novices in choosing financial products and investments (Figure 5-4). Since then 33% of surveyed New Zealanders in March 2011 rated themselves as competent (up 8 percentage points) in choosing financial products and investments. Slightly fewer considered themselves to be novices in in choosing financial products and investments (down 5 percentage points compared to September 2010). Financial expertise was slowly improving just before and during the implementation of the FAA.

Figure 5-4: Self rated financial expertise, 2009-2011



Source: RaboDirect (2011)

In 2009 the Retirement Commission conducted a survey of the financial knowledge of adult New Zealanders (850 people). The Commission scored people on their answers to 42 financial knowledge questions. Survey questions were designed to capture the most important skills and knowledge in the areas of personal financial knowledge like budgeting, goal setting, financial planning, home loans and mortgages, managing risk, savings, and planning for retirement and investing. Each question was assigned a score. When added together, an individual's total score indicated whether they had basic, sound or advanced personal financial knowledge. 31% of the surveyed people fell into the low knowledge group (Table 2).

Table 2 Financial knowledge

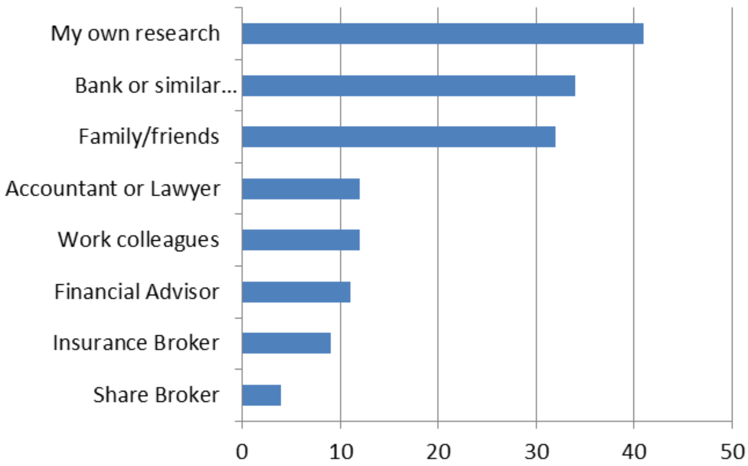
High knowledge group	43%
Medium knowledge group	26%
Low knowledge group	31%
	100%

Source: Retirement Commission (2009)

About one in six New Zealanders (16%) indicated that they are having difficulty managing money. Amongst those with a low level of knowledge the percentage was higher, 26% indicated that they were having difficulty managing money.

The RaboDirect's 2011 survey on financial confidence showed that only 7% of New Zealanders had consulted a financial adviser when seeking financial advice or investment guidance. The usage of financial advisers had slipped from 10% compared to September 2010. Most respondents did their own research (41%) when seeking investment guidance (Figure 5-5). Otherwise respondents mainly asked a bank and/or a family member or friend for advice.[27]

Figure 5-5: Institutions used for financial advice – per cent



Source: 2011 RaboDirect survey

Households with higher income and assets remained the most likely to conduct their own research. The Ministry of Consumer Affairs carries out research on New Zealand consumer awareness, experience and perceptions (Consumer survey). According to the consumer survey New

[27] Different surveys repeatedly rank banks and friends or family members as most often mentioned source of financial advice. According to the 2009 National Consumer survey of those respondents who had received advice, 19% received advice from bank employees and 17% from friends or family members. According to the Retirement Commission survey 2009 51% of respondents sourced financial advice from banks and 35% sourced financial advice from friends and relatives.

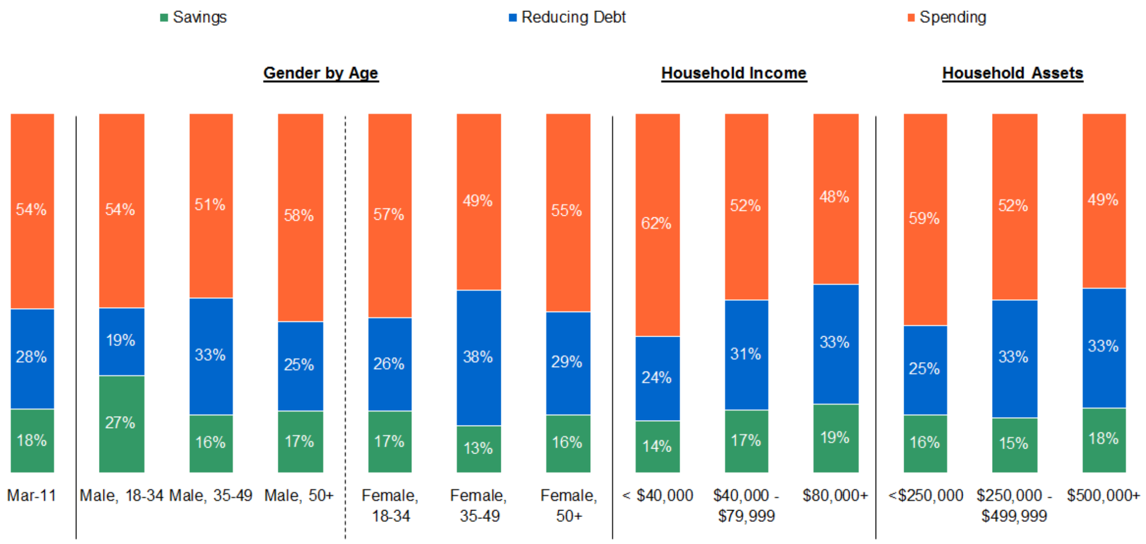
Zealanders under 30 years of age were particularly likely to have received financial advice from friends and family (32%) and less likely to have received advice from a bank employee (13%) or a financial/investment advisor (2%). In contrast, New Zealanders aged 65 and over were more likely to turn to a financial or investment advisor (12%). New Zealanders who have completed post-graduate education are also more likely to turn to an accountant for advice (12%). Women (59%) are more likely than others to receive financial advice, particularly from bank employees (21%) and friends or family members (20%).

5.5.2 Income allocation

New Zealanders make choices how to allocate their income between spending, saving or reducing debts. A decision to change their income allocation potentially leads to higher demand for financial advice and services. According to the RaboDirect survey two in three New Zealanders claimed to have debt, the most common types being credit cards and mortgages.

In RaboDirect's 2011 survey respondents were asked how much of their monthly income was allocated between reducing debt, saving and spending (Figure 5-6). Amongst the respondents just over half of their monthly income was spent (54%), 28% was allocated to reducing debt and 18% was put towards savings.

Figure 5-6: Income allocated between Reducing Debt, Saving and Spending



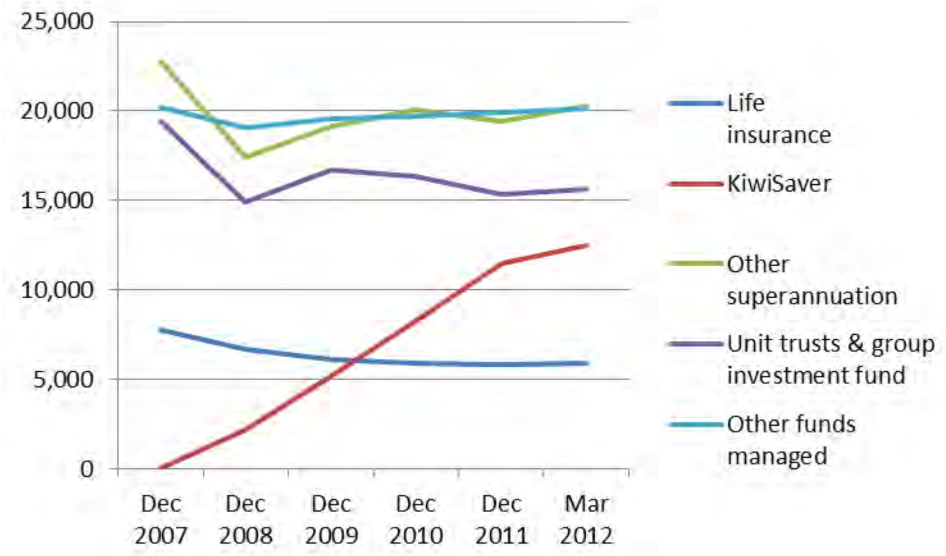
Source: RaboDirect (2011)

The introduction of the KiwiSaver scheme in July 2007 was a major change in the market for savings and investment in New Zealand (Figure 5-7). KiwiSaver is a voluntary, long-term retirement savings scheme established through the KiwiSaver Act. KiwiSaver participants put their savings in an approved KiwiSaver scheme, many of which are managed by New Zealand fund managers. Fund managers began receiving contributions from KiwiSaver schemes from 1 October 2007. As at December 2007 there was an estimated $378 million invested in KiwiSaver funds. As at March 2012 total funds invested in KiwiSaver were $12,503 million (Figure 5-7).

According to results from the MED survey financial advisers were almost evenly divided between those who served the KiwiSaver market (49%) and those who did not (51%). The feedback from survey participants who were employed by KiwiSaver providers is that their organisation will continue to service this market so there is no significant change for them in terms of the services provided although there is now more rigour around processes.

According to MED's survey financial advisers who did not serve the KiwiSaver market say that they were supportive of KiwiSaver as a concept but it was not economically viable for them to continue offering KiwiSaver related services because of the lack of margin in it. They could only charge a small fee for service. There were also additional risks which they were not willing to take on.

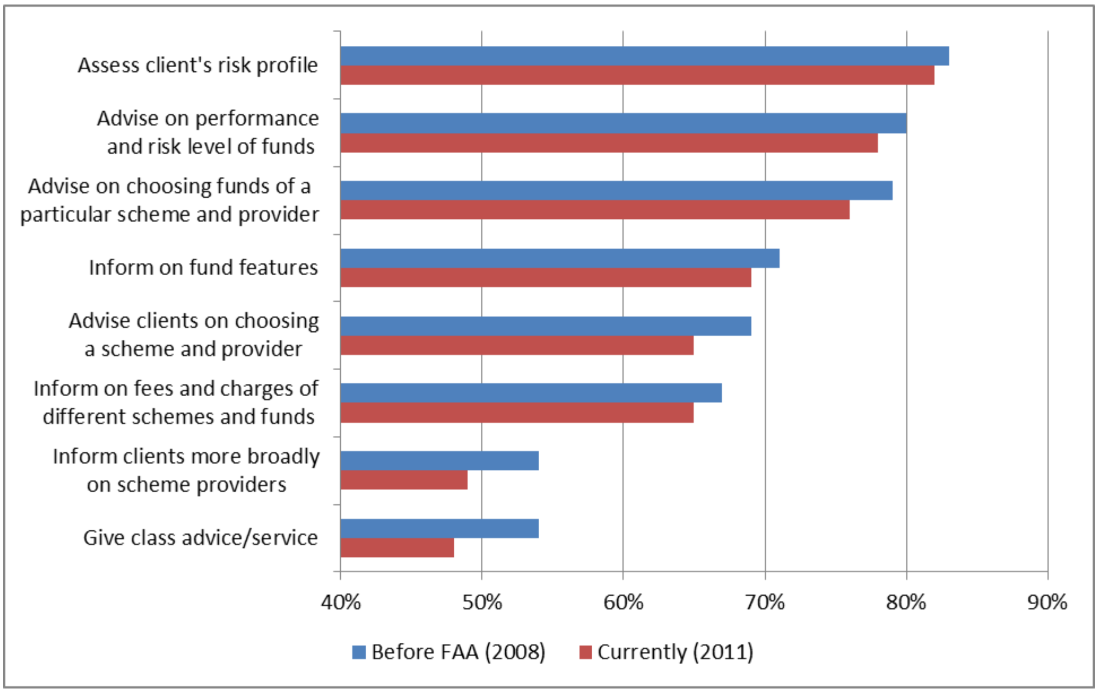
Figure 5-7: Managed funds assets, $NZ million



Source: Reserve Bank of New Zealand, Managed fund assets

According to MED's survey the introduction of the FAA has not resulted in a significant change as to how financial advisers serve the KiwiSaver market (Figure 5-8). The areas of greatest change were in giving class advice/service, i.e. giving brochures, seminars and internet material and in informing clients more broadly on scheme providers.

Figure 5-8: KiwiSaver – percentage



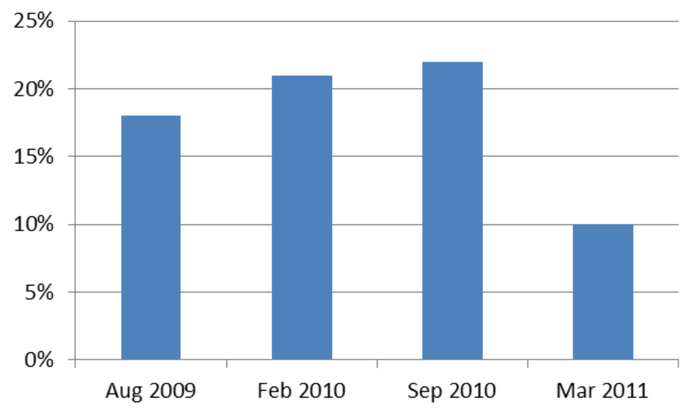
Source: MED survey

5.5.3 Confidence in the New Zealand financial system

Investors need to be able to access objective, quality advice when making savings and investment decisions. Until individuals feel they can trust financial advisers –and more generally, the financial system - and understand what they are paying for, it is unlikely the use of financial advisers will increase. Set out below are the results from the RaboDirect survey question on New Zealanders' confidence in NZ's financial service providers.

Results show that confidence in the NZ financial system has suffered a large decline in 2011. Figure 5-9 shows the Financial Confidence Index since it was first conducted in August 2009. The earthquakes in Christchurch have certainly contributed to this decline, with people feeling less confident in the NZ economy as a result.

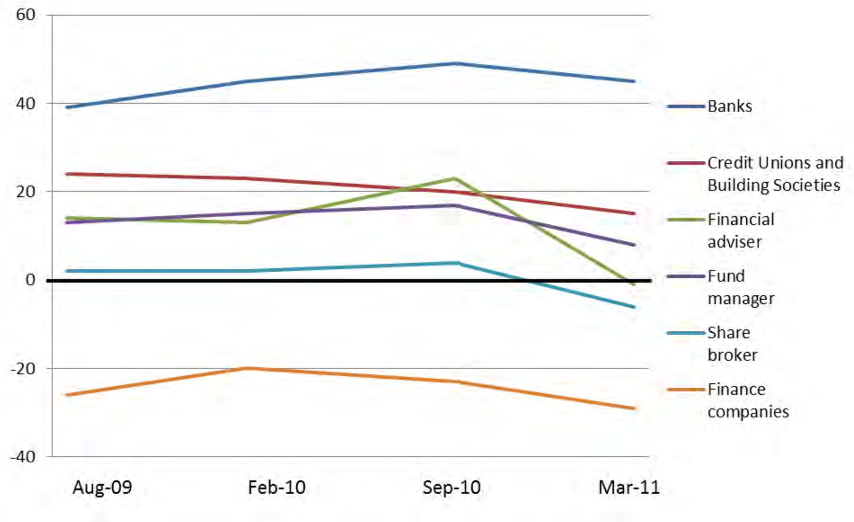
Figure 5-9: Overall financial confidence index



Source: RaboDirect (2011)

RaboDirect's Financial Confidence Index can be broken down by financial service. According to the survey, over time confidence has declined across each type of financial service surveyed (Figure 5-10). Financial advisers experienced significant decline in confidence between September 2010 and March 2011. Finance companies had high negative scores probably due to the scandals and bankruptcies around a number of finance companies in 2008 and 2009.

Figure 5-10: Confidence in the NZ financial system, index score



Source: RaboDirect (2011)

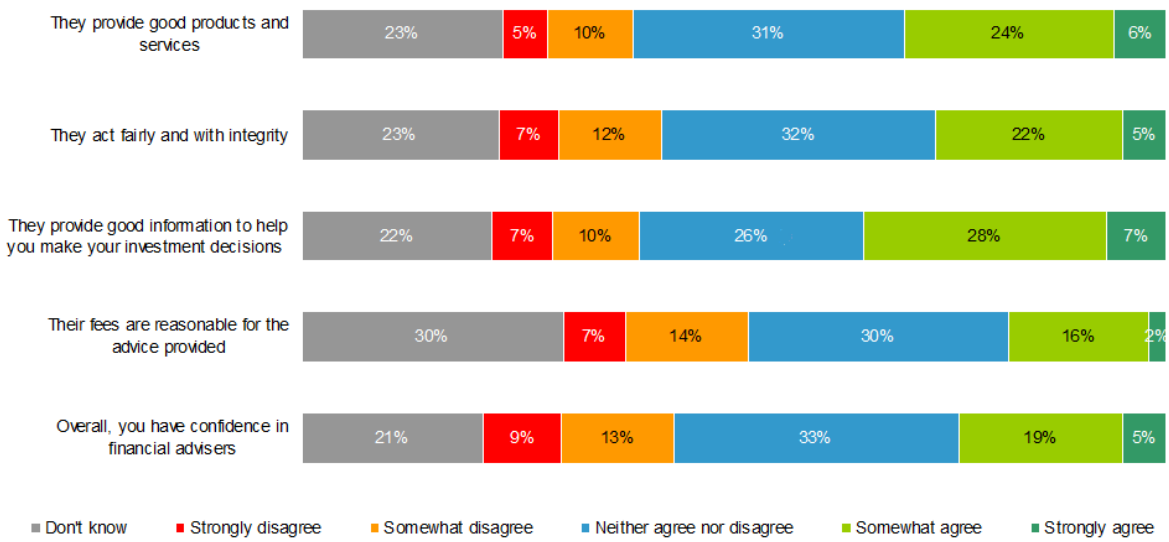
In addition to overall confidence, the RaboDirect survey asked questions about confidence in NZ's financial service providers in helping to grow and protect your wealth and perceptions of respondents on regulated business areas. In March 2011, 40% of New Zealanders agreed weakly with the statement 'Financial service providers are helping me to grow and protect my wealth' rather than strongly (only 4%). Confidence was highest amongst the under 35's.

In the 2011 survey current customers could be distinguished from past and non-customers. Amongst current customers of financial services, the highest level of confidence remained for credit unions/building societies and also banks. But, encouragingly, confidence in current users of financial advisers was also favourable.

Given the collapse of a number of finance companies it is not surprising that past users of financial service suppliers or people who have never used financial services were less confident–with index scores in the negative.

Respondents' perceptions of financial advisers in terms of good service provision, being fair, having integrity and provide good information were favourable (Figure 5-11).

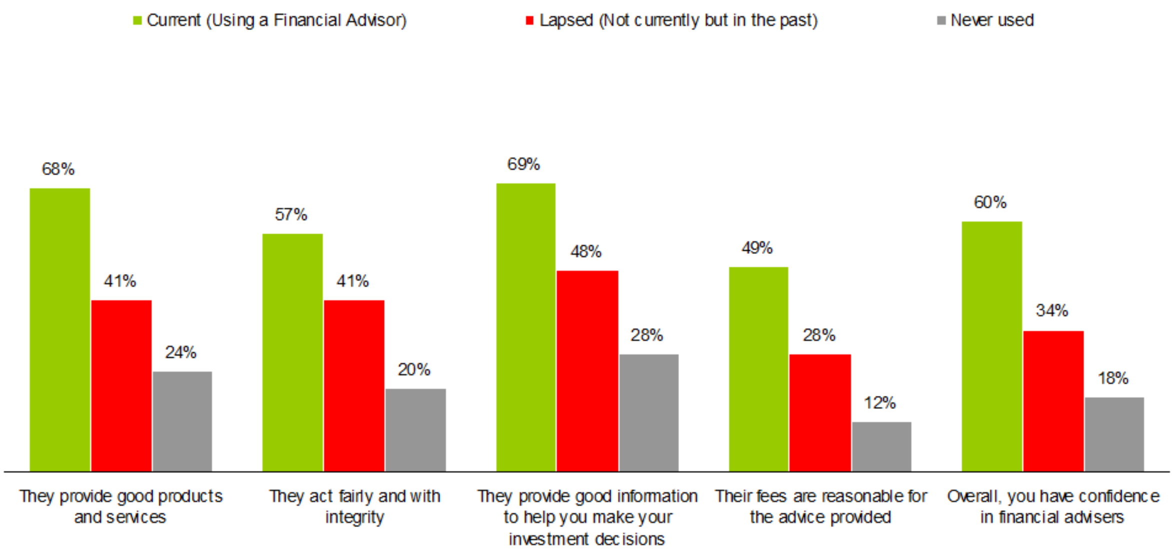
Figure 5-11: Perception of Financial Advisers



Source: RaboDirect (2011)

Again, there was a significant difference between current users and other users (lapsed and non-users). Current users of financial advisors (at that time) rated the relationship more positively (Figure 5-12).

Figure 5-12: Perceptions of Financial Advisers by current relationship



Source: RaboDirect (2011)

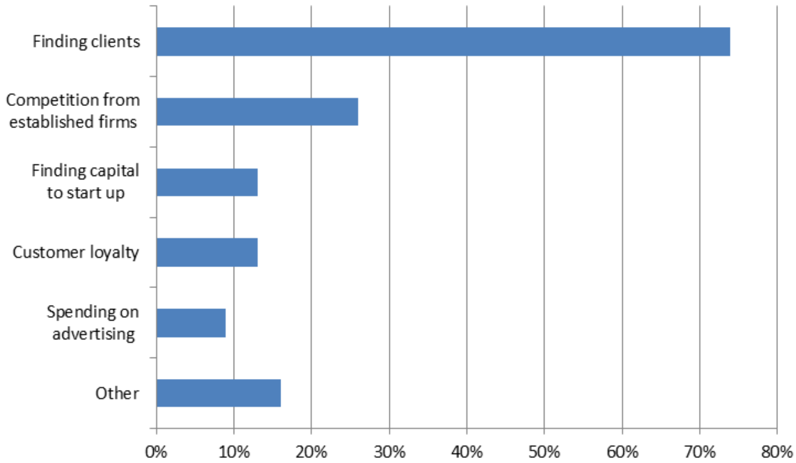
The Ministry of Consumer Affairs 2009 Consumer survey provided some perceptions about financial advisers before the FAA was implemented. According to the survey almost everyone who received financial advice said that the information was either 'very helpful' (49%) or 'quite helpful' (45%). In terms of source of advice, advice from friends and family, accountants, and financial/investment advisors tended to be considered more helpful than advice from bank employees.

The results of a 'mystery shop' survey carried out by Consumer NZ assessed the quality of financial advice in 2009.[28] As the survey had a small sample size (17 financial plans), it is difficult to draw any firm conclusions. However, only 3 advisers were rated as 'good' by the expert panel.

5.5.4 Barriers to entry and compensation structure

According to MED's survey of financial advisers the most challenging issue when starting work as a financial advisor was finding clients (Figure 5-13). This included finding the right level of fees for service (Kiwisaver), clients not wanting to pay for advice although they recognised their needs, and misinformation in the market place regarding fees. Once a financial adviser had clients, they then needed to generate revenue from them.

Figure 5-13: Barriers to entry – category mentioned



Source: MED (2011)

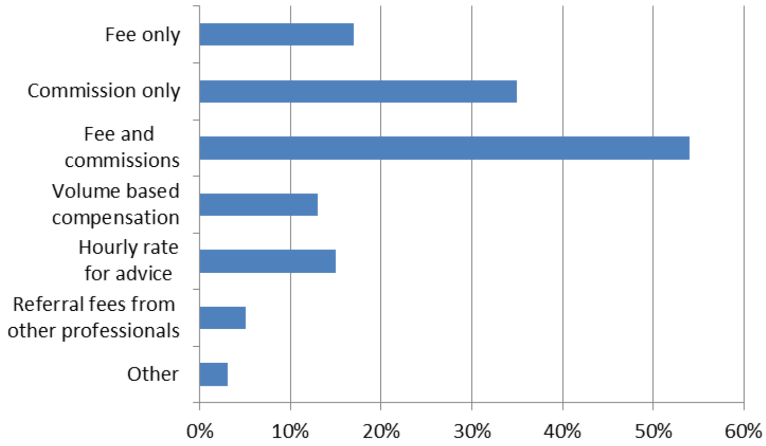
While competition from established financial adviser firms existed for new entrants, it was relatively less of an issue than finding customers.

One of the goals of the FAA was to ensure that financial advisers appropriately manage conflicts of interest. One such conflict of interest is around commissions. Commissions are mostly designed to suit the business models of financial advisers rather than serve the needs of the client and products with higher commissions are likely to be favoured by financial advisers.

Respondents were asked about their firm's fee structure and also how their personal compensation is calculated. A firm's fee structure depended to some extent on the type of services that the firm provided. Fees were discussed and agreed with clients before proceeding. Commissions – either commission only or in combination with fees – formed the major form of compensation.

[28] Consumer New Zealand, Financial advisors, November 2009, consumer.org.nz

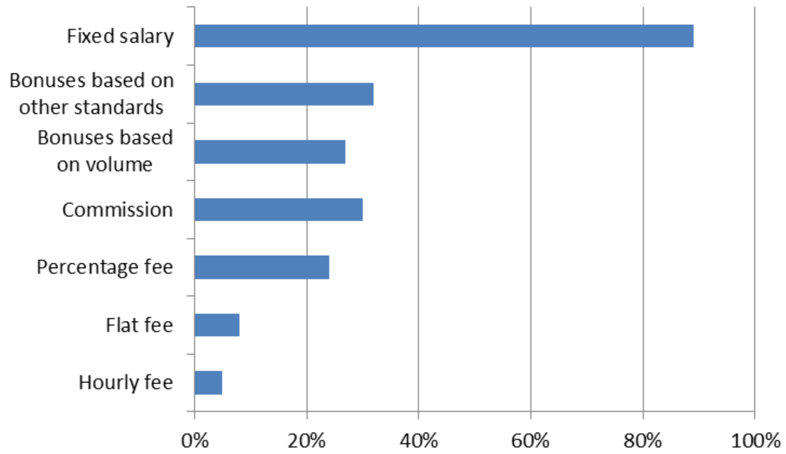
Figure 5-14: Firm fee structure – % distribution



Source: MED (2011), sample size: n=347

The main forms of personal compensation for financial advisers were a fixed salary or a combination of fixed salary plus other forms of compensation (Figure 5-15). Financial advisors in companies who were selling their own products were less likely to receive financial incentives or commissions than those who were not tied to a product or supplier.

Figure 5-15: Personal compensation – % distribution



Source: MED (2011), sample size: n=49

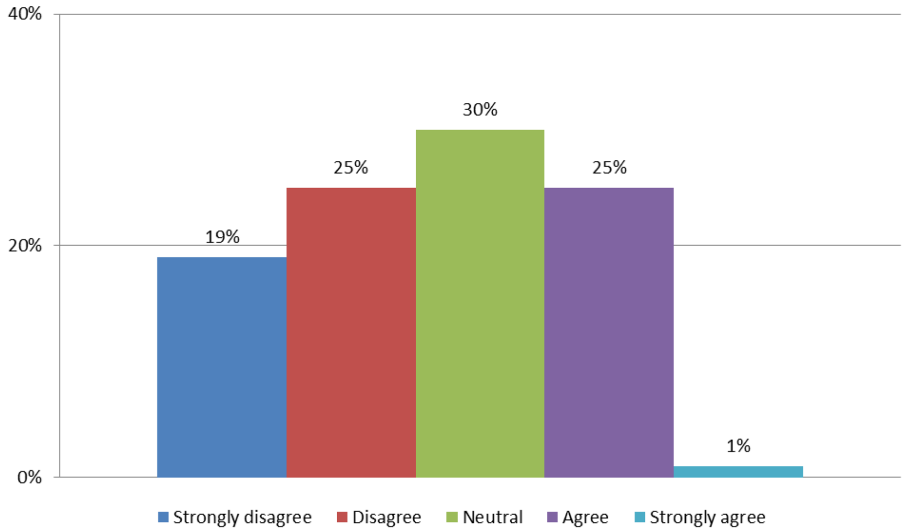
6. Initial findings (as at May 2011)

We describe in this chapter initial findings on the implementation of the FAA from MED's survey of financial advisers (May 2011) and consequent changes in the industry. The MED survey and its methodology are described in more detail in Appendix 10.3; where useful, we contrast MED's finding to other survey findings.

6.1 Implementation process

Respondents were asked whether the overall process of implementing the financial adviser regulation was efficient[29]. Most respondents had some level of disagreement (44%) with the overall implementation process of the new regulation being efficient (figure below). One major feedback from industry representatives was that various government agencies seemed, at that time, to be in a state of flux and didn't have their own systems and processes sorted out first. Financial advisers had the impression that the whole process was rushed, reactive, and not well managed and organised.

Figure 6-1: Efficiency of overall process of implementing Financial Advisers regulation



Source: MED (2011)

Two key themes stood out from interviews and the comments provided:

- There was a significant cost in terms of time, money spent and opportunity costs on most parts of the process (more than had been anticipated).
- It was difficult at the time to obtain reliable information because of the frequent changes to the requirements and uncertainty about how the legislation applied.

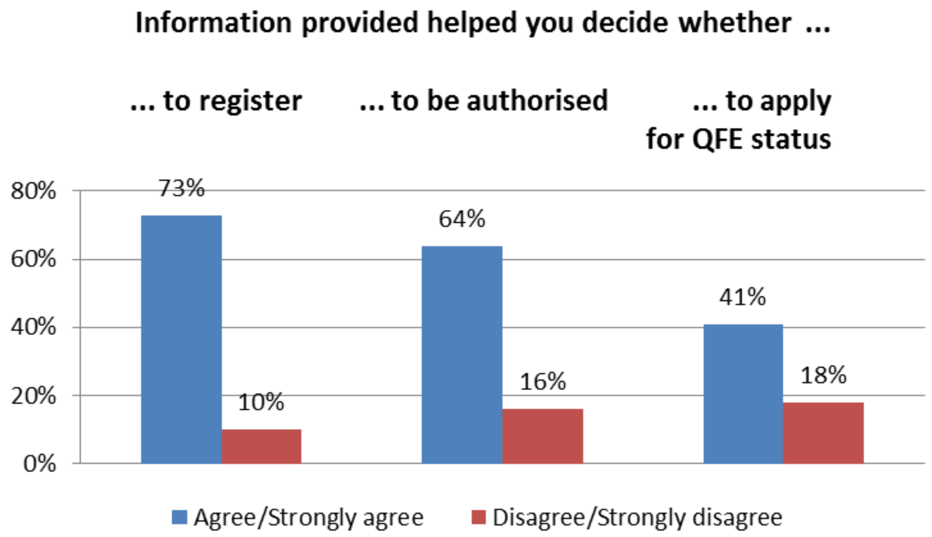
6.2 Registration process

As explained in chapter 3, in order to provide financial advice under the FAA a person must be registered as a financial adviser. The registration at the Financial Service Providers Register (FSPR) website is the first requirement of financial advisers. The register is a public register of entities and individuals in New Zealand who provide financial services. The register is run by the Companies Office.

[29] Efficient: Given the purpose stated in the financial adviser regulation was the time and money you spent appropriate.

Survey participants were asked whether the information provided helped them to decide whether they had to register, be authorised and/or apply for QFE status under the FAA. Their responses are shown in Figure 6-2.

Figure 6-2: Information provided, level of agreement



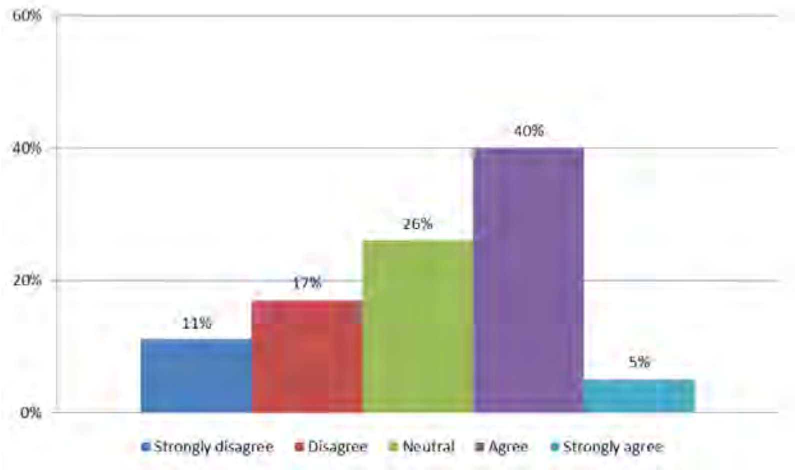
MED survey (n=348)

Overall most advisers (73%) agreed that information provided by the different government agencies helped them to decide whether to register or not. While still the majority, fewer advisers agreed that information on authorisation (64%) and QFE status (41%) was helpful. Those advisers who disagreed found that the information available through websites was contradictory and lacking in clarity. It was not always easy to determine what was most appropriate for them and the overall process was considered to be time consuming, laborious and confusing. Road shows and industry associations such as IFA, IBANZ and PAA played a helpful role in providing information.

Most financial advisers agreed or strongly agreed that the time and money spent on gathering information for the registration was appropriate given the purpose stated in the financial adviser regulation (Figure 6-3).

If advisers provide a financial service to retail clients, they must be a member of a dispute resolution scheme. Joining a dispute resolution scheme appears to be straightforward. 56% of respondents agreed or strongly agreed that the time and money spent on joining a dispute resolution scheme was appropriate given the purpose stated in the financial adviser regulation.

Figure 6-3: Time and money spent gathering information for the registration



MED survey (n=348), level of agreement

But other aspects of the implementation did not rate so highly. Survey respondents were almost evenly divided between “agree/strongly agree” (34%) and “disagree/strongly disagree (33%) that time and money they had to spend on the AFA authorisation itself was appropriate.

Survey respondents scored one of the highest levels of disagreement to the statement that the time and money spent on training required for the registration/AFA authorisation was appropriate (37% disagreed/strongly disagreed). Section 6.5 will look at aspects of training and skills in more detail.

Some emerging issues were:

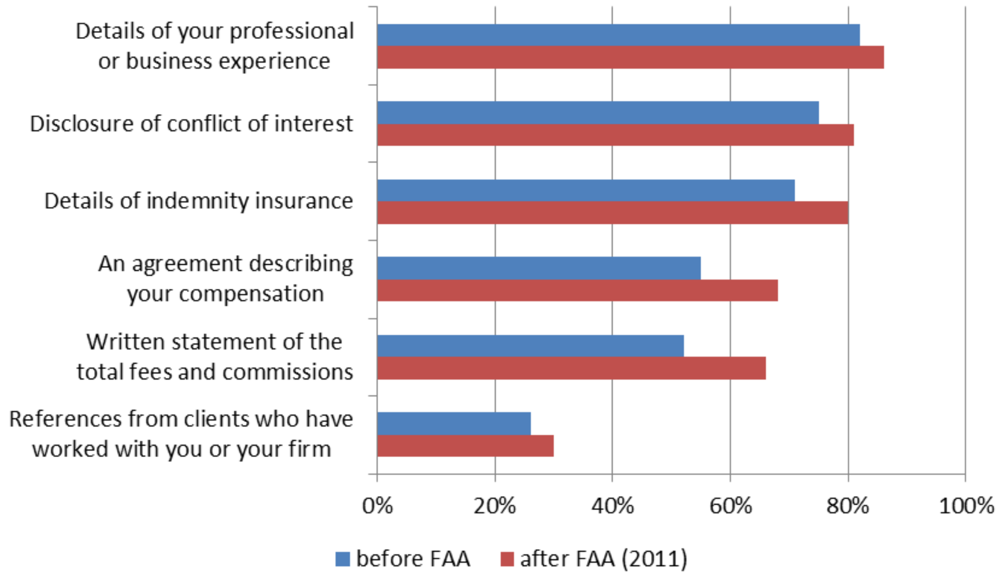
- AFA and QFE face different obligations; however, in some cases they serve the same clients or give advice on same product.
- The term “registered financial adviser” is used in parts of the industry as a trade mark or sign of quality. The requirements of registered financial advisers are, however, fairly low. It has to be seen whether consumers are confused by the different categories and label for financial advisers.

6.3 Information disclosure

Disclosure of information by financial advisers is an essential element in the FAA to ensure that clients can make informed decisions about whether to use a financial adviser and whether to follow a financial adviser's advice. Survey participants were asked how information disclosure had changed since the FAA and, in addition to what they are legally required to disclose, what type of information did they provide voluntarily.

Before the FAA was introduced there was little information that financial advisers were legally required to disclose. However, as indicated in Figure 6-4, most financial advisers still voluntarily provided information that helped their business, e.g. details of their professional experience or details of indemnity insurance. Before the FAA 75% of respondents claimed that they informed clients about conflicts of interest.

Figure 6-4: Information disclosure before and after FAA
% of all financial advisers



Source: MED (2011)

As with any self-reported survey, there was a risk of an upward bias from the MED data. According to the Ministry of Consumer's consumer survey in 2009 before the FAA was implemented New Zealanders were less likely to be provided with information on conflicts of interests. At the time only 28% of all financial or investment advisors (n=70) and 18% of all bank employees (n=189) were reported to provide information about potential conflicts of interest they had.

The effect of the new legislation is to provide a more comprehensive minimum disclosure requirement with an increased level of detail and greater specificity. While there is still not full disclosure, financial advisors appear to disclose information more often than before the FAA.

However, in terms of respondent comment the picture is different. Most financial advisors said that, for them, there will not be a significant change about what type of information they disclose but that disclosure is now more complicated than before. For some parts of the industry, e.g. banking, disclosure has been in place for a long time and the new regulation does not change much. The new legislation ensures the requirements are met by all advisers, however, advisers also admit that they do not go much beyond what they are required to disclose.

Most participants in the financial industry questioned whether the information will help customers. They claimed that the quality of the (mandatory) documentation is poor and most people will not really appreciate the increased level of paper they are given. Industry representatives said that most clients do not look at the document, though they happily sign receipt that they have received it.

In addition, some financial advisers thought that a disclosure requirement being more rigorous for some than others was not helpful either, e.g. AFAs have to disclose commission on risk products and RFAs and QFEs do not. They claimed that this made it an uneven and unfair playing field and did not protect the consumer.

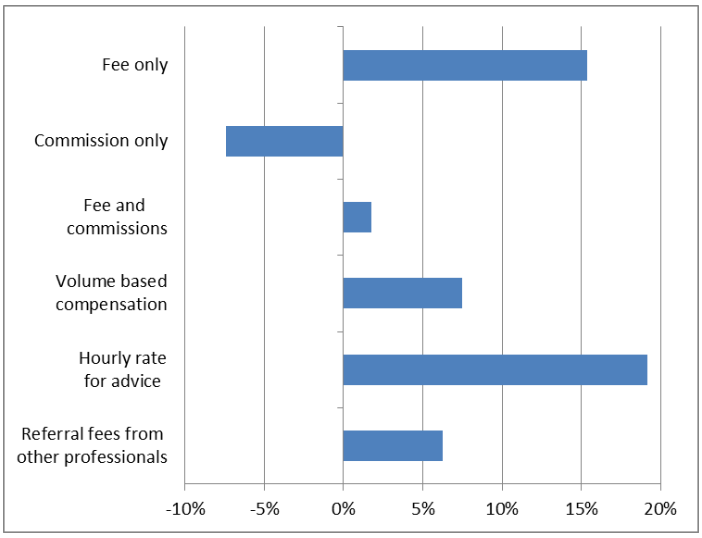
6.4 Compensation

As explained in chapter 2 how financial advisers are compensated raises a number of issues. Commissions may be problematic, especially if they lead to anti-competitive behaviour. Financial advisers could favour products with higher commissions and equally good or superior products, which do not pay a commission, could seldom be recommended. In addition, commissions can be inefficient in the sense that they are not tied to the provision of quantity or quality of advice – rather, commissions are paid irrespective of ongoing provision of advice services. The structure of commissions and fees is often designed to suit the business models of financial advisers, rather than serve the needs of the client. In some cases commissions lead to bad advice because they encourage the financial adviser to steer consumers into strategies which inflate their investments or exposure to risk, to increase up-front commissions.

Because of the important link to possible conflicts of interest the MED survey asked how firms and individuals were compensated for financial advice (before and after FAA).

Figure 6-5 shows that there was a move towards applying more fees and charging by the hour as workloads and risks had increased because of the legislative requirements. The usage of 'commission only' has decreased but is still widely used (32%).

Figure 6-5: Firms' fee structure between 2011 and before FAA (2008) – change in %



Source: MED (2011), n=348

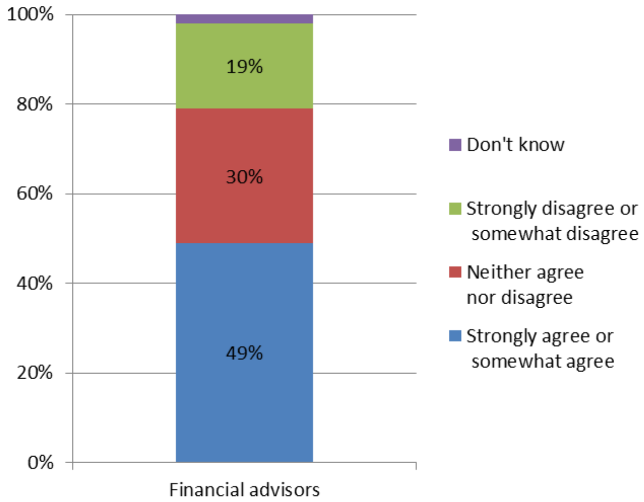
Firms seemed to continue to use a variety of forms of remuneration. They considered it was more important that clients should understand how and how much they are paid, and that clients are in agreement with that, as opposed to what form the compensation takes.

Anecdotal evidence indicated that fees would be increased for time spent. Before the FAA, clients got service without fees, since financial advisors earned income through commission. In future financial advisors' fees will be more like those of lawyers or accountants. The industry appears to have introduced a simple compensation structure: fee charged for services rendered, e.g. a financial plan or a pension transfer. For other products like life and general insurance, clients pay commissions.

In the MED survey, participants were also asked how their personal compensation was calculated. The number of respondents was significantly lower than for other questions in the survey. The main form of personal compensation was still a fixed salary (92%). From comments provided by participants and survey data, there does not appear to have been any major changes to the form of personal compensation as a result of the new FAA legislation, although the amount earned as percentage fees or commissions has reduced.

The 2011 RaboDirect survey asked users of financial advisers whether they think fees were reasonable for the service provided. As shown in Figure 6-6 almost half of all respondents using financial advisers agreed or strongly agreed that fees are reasonable while 19% disagree or strongly disagree.

Figure 6-6: Reasonable fees for service provided – users of financial services



Source: RaboDirect (2011), level of agreement

The Ministry of Consumer Affairs' National Consumer Survey of 2009 (1000 face-to-face interviews) contains useful information regarding the behaviour of financial advisers before the FAA was implemented. Participants were asked whether they received information on fees. 39% of respondents who had received financial advice were given information about the fees they would be charged for the advice. In general, information on fees was easy to understand, short and concise, and useful.

To summarise the above, the usage of commission appears to have decreased slightly since the introduction of the FAA.

6.5 Skills and experience

Better financial literacy of investors is one answer to protecting investors from poor financial advice. However, the complexity of investment strategies leaves the prospect of clients determining the quality of financial advice they receive, through the filter of personal knowledge. The regulatory system of the FAA tries to protect investors from poor advice, rather than relying on investors' being sufficiently financially literate to determine for themselves whether their adviser's recommendations are in their interests. Most clients trust in the knowledge and professionalism of their financial adviser to provide them with good advice.

The FAA has addressed these areas and competency of authorised financial advisers is an essential element. One of the aims of the FAA is to ensure that there are authorised financial advisers who have the experience and expertise to effectively match a retail client to a financial product that best meets that person's need and risk profile.

Under the FAA a Code of Professional Conduct applies to all Authorised Financial Advisers. The code is also the benchmark for the conduct of Qualifying Financial Entities advisers who are generally expected to demonstrate a similar standard of behaviour to AFAs for similar work. The code includes requirements for continuing professional training. The purpose is to maintain the competence of AFAs and require them to keep up-to-date with developments relevant to their business. AFAs must also maintain a professional development plan.

The code is flexible, allowing it to be adapted to changes in the area of financial advice or altered if the current standards prove inappropriate.

To establish a nationally consistent standard the Industry Training Organisation (ITO) model was adopted for the FAA, with ETITO (Electrotechnology Industry Training Organisation) appointed as the ITO. Similar to other national standards, training providers need to be NZQA registered and accredited. Registered and accredited training providers will be able to provide training for all unit standards. To become registered and accredited, provides must meet general NZQA requirements and must demonstrate to ETITO that they have the ability and capability to provide the training.

Current registered and accredited providers of training and assessment are listed in the table below.

Table 3: Registered and accredited providers of training and assessment

Institutes of Technology and Polytechnics	The Open Polytechnic of New Zealand
	Southern Institute of Technology [SIT]
	UNITEC New Zealand
	Waikato Institute of Technology [WINTEC]
	Wellington Institute of Technology [WELTEC]
Private Training Establishments	Adviserlink Ltd
	Australian and New Zealand Institute of Insurance and Finance [ANZIIF]
	IBANZ
	College
	Strategi Institute Limited
Universities	University of Auckland Business School
	Massey University

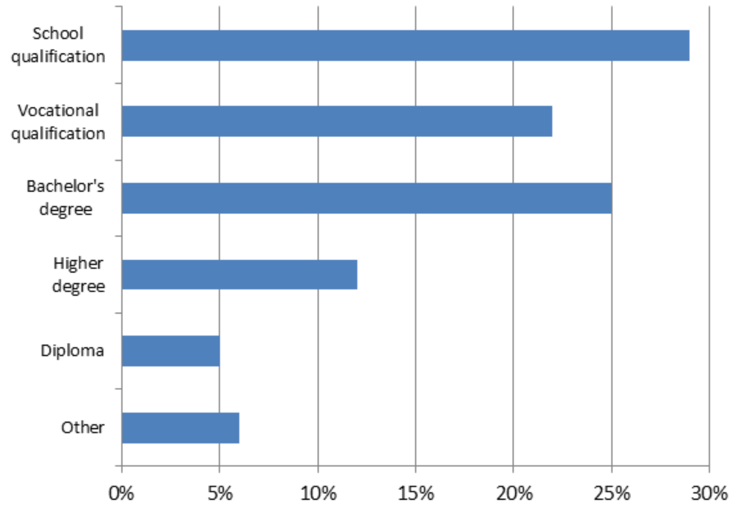
The FAA effectively created a new market - financial advice training – and it will take a while for this market to completely develop in terms of providers, their ability and pricing.

To find out about the current level of competence participants in the MED survey were asked a number of questions related to their skills and experience.

Half of all respondents had a school level or vocational qualification on entering their profession. Some financial advisers may not have had the opportunity to gain higher qualifications because there were fewer options for study available to them at the time when they entered the industry.

Financial advisers were more likely to hold tertiary qualifications (43.8%) on entering the profession than those providing a broking or other service (30.6%).

Figure 6-7: Qualification on entry

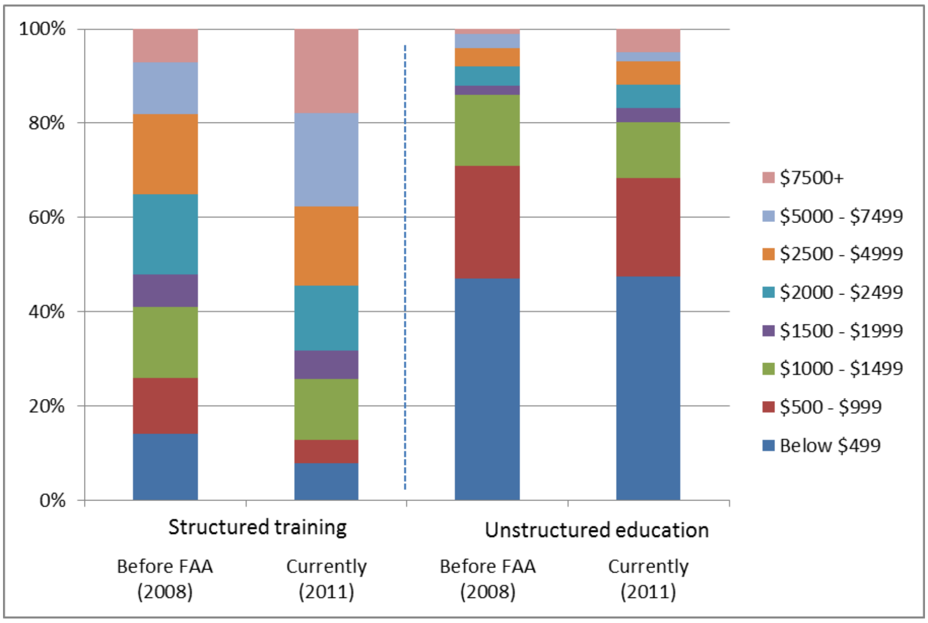


MED (2011), n=348

Participants in the MED survey were asked how much time and money they spent on developing their professional skills in a typical year before the FAA and in 2011. Results are shown in Figure 6-9 and Figure 6-8

There is an increase in hours and costs of structured training and unstructured education such as reading industry magazines has changed as a result of FAA.

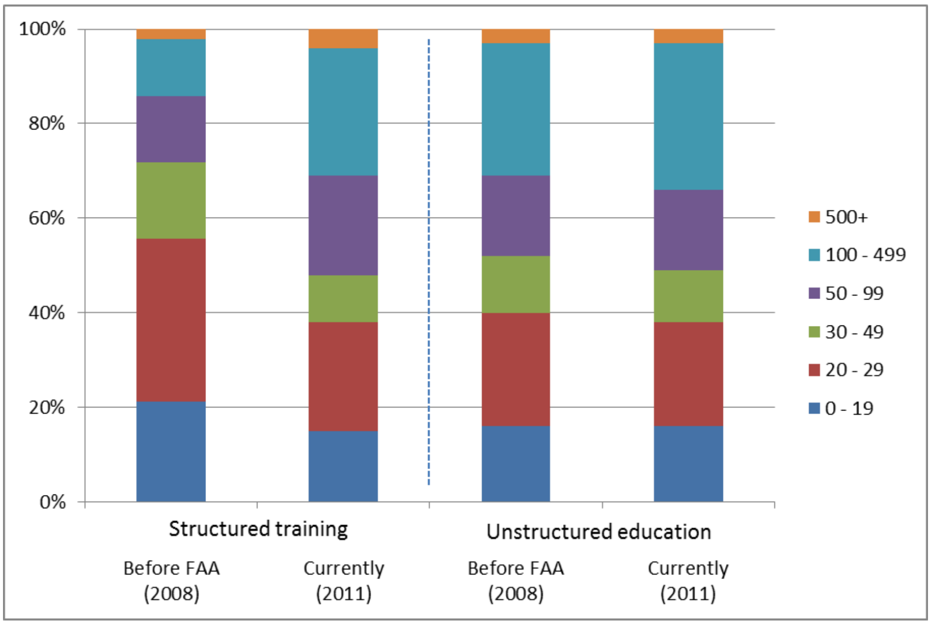
Figure 6-8: Structured training and unstructured education – distribution, estimated cost



Source: MED

The proportion spending more than $5,000 in structured training increased from 18% to 38%. 28% of participants spent over 50 hours on structured training before FAA, but this rose to 52% once the FAA was implemented.

Figure 6-9: Structured training and unstructured education – distribution, estimated hours



Source: MED (2011), n=348

Key themes from survey participants were:

- Continuing professional development is an essential part of being able to do business and Continuing Professional Development (CPD) requirements are an accepted part of industry association membership.
- Training required to be completed was not always relevant or of good quality and there are concerns about the quality of future structured training.
- Statistics do not easily reflect the additional “hidden” costs of training such as time out of the business and lost business opportunities.

Of lesser significance were comments that training is expensive. There is a significant cost to companies who are located outside main centres. The scope of approved organisations that can provide training should be wider and tight timeframes were a burden. It was commented that training for AFAs lacked relevance and quality and previous experience or qualifications should be taken into account more.[30] The amount of time and effort involved in assessing competency was underestimated and time and money was spent unnecessarily due to changing requirements.

6.6 Research

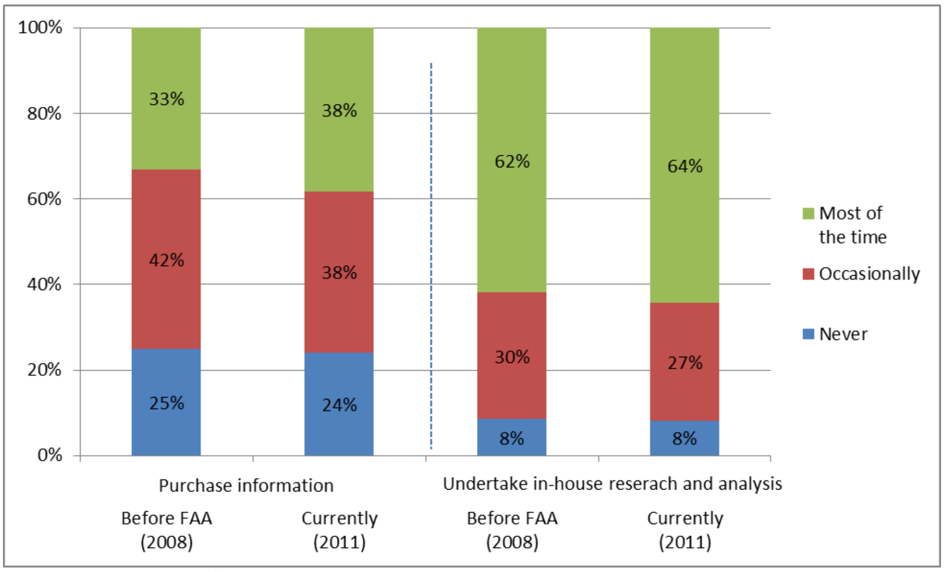
Participants in the MED survey were asked to what extent they or their organisation obtained expert information. While there was no significant change in the in-house research and analysis as a result of FAA, there has been an increase in those saying they purchase information ‘most of the time’.

Survey participants were asked to what extent the amount of research they undertake will change as a result of the FAA. Larger organisations such as banks have their own internal research teams and the amount of research they undertake is not anticipated to change greatly. Other participants said that they will need to spend more time justifying their recommendations, whereas before they could rely on their knowledge and experience. Overall, participants said that the amount of research will increase (29%) or increase substantially (7%). 61% of respondents anticipate no

[30] Placing a greater emphasis on experience is however contrary to the establishment of minimum standards.

change in behaviour, while 3% of respondents think the amount of research they undertake will decrease.

Figure 6-10: Research and information – before FAA and currently



Source: MED (2011)

Another indicator of measuring the quality of financial advice is the number and composition of clients an adviser serves. The MED survey did not detect any significant change in this area. However, although larger companies such as banks may not have been greatly affected, there appears to be some changes in the composition of clients.

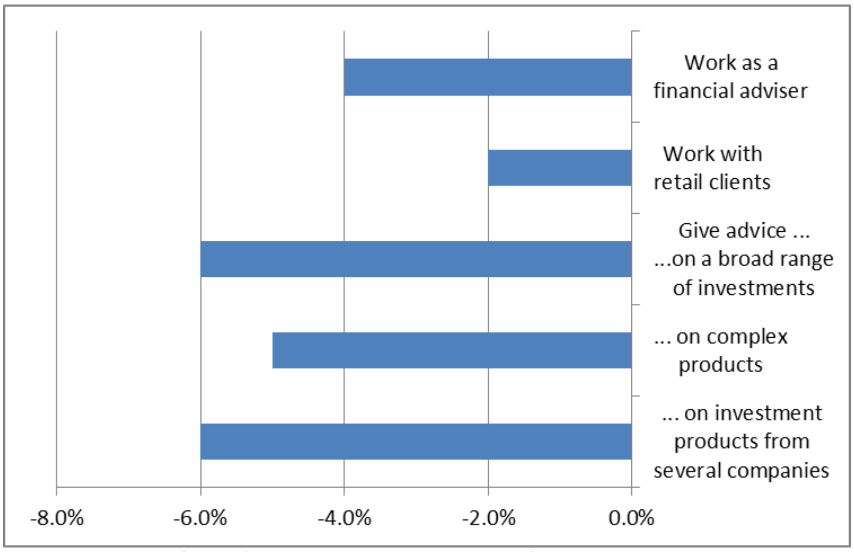
- Client numbers have changed because financial advisers have sold part of their business or merged with other companies.
- The focus of smaller companies has moved to higher net worth clients and they are turning away or divesting themselves of clients who are no longer economic to work with.

6.7 Changing role of financial advisers

This section describes how the role of financial advisers or companies employing financial advisers changed on the introduction of the FAA. Participants in the MED survey were asked about the main tasks financial advisers did in a typical year before FAA and in May 2011. Results are shown in the figure below.

On the introduction of the FAA the number of active financial advisers in the sample reduced by four percentage points. Participants also said that they ceased to work in certain areas of advice. Fewer gave advice on a broad range of investments, on complex products, and on investment products from several companies immediately after the introduction of the FAA (Figure 6-11).

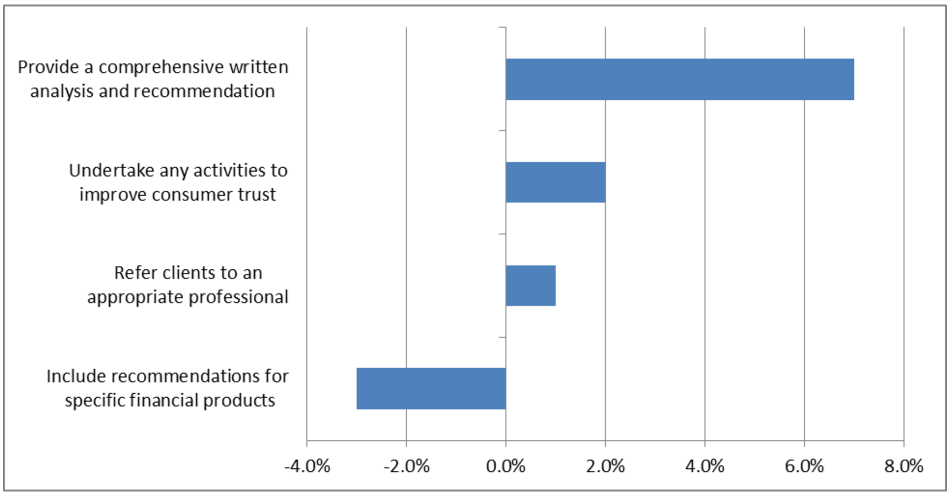
Figure 6-11: Changing role of financial advisers – before FAA and May 2011



Source: MED (2011), n=348, percentage points

On the other hand, the proportion of financial advisers who provided a comprehensive written analysis of the client's financial situation and recommendations increased (Figure 6-12). Financial advisers said that they were trying to improve consumer trust and were referring clients to an appropriate professional more often immediately following the implementation of the FAA when clients ask for advice outside their core competence.

Figure 6-12: Changing role of financial advisers – before FAA and May 2011



Source: MED (2011), percentage points change

Although the data is self-reported, it suggested that there was a behavioural change within the financial industry immediately following implementation of the FAA. It appeared that the level and quality of advice improved. These changes were in line with the objectives of the FAA.

Most financial advisers who provided comments during the survey said that there had been no, or only minimal, change to their role immediately following implementation. Other participants' comments confirmed the quantitative findings regarding the range of services provided and the impacts of the additional paperwork and additional administration.

As financial advisers had moved out of providing financial planning advice immediately following implementation the nature of their services provided had changed. The most significant changes was that fewer financial advisers were providing advice on 'investment review and planning' and also less time giving advice regarding 'KiwiSaver schemes and funds'.

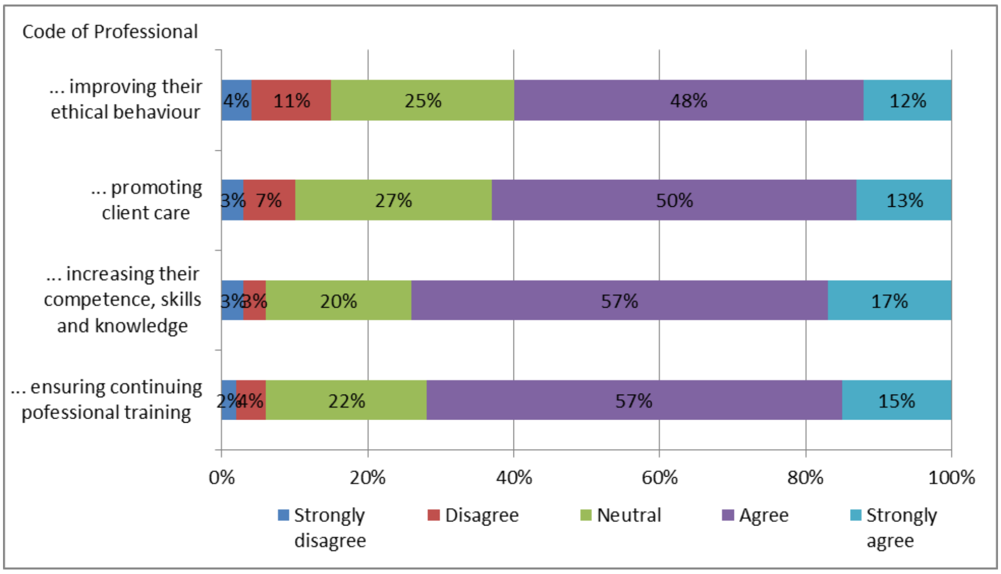
Some survey participants said that they were more wary of risk with the new legislation although the larger QFEs were more likely to have the systems, processes and infrastructure to manage the changes. Comments were also made about the effects on smaller customers and concerns raised that they would have fewer choices and less access to advice than they had in the past.

6.8 Professional conduct and accountability

Participants in the MED survey were asked to what extent the Code will result in advisers making certain improvements. Results are presented in Figure 6-13). On balance, financial advisers are positive about the Code of Professional Conduct. The most positive perceived benefits are that the Code will result in increased competence, knowledge and skills.

Comments by financial advisers made immediately following implementation expressed scepticism that legislation would change the practices of those advisers within the industry who are unethical.

Figure 6-13: Code of Professional Conduct



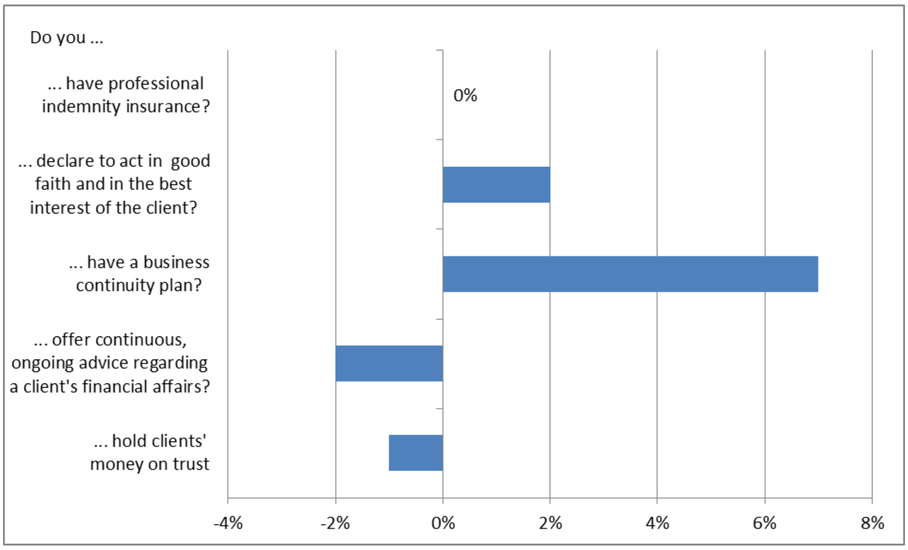
Source: MED (2011)

A smaller proportion of participants said that:

- It would provide a core set of ethical guidelines to use as a benchmark across the industry.
- Industry associations already have existing codes and standards in place so it will not affect advisers who are members of these organisations.
- To be effective, the Code had to have teeth and be enforced.
- The Code was too limited/narrow and did not apply as widely across the industry as it should in order for it to be effective.

Survey participants were also asked about changes in terms of their accountability Figure 6-14. As most financial advisers had professional indemnity insurance before the introduction of the FAA (92%) the FAA did not result in increased insurance. There was only a slight increase in declared acting in good faith and in the best interests of the client. However, there was a significant increase in members with a business continuity plan. It was noted by some participants that this was required to be provided in a prescribed format as part of Adviser Business Statement (ABS) documentation.

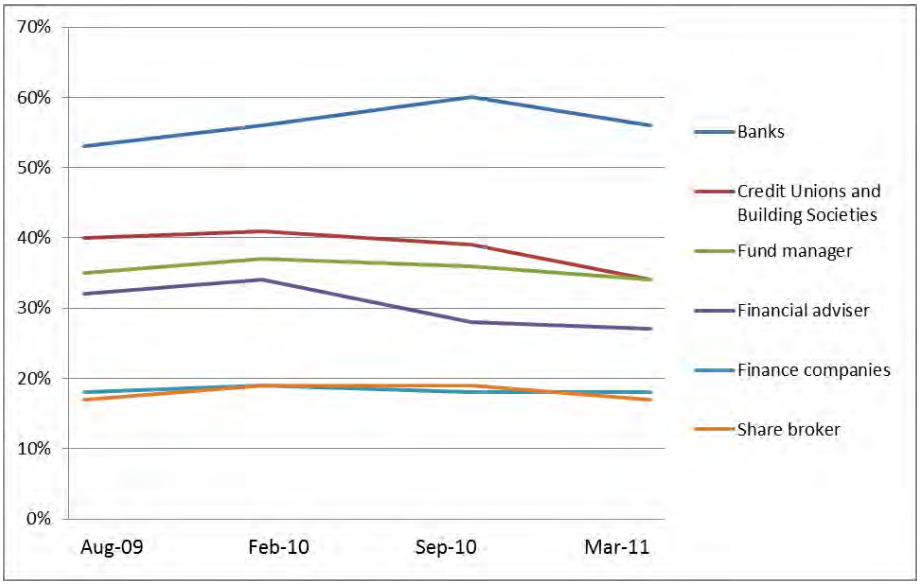
Figure 6-14: Accountability – before FAA and currently



Source: MED (2011), percentage points change

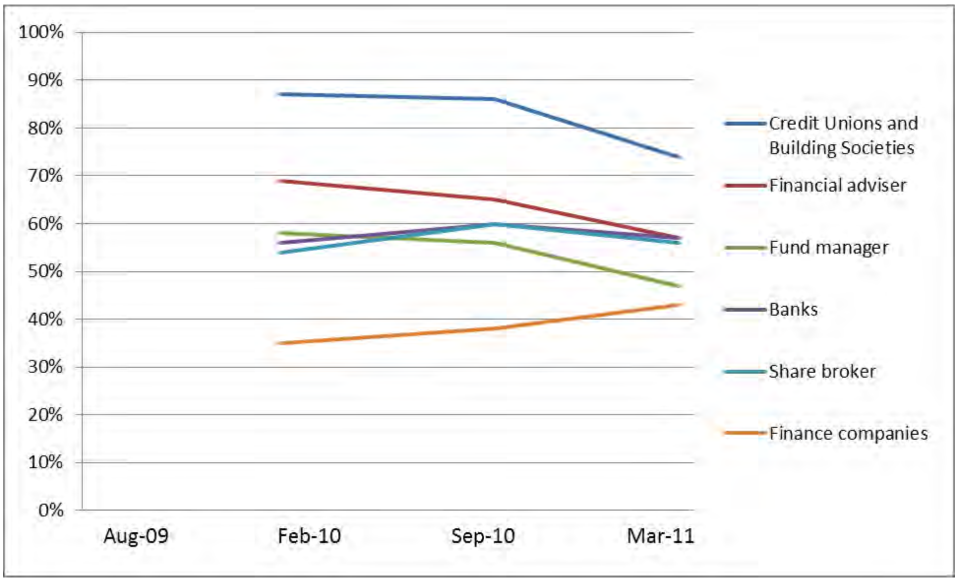
It is useful to compare results from MED's survey in May 2011 with the RaboDirect 2011 survey which measured perceptions of different financial institutions over time amongst New Zealanders (Figure 6-15) and amongst users of financial services (Figure 6-16).

Figure 6-15: Perception "act fairly and with integrity" – amongst all New Zealanders



RaboDirect (2011)

Figure 6-16: Perception "act fairly and with integrity" – amongst users of financial services



Source: RaboDirect (2011)

6.9 Perceived value of legislation

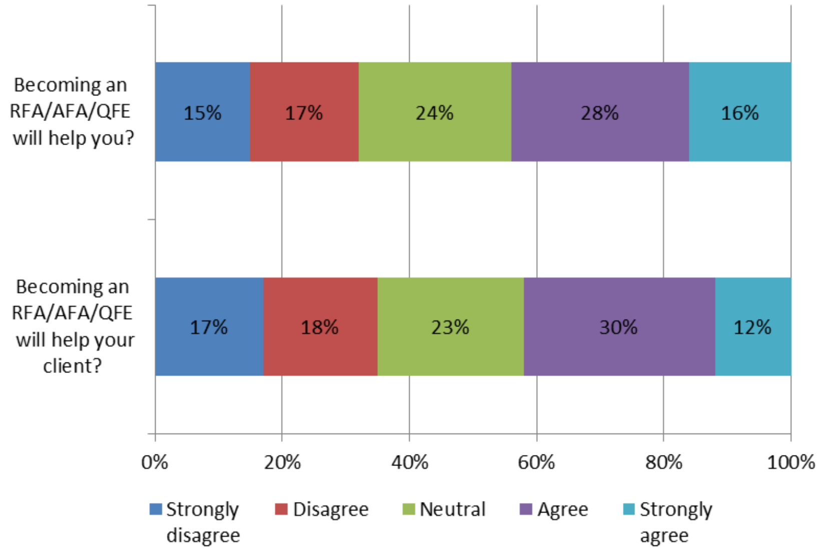
Participants in the MED survey in May 2011 were asked to what extent the FAA helped their business and clients. Results showed that there is a small net agreement (more agreed than disagree) that registration would be beneficial to both the business and its clients (Figure 6-17). Participants who were interviewed felt much more strongly that there would be little or no benefit to them or their clients than those who took part in the online survey.

The view that registration was beneficial varied strongly with the age of respondents. Participants under 40 had a net agreement that registration would be helpful to them of 40%, and to clients, 31%, compared with 13% and -11%, respectively for participants over 60.

The key themes from MED's survey in relation to perceived value were:

- Mandatory registration would provide a baseline standard for the industry, impose discipline and potentially "weed out" the less ethical elements.
- Becoming registered would not help them directly because they already had internal systems and processes in place to ensure quality.
- Increased compliance costs would impact advisers and clients.

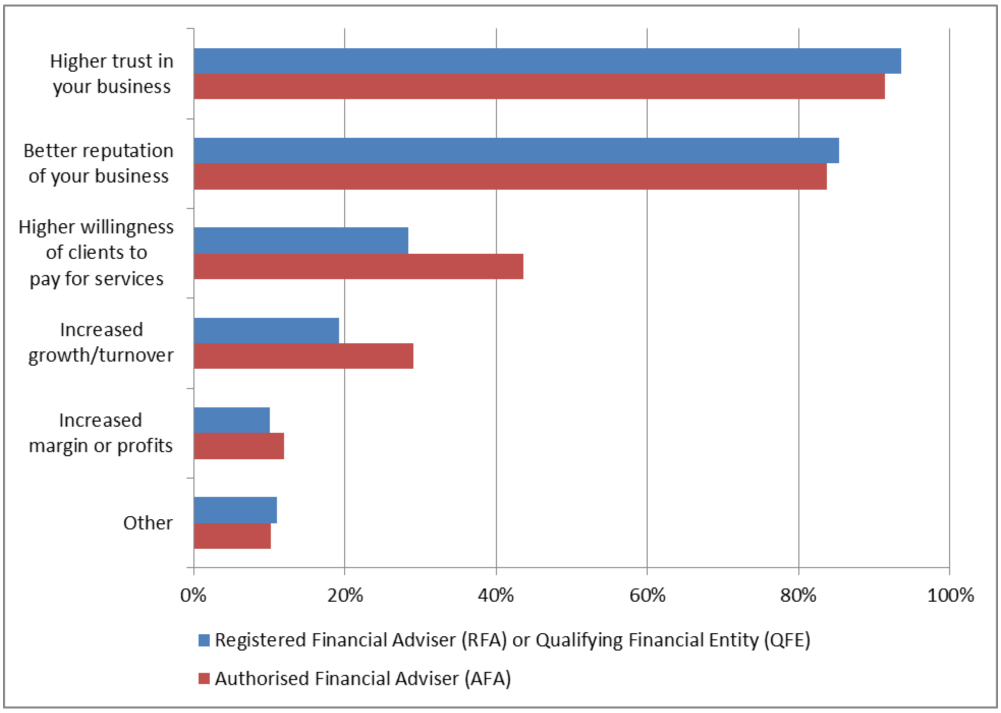
Figure 6-17: Registration is helpful – agreement in %



Source: MED (May 2011), n=348

Financial advisers were also asked in what ways they (or their business) would benefit from being registered or authorised. One out of two RFAs or QFEs (49%) did not expect any benefits from registration. Most expected some benefits from registering as a RFA or QFE in terms of higher trust in and a better reputation for their business. Monetary benefits (increased turnover or profits) were hardly mentioned (Figure 6-18).

Figure 6-18: Benefits of registration – category mentioned by participants in %



Source: MED (2011), n=348

There was a slightly different picture for Authorised Financial Advisers (AFA). More than 62% expected some benefits from registration. A higher proportion of AFAs saw tangible benefits for their business, 44% said clients would be more willing to pay for their service and 29% expected higher growth or turnover.

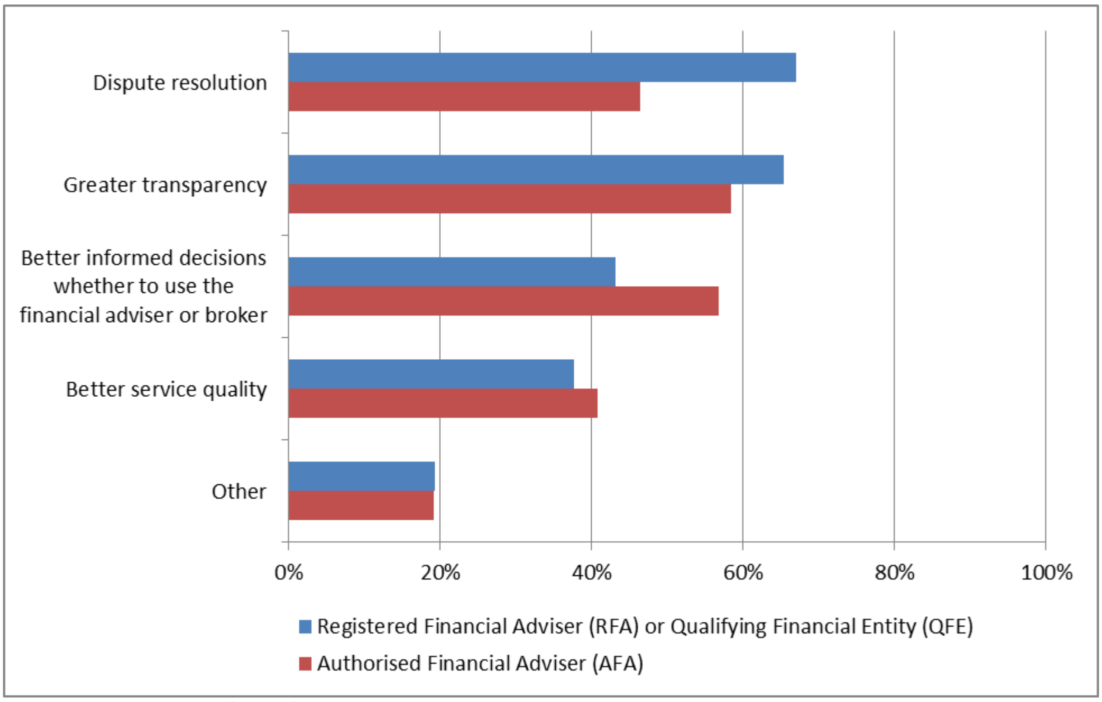
Financial advisers were asked about the expected benefits to clients from registration. A similar proportion of RFAs/QFEs (38%) and AFAs (34%) said there will be no benefit to their clients.

RFAs and QFEs who felt that their clients would benefit said this will be from the dispute resolution provisions and from the greater transparency. AFAs more often said registration would result in greater transparency and it would lead to better informed decisions about whether to use an adviser (Figure 6-19).

Key themes are:

- Registration would promote a higher degree of accountability, professionalism and responsibility within the industry. Clients would benefit from clarity around dispute resolution which provides reassurance that when things go bad there is something they can do about it.
- Compliance would result in additional paperwork and increased costs which would be passed on to clients.
- The general public had limited awareness of the new designations and would need effective education to understand the differences.

Figure 6-19: Benefits of registration to clients – category mentioned by participants in %



Source: MED (2011), n=348

There were also comments, but of lesser significance, that the legislation had a “one size fits all” approach which had caused concerns and there was some sensitivity regarding varying requirements for disclosure.

6.10 Summary

There was a range of diverging views at the time these surveys were done in May 2011 on the perceived overall value of the FAA legislation from the financial industry. On the positive side, financial advisers said they understood stronger regulation was necessary to raise average competency of financial advisers and levels of disclosure, and as a means of enforcing competence testing. They embraced the reform and rationale behind it and saw the process as having introduced some order into the provision of financial advice. While the legislation might have been more complicated than it needed to be, there was acknowledgement that the Financial

Markets Authority (formerly the Securities Commission) had tried to make it as easy as possible. They felt there were aspects of the FAA that were going to work very well while other aspects were going to take longer to bed down. In May 2011, not all the rules had yet come into play, making it difficult to tell what the long-term effects or implications of the changes would be.

Those who took a more negative view described the FAA as being politically motivated, expensive and a "*complete waste of time*". It was described as a "*blunt instrument*" to what was a problem in a certain sector. The issue of poor advice or self-serving from financial advisers was said not to have been addressed but that mortgage brokers and insurance brokers had been caught up in the attempt to correct this. They also said that there was a missed opportunity to provide a level playing field. There was a lack of awareness and understanding of the issues which had resulted in legislation being written by individuals "*for an industry they did not understand*". They felt investors were potentially the biggest losers in all this. In applying the new regulation, administrators and academics were trying to apply principles that might conflict with real life and they would have liked to see more advisor input into how the bar could have been raised so that better and more transparent service was delivered to clients without all the added complexity "*being justified as mandated*". In order to efficiently deliver consumer protection more rigorous controls and an active policy of prosecution would be required.

It had become increasingly difficult for new advisers to enter the industry and there were concerns that the increased costs of training and compliance under the new regulations would have adverse effects in the future, especially on smaller independent companies. Finding suitable employees or people to buy existing businesses might be an issue in the future.

Many participants in the financial industry expressed concerns that the current qualification scheme acted as a barrier to entry. It would take a certain number of years before advisers could get their qualification and this might deter potential new entrants. This situation could create a shortage of financial advisors (especially AFA and independently owned AFA) in New Zealand. Anecdotal evidence showed that a number of older financial advisers were seeking to retire early due to the introduction of the FAA.

Financial advisers and industry representatives said that there had been huge additional time and money costs to run their businesses and comply with the rules. It was felt there were "*too many changes*" to the legislation and it needed more thought put into it rather than being rushed through. In terms of consultation with the industry, the Securities Commission was considered to have done a great job but other government agencies did not consult until they had to be seen to consult. Consultation often had to be done in a rushed way and there was a "*lack of understanding of the impact of some decisions*". Industry associations were consistently saying very similar things, but were not given any feedback.

A range of government departments handled implementation but operationally there was "*nobody across those departments that actually drove the project*". It was suggested it would have been more effective to have had one controlling body with one website who dealt with everything. The implementation was considered to be "*poorly managed*" and the communication described as "*atrocious*". More thought could have gone into making things easier and more streamlined. It all took much longer than anticipated.

The most cited effect on the financial industry was the likelihood of advisers choosing to exit the industry because of the new legislation. As has happened overseas in the UK and Australia, participants said it was likely that many highly successful, ethical and experienced advisers would take the opportunity to leave (and were already doing so). Some would retire earlier than originally planned because they did not want to pay the costs and deal with the additional compliance requirements, while others who were not seeing this as a full-time profession might also leave. It might make it more attractive to younger people to see it as a profession they want to enter.

There were concerns about the number of AFAs being qualified and what effect this would have in terms of the labour market. If the number of advisers becoming AFAs post-regulation was much lower than originally predicted, there were queries about how ongoing costs would be funded and if the lower number of AFAs would be required to carry a higher financial burden than anticipated.

The comments from the financial industry reflected the tensions and concerns regarding the various designations (RFA, AFA, QFE) and their perceptions about them. The Securities Commission/Financial Market Authority was felt to be "*regulating QFEs as if they are the entity equivalent of AFAs*", whereas they were closer to being the entity equivalent of RFAs. It was an "*uncomfortable fit*". There were fears that AFAs would come out better off than RFAs and that QFEs would "*get away with quite a bit*". They were not going to get caught out by providing advice on their own product, whereas from a broking point of view other advisers would have to give correct advice on a range of products that were in the marketplace. AFAs were accountable in a disciplinary sense and there was a quite heavy licensing system with the AFA Adviser Business Statement but the licensing system for QFEs was "*not very clearly defined*". The good advisers were all now made accountable as AFAs while the problematic advisers who brought the reputation of the industry down had been "*provided with a 'lifeline' called RFA, or they will hide behind a QFE*". The intent of the Act was never to include mortgage brokers and it added unnecessary regulation and expense to the industry.

If advertising was done in the future it should educate the general public about the differences between the different categories of registration, and that "*to buy a product these days they have to go through a process*".

There was a range of views relating to the content and delivery of educational components and the resulting issues they had encountered. Financial advisers and industry representatives said that to be effective, the educational components for their Continuing Professional Development (CPD) needed to be of value to the adviser or their business, not something done just for the sake of it. It was felt there should be some consideration for experience such as providing a two tier continuing education credit system where those who had reached a certain level of experience were allowed to focus less on structured training and more on unstructured training. Some of the content in training courses was reported to be of very "*low quality*" and "*not current*". However, it was hoped the standard will be improved over time.

If a certain level of competence was required then courses and qualifications had to be available for people to be able to prove their competence. There were issues where assessors could not become qualified as assessors until the qualification had been developed which meant people were not able to prove their competence to become an AFA and were affected by tight timelines. There were said to be "*quality issues*" in ETITO's questions, exams and product release information and problems with their processes. Their website and instructions were "*highly complicated*". AFAs who had gone through the ETITO process, the Open Polytechnic or Adviserlink courses had not been tested on the same information and had not had to provide the same level of information to attain that examination so there were concerns that the outcome would be differing standards. The exams that had been devised were not considered to provide a good measure of advisers' competence to do the job.

Regarding the effects of the legislation on clients there was a strong feeling that "*clients are going to be disadvantaged*". They were not necessarily going to get better advice and the opportunity for them to receive impartial independent advice might be "*seriously eroded*". Advisers might not be offering the same level of service and would walk away from helping clients they would have helped in the past because compliance now meant they were not able to make any money. A reduction in adviser numbers and fewer than expected AFAs being qualified was "*not a good omen for low net worth clients*". Advice could end up being limited to "*large soulless organisations (banks) who will determine 'A' clients and price out small investors and families*".

There were concerns about simple products being included under category 1 products, and there needed to be some allowance to provide advice to smaller clients with relatively straightforward needs (e.g. for KiwiSaver) without having to spend many hours preparing 30-40 page documents. The detail required to be provided to clients to meet the requirements of the code had increased markedly, and clients would end up with significantly more information given to them which they "*will not read*" as opposed to what they had been given in the past which was "*all they want and need*".

PART FOUR

EVALUATION OF FINANCIAL ADVISER REGULATIONS

7. Evaluation of the Financial Advisers Act 2008

The FAA is scheduled to be reviewed five years after its implementation. In this chapter we propose a framework for future evaluation.

Evaluation will answer the following questions:

1. What outcomes are expected from the FAA, are the policy objectives relevant and are they clearly elaborated?
2. What are the interdependencies for the success of the FAA?
3. What performance measures would determine success of the FAA and how will the FAA be evaluated in the future?

7.1 How will the expected objectives translate into outcomes?

To recap, the overall aim of the FAA is to promote the sound and efficient delivery of financial advice, and to encourage public confidence in the professionalism and integrity of financial advisers and brokers. There are 3 objectives to the FAA:

1. Disclosure ensures that retail clients can make informed decisions
2. Competency ensures that there are certain financial advisers who deal with retail clients who have sufficient experience, expertise and integrity to match effectively a person to a financial product that best meets that person's need and risk profile
3. Accountability ensures that financial advisers are held accountable for any financial advice that they give and that there are incentives for financial advisers to appropriately manage conflicts of interest

The implementation of the FAA led to some immediate outputs and outcomes. One of the direct outcomes is a publicly available register of financial advisers. It enables the public to identify financial advisers, the dispute resolution scheme they belong to, and the financial services they are registered to provide, including any licensed service (AFAs or QFEs). There are some people who cannot register. People who have been convicted of crimes involving dishonesty (such as fraud) and undischarged bankrupts. Banned directors will also not be able to register. However, will consumers and investors make effective use of the register when choosing a financial adviser?

The FAA introduced different types of financial advisers. Are these categories understood by consumers and do they know the difference between a registered and authorised advisers regarding their level of qualification or how conflicts of interests are managed? Or do the different types raise more questions and consumers and investors feel confused?

There are also mandatory competence and continuing professional training requirements for authorised financial advisers. But only a future evaluation will show whether these have made a substantial impact in the sense of better advice or if they merely increase entry cost in the industry. How many financial advisors are not authorised because they do not meet the competency requirements in the Code (weed out under-qualified candidates)?

These systems (training, disclosure, etc.) have already been established (see section 3.3) but the quality of the systems and their impact have not yet been evaluated. The future evaluation will also include the expected final outcomes of the FAA:

- Consumers increase their use of financial advisers: increased financial savings due to better advice;
- NZ's financial adviser regime in line with international best practice and trans-Tasman coordination improves.

7.2 What will success look like?

The final success for the FAA will be demonstrated when

- The New Zealand financial adviser regime is in line with international best practice;
- Regulatory cooperation between Australia and New Zealand has improved;
- Consumers can make informed investment decisions;
- Consumers can judge the quality of financial advisers;
- Consumers can determine the interests and incentives of financial advisers;
- Consumers increase their use of financial advisers.

The FAA is not about guaranteeing high returns or avoiding losses to investors. Investors always run the risk of lower than expected returns and even losing money. A successful FAA and a competitive financial adviser industry will result in fully informed choices, transparency, minimum standards of competence, knowledge and skills and the effective market surveillance by the financial regulator.

A successful FAA includes financial advisers attaining the requisite levels of skills needed to create greater confidence in investors and consumers of advice. The FAA has focused so far more on requirements regarding skills. The market for financial advice has not yet reached the point where there is a track record on which higher confidence can be assessed. To build up or to re-establish confidence and trusts takes time; and whether this translates into higher confidence will only be seen in the future. The lack of market confidence can have several detrimental outcomes. It can adversely affect consumer demand and make it not worthwhile for firms to innovate and increase product offerings, thereby reducing choice. Another outcome is that lack of confidence leads to higher transaction costs and efforts spent by market participants to overcome confidence problems in the market, e.g. increased costs of reputation building. The worst case scenario emerges when lack of confidence exacerbate contagion effects. Market participants perceive bad advice not as a 'single' incidence but that there are wider problems in the system, leading them to make less use of advisers or even withdraw funds.

Building a competitive and trustworthy financial adviser industry in New Zealand overlaps with capital market reforms. A well-functioning capital market relies on the participation of investors. An effect of low participation is a higher cost of capital for New Zealand firms, given that capital markets are not perfectly integrated across countries.

While the FAA targets reducing market failure, mitigating risks and improving incentives it also imposes costs, e.g. mandatory training, that may be disproportionate to the economic problems it seeks to address in the market. Direct measurement of improvements in market outcomes due to regulatory intervention is difficult in practice. Hence, actual measurement will require systematic analysis and measurement of the mechanisms through which regulation delivers benefits and improves market outcomes.

The FAA has an impact along more than one dimension of market outcome and also involves direct and indirect costs. The FAA may improve transparency in the market but have a negative impact on the number of and competition between financial advisers. However, while increased regulation could affect market efficiency, the benefits it will deliver, in terms of increased investor confidence causing retail investors to re-enter the market, may outweigh the costs. The FAA may exacerbate rather than reduce existing problems. It could give consumers a 'false' impression of security while potential conflicts of interest, e.g. commissions, continue to exist. The future evaluation of the FAA will need to consider all these dimensions.

7.3 Evaluation timetable and scope

The evaluation of the FAA will be undertaken by MBIE and is scheduled for 2016. The evaluation will cover the underlying rationale for the regulation, efficiency of implementation, and an assessment of outcomes.

One of the policy rationales of the FAA is an underlying information problem in the market for financial advice. Incomplete product disclosure or the provision of financial advice can make it difficult to make fully informed financial decisions. The complexity and number of financial investment opportunities will probably increase in the future and make it even more difficult for interested consumers to make informed decisions. Mandatory disclosure (conflicts of interest, fees and competency) can help to reduce information asymmetries and contribute to a better functioning market for both investors and firms. Consumers should be able to judge the quality of the financial advice they are getting. The future evaluation will look at the rationale for the FAA regulation, future market developments and unintended consequences that might lead to a revision of the policy rationale.

The implementation review will involve a review of outputs from a quality and process perspective and will include FMA, the Companies office and other involved organisations like the Ministry of Consumer Affairs and Dispute Resolution Scheme Providers. The evaluation will include a review of the processes that have been used for communication, authorisation, market monitoring and surveillance, complaint handling, investigation and enforcement.

The future evaluation will consider whether the policy has effected change and whether this change exceeds what would otherwise be the case without the new regulatory measure.

The terms of reference for the evaluation will be mutually agreed between MBIE and FMA. However, MBIE suggests that key questions for the evaluation may include:

<u>*Implementation*</u>

- *Has the FAA been implemented as planned?*
- *What outputs (quantity and quality) has the FAA delivered?*
- *Are all those offering financial advice on a professional basis and intended to be regulated covered by the new regime?*
- *How do the different organisations involved in the FAA (FMA, Companies Office, etc.) work in practice?*
- *What has been the cost of implementation and operation?*
- *Is the current level of funding adequate? How does it compare with similar regimes elsewhere?*

<u>*Impact*</u>

- *What are the observed outcomes of the policy?*
  - *Have there been any changes to the consistency and standard of financial advice?*
  - *Are the competency requirements and minimum training standards adequate (particularly given complexity of products)? Are they consistent across the industry? Or did they just increase the entry costs?*
  - *Has consumer confidence in financial advisers improved as a result of the regulatory changes?*
  - *How have the different stakeholders been affected by the new regime?*
  - *Has the alignment with Australian regulation led to more competition or greater choice for consumers in NZ? Any other benefits?*
  - *Has demand for financial advice increased as a result of the new regime?*

- *Do current regulatory arrangements protect consumers from poor financial advice and its consequences?*
  - *Can consumers identify varying capabilities?*

- *Is conflict of interest disclosure adequate? Do consumers understand conflicts of interest?*
- *Have disclosure documents led to more informed decisions?*
- *Has the FAA restructured the scope and choice of advice offered?*

- *What is the interplay between the different types of financial advisers (RFA, AFA, QFEs) regarding disclosure and other aspects? Is the licensing system sufficient?*
- *Has the code of professional conduct lead to any change in behaviour?*
- *Is oversight of financial advisers adequate? What is the number of actions taken against financial advisers (complaints, non-authorisation, and removal from the register)?*
- *Has implementation of the policy led to the intended outcomes?*
- *Would observed benefits have been realised in the absence of the new regulation (i.e. what difference has implementation of the policy made)?*
- *What are the unintended outcomes (positive and negative) of the policy?*
- *What is the impact on the shape of the industry and competition?*
- *Has more trans-Tasman coordination been implemented and what does it look like?*

<u>Wider policy questions</u>

- *Are there changes that could be made to the design of policy that would improve its effectiveness?*
- *How effectively has the policy worked with other, related, policy?*
- *Does the policy problem still exist, i.e. is there still a role for government? Is this role the same or different to when the policy was established?*
- *Is the current regime adequate for dealing with the current situation regarding financial advisers?*
- *Does the policy follow regulatory development in Australia?*

The evaluation will be accompanied by a Steering Group that involves stakeholders from government and FMA.

7.4 Monitoring and future data collection

An assessment of the success of the FAA is likely to require analysis based on qualitative and quantitative inputs.

The following organisations are involved in the implementation of the FAA, collect data on a regular basis and are able to deliver data for the evaluation. It might be necessary to repeat parts of the MED survey or the RaboDirect Financial Confidence Survey in the future. The Ministry of Consumer Affairs intends to include questions regarding financial advice in one of its future consumer surveys.

Part of evaluation	Information source	Purpose
Authorisation of AFAs and accreditation of QFEs	FMA	Implementation
Commissioner for financial advisers	FMA	Implementation
Code of conduct for financial advisers	FMA	Implementation
Register of Financial Service Providers	Companies Office	Implementation
Dispute resolution	Consumer Affairs	Implementation
Training arrangements and skills	ETITO	Implementation
Efficiency: costs of implementation, barriers to entry	FMA, companies office	Implementation
Competency of financial advisers	ETITO, FMA	Intermediate outcomes
Minimum conduct and disclosure standards	FMA disciplinary committee	Intermediate outcomes
Accountability of financial advisers	Dispute resolution organisations, Ministry of	Intermediate outcomes

	Consumer Affairs, FMA disciplinary committee	
Conflict of interests	Dispute resolution organisations, FMA disciplinary committee	Intermediate outcomes
Disciplinary committee, compliance	FMA	Intermediate outcomes
Competitive financial adviser industry	RaboDirect Financial Confidence Survey	Intermediate outcomes
Consumer confidence in financial advisers	Ministry of Consumer Affairs National Consumer Survey, RaboDirect Financial Confidence Survey	Final outcome
Increase use of financial advisers	Ministry of Consumer Affairs National Consumer Survey, RaboDirect Financial Confidence Survey, own survey	Final outcome
International best practice	FMA	Final outcome

When direct measurement of outcomes is difficult, there is a need to identify and measure proxies which are themselves good and robust indicators of changes in the desired market outcomes. Indirect measurement focuses on proxy metrics that provide an indication of the degree to which regulation reduces the underlying market failure, mitigates risks, and/or aligns incentives.

7.5 Related evaluations

It is a requirement of the FSAP that, not more than five years after commencement of the Act, the operation of the both the register and the dispute resolution schemes be reviewed. The Ministry of Consumer Affairs is responsible for conducting these reviews.

Chapter 4 already highlighted influences on the financial adviser industry besides the FAA.

Financial advisers must belong to one of four approved financial dispute resolution schemes.

Dispute resolution scheme	Details	Membership cost
Financial Services Complaints Ltd	An independent, not for profit, scheme. Provides dispute resolution services to participating financial service providers and their clients.	$515 joining fee individual advisers, $310 to $515 annual fee $1,025 to $3,075 joining fee QFEs, $105 to $310 per adviser annually or $15,375 company fee
Insurance and Savings Ombudsman	Set up in 1995 by the insurance industry to resolve disputes between consumer and insurance and savings companies.	$400 incl GST individual financial advisers and representatives of QFEs $400 - $14,000 financial adviser business (dependent on number of advisers)
Banking Ombudsman	Investigates and resolves disputes between customers and their banking service providers.	
Financial Dispute Resolution	The government reserve scheme. Since 1st July 2011 has been an independent Crown company.	$500 base fee for individual fas (4 or less) but no base for sole operations. $1,000 base 5 or more + price/adviser? $1,000 base QFE + price/adviser ($100-$200, maximum $20,000).

A complaint by a consumer is heard by the scheme to which the financial adviser or provider belongs. The schemes can investigate the following types of complaints:

- Breach of contract
- Not following industry codes of practice
- Conduct that is not fair or reasonable

- Breaking the law

As noted in Section 4.2 the Securities Act 1978 is currently under review. The Financial Markets Conduct Bill is still under consideration. How and when a review is foreseen is unclear at this stage.

8. Conclusions and recommendations

- Our starting point for the baseline review was the new financial adviser regulation, a number of reports related to financial advisers and their products and services (Report of the Capital Market Development Taskforce, MED discussion document, Report prepared for Financial Services Authority) and surveys (RaboDirect Financial Confidence survey, National Consumer survey, own MED survey of financial advisers).

- This baseline review describes the financial advisers industry at the time of implementation of the new regime in May 2011. MED estimated that, before the time the FAA was implemented, around 11,300 financial advisers existed in New Zealand. Based on the research conducted in this review, we believe that the MED estimate is a fairly accurate assessment of the number of financial advisers before the new financial adviser regulation was implemented in 2010. According to our sample of financial advisers, there was a significant cost in terms of time, money spent and opportunity costs on most parts of the implementation process.

- There is a requirement that the new regulatory regime has to be reviewed five years after its implementation. We outline a framework for future evaluation of the new regulatory regime. We propose to look at expected outcomes and the policy objectives, how they translate into outcomes and impacts, and what success of the new regime looks like.

To ensure that the future evaluation is a helpful input to further policy development the government agencies involved in the design and implementation of the new regime need to have an agreement on the evaluation framework (MBIE, FMA, Ministry of Consumer Affairs). This would include:

- a common view on what success of the new financial advisers looks like;
- a common methodology for the evaluation;
- relevant data gathering from a number of sources as input in the evaluation, in particular from monitoring and surveillance of market participants;
- feedback mechanisms to further understand the policy environment of financial adviser industry and to identify issues associated with financial advisers.

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10. Appendices

10.1 Categories, requirements, and exemptions of the FAA

The FAA sets up a tiered approach to regulation. In addition to basic requirements (registration, dispute resolution scheme), specific types of financial advisers are subject to additional regulatory requirements.

Types of financial advisers

Under the FAA there are three types of individual "financial adviser"[31]:

1. A financial adviser who is authorised and registered (called an authorised financial adviser);
2. A financial adviser who is registered but who is not authorised; and
3. A financial adviser who is neither authorised nor registered but who is an employee or agent of a qualifying financial entity (QFE)[32].

There are restrictions as to what financial products and services each type of financial adviser may advise on. In order to become a QFE an entity must obtain approval from the Financial Markets Authority (FMA), the single securities market conduct regulator.[33]

The FMA explains in detail how to apply to become an Authorised Financial Adviser (AFA).

The steps required for authorisation are fully explained in the "AFA Authorisation guide"[34]. The main requirements are:

- Register with ETITO
- Obtain evidence for proof of competence.
- Prepare an Adviser Business Statement (ABS).
- Join a dispute resolution scheme

Financial adviser services

As noted in section 1.1 the FAA provides for three categories of "financial adviser services":

1. Giving financial advice, i.e. give recommendations or opinions in relation to acquiring or disposing of a financial product
2. Providing investment planning services, i.e. design an investment plan for an individual based on an analysis of the individual's financial situation and goals
3. Discretionary investment management services, i.e. deciding which financial products to acquire or dispose on behalf of a client.

[31] Overseas financial advisers who advise clients based in New Zealand are subject to the normal requirements under the FAA unless they only give advice to wholesale clients in which case no licensing, conduct and disclosure obligations apply.
[32] An organisation might want to become a QFE if they employ a large number of financial advisers. QFE status enables an organisation to streamline the registration, disclosure, dispute resolution and supervision arrangements that will apply to its advisers under the financial adviser regime. In return, the QFE takes responsibility for its advisers' compliance.
[33] FMA was established on 1st April 2011 and assumed the powers and responsibilities of the former Securities Commission, as well as some of the functions of the Companies Office and the Government Actuary.
[34] http://www.fma.govt.nz/media/143464/afa-authorisation-guide.pdf

Only Authorised Financial Advisers can provide investment planning services. The other services may be provided by the other categories of financial adviser, but restrictions relating to the types of financial products and the type of client apply.

Across the three categories of financial adviser service there are two further distinctions:

1. "Personalised" financial adviser services ie services that are provided to a named client or a client that is otherwise readily identifiable by the financial adviser where the financial adviser has taken into account the client's particular financial situation or goals in providing the service or in the circumstances in which the service is provided the client would reasonably expect that the adviser has done so
2. "Class" financial adviser services: anything that is not a personalised service, e.g. brochures, seminars and internet material targeted towards a wide class of people rather than an individual.

Clients

The FAA provides for two categories of "clients":

1. Wholesale clients and
2. Retail clients.

Under the FAA retail clients are distinguished from the following categories of (wholesale) clients: (a) financial advisers, brokers or other financial service providers who receive a financial adviser service or broking service in the course of their business (b) a person whose principal business is the investment of money or who, in the course of and for the purposes of their business, habitually invests money (c) large entities (defined as having at least NZ $1 million net assets or turnover at the end of each of the last two completed accounting periods) (d) related body corporates of large entities (e) certain state sector entities (e) in relation to services relating to securities offered or to be offered to a person in a private offer of securities persons who fall within one or more of the categories listed in section 3(2), 5(2CB) or 5(2CBA) of the Securities Act 1978 (f) eligible investors (being those investors that have sufficient financial knowledge, skills or experience to assess the value and risks and the merits of the service to be provided and have completed a certificate confirming they are an eligible investor).

Authorised Financial Advisers, individual Registered Financial Advisers and QFE Advisers may provide financial adviser services to both retail and wholesale clients.

Financial products

Under the FAA financial products are separated into two categories:

1. **Category 1 products**: these include securities (other than a security that is a category 2 product), land investment products, interest-linked contracts of insurance, and futures contracts.

2. **Category 2 products**: these include bonus bonds, call debt securities, call building society shares, call credit union shares, co-operative company shares, units in cash or term portfolio investment entities, bank term deposits, contracts of insurance (other than an investment-linked contract of insurance), life insurance policies (excluding a life insurance policy before 1st January 2009), and consumer credit contracts.

The type of adviser, and what advisers need to do to comply, partly depends on whether advisers offer category 1 or category 2 products. Category 1 products have more of an investment focus. Category 2 products are generally less complex. Only Authorised Financial Advisers and QFE advisers can give personalised advice to retail clients on category 1 products. QFE advisers are limited to advice on category 1 products promoted or issued by their QFE. Personalised advice on category 2 products can be given by Registered Financial Advisers and QFE Advisers. However, if advice on category 2 products is given as part of providing an investment planning service, then the adviser must be authorised as well as registered.[35]

Financial advisers' obligations

The FAA establishes different tiers of disclosure and conduct obligations for financial advisers according to the complexity and risk posed by the financial service given.

Registered financial advisers must be registered and be members of a dispute resolution scheme if they offer services to retail customers, must make simple disclosure to clients and must abide by minimum statutory standards of client care.

Authorised financial advisers must be registered and be members of a dispute resolution scheme if they offer services to retail customers. They must also make detailed disclosure to clients, and must not recommend the acquisition of securities if an offer for subscription is illegal. While authorised financial advisers are subject to the same minimum staturtory standards of client care obligations as registered financial advisers they must also comply with a Code of Professional Conduct (the "Code")[36] and with the Standard Conditions for Authorised Financial Advisers. The Code lays down minimum standards of client care, ethical behaviour and competence, knowledge and skills along with minimum requirements for continuing education and training.

An exception to the above rules is the Qualifying Financial Entities (QFE) model. While a QFE has to be registered and given QFE status under the Act, an individual who is an employee or agent of a QFE does not need to be registered. In such cases, the QFE takes responsibility for ensuring that its advisers comply with the FAA. This model allows entities with large numbers of financial advisers to operate more efficiently. However, an agent or employee of a QFE must be authorised in order to provide an investment planning service or provide personalised advice to retail clients on category 1 products that are not issued or promoted by the QFE.

Exemptions and exclusions

In certain circumstances it may be possible to obtain an exemption from being registered as a financial adviser or from any of the obligations under the Financial Advisers Act 2008, regulations or the Code of Conduct, e.g.

- Under section 5A of the FAA financial adviser services that are provided internally within a business or certain related businesses are excluded from the regulatory requirements.
- In section 10 of the FAA certain types of financial advice are excluded from the regulatory requirements.
- In section 13 of the FAA "incidental" financial adviser services are exempted from the regulatory requirements. This exclusion applies where the financial adviser service is provided only an incidental part of another business that is not otherwise a financial service or does not have, as its principal activity, the provision of another financial service[37].

[35] See the flowchart in Annex 10.7 to help identify what type of financial adviser there are.
[36] The Code came into force on 1st December 2010. For a detailed description of the Code, refer to www.fma.govt.nz
[37] Example is a co-operative company marketing their member shares to prospective members.

- In section 14 of the FAA certain professions and occupations are exempted from the regulatory requirements[38].

- Certain other activities and persons are also exempted from the regulatory requirements of the FAA, , e.g. not-for-profit organisations providing free financial adviser services

- Under section 148 of the FAA the Financial Market Authority (FMA) is granted a wide-ranging exemption making power. The FMA may exempt any person or class of persons from any obligation under the FAA, any regulations made under the FAA, or the Code of Conduct.

Summary of requirements

The different types of financial advisers and their regulatory requirements are summarised in the table below.

Authorised financial advisers are selected by the FMA for monitoring reviews. Selection may be random, risk-based, targeted-based on information received or part of a theme, eg researching a particular service, or exploration of a potential industry problem.. FMA's monitoring activities include a mix of desk-based research (investigating complaints, checking websites, and reviewing documents), phone discussions and office visits. They may also use mystery shopping.

FMA monitoring and surveillance work with QFEs is

- risk-based, i.e. taking into account information on the nature, scale and extent of the business and the compliance controls;
- targeted – based, i.e based on information received; and
- theme-based: i.e. researching a particular service, or exploration of a potential industry approach or problem

FMA also monitors to a more limited extent RFAs.

[38] Exempt professions include teachers and lecturers, journalists, certain members of the state sector, lawyers and legal executives, conveyancing practitioners, chartered accountants, tax agents, real estate agents and registered valuers, directors, authorised futures dealers.

Table 10-1: Obligations of financial advisers under the FAA

Obligations for all types of financial advisers			
Financial advisers must: • exercise due care, diligence and skill. They must take into account the nature and requirements of their client.			
• not engage in misleading or deceptive conduct			
• ensure advertisements are not misleading, deceptive or confusing			
• comply with disclosure obligations when providing personalised services to retail clients			
• where applicable, register and annually renew their registration and notify the Registrar of changes, ie QFE advisers and exempt providers may not have to register or join a dispute resolution scheme			
• where applicable, be a member of a dispute resolution scheme (if providing services to retail clients)			
Other obligations depending on the sort of financial advisers			
	Registered Financial Advisers (RFAs)	Authorised Financial Advisers (AFAs)	Qualifying Financial Entities (QFEs) Advisers
Adviser Business Statement	No	Have and maintain an Adviser Business Statement	Have and maintain an Adviser Business Statement
Compliance	Minimum standards of client care.	• Comply with the obligations of the Code of Professional Conduct • Comply with the terms and conditions of authorisation	• Comply with the terms and conditions set out in the QFE's grant of status (including members, employees and nominated representatives) • Ensure that employees and nominated representatives comply with their financial adviser obligations
Reporting	No	notification obligations and reporting under the Standard Terms and Conditions	Submit an Annual Report to the Financial Markets Authority
Monitoring and Surveillance	FMA will follow up queries and complaints and take appropriate action. FMA will check to see whether RFAs are providing services, which can now only be provided by AFAs. FMA also monitors advertising by RFAs through web-based research and may undertake	Systematic	Systematic

	mystery shopping visits and review RFA documents.		
Disclosure	Limited disclosure is required where a personalised service to a retail client is provided.	AFAs must make both primary and secondary disclosure where a personalised service to a retail client is provided. Additional information must also be provided (Standard 7 in the Code of Professional Conduct).	Additional requirements set out in a QFE's standard conditions.
Financial adviser services	Financial advice or discretionary investment management services for category 2 products. They can also provide class services and services to wholesale clients. They cannot provide an investment planning service.	• AFAs can provide the same services as an RFA, but can also provide services in relation to category 1 products, and can provide an investment planning service	Financial advice and discretionary investment management under restrictions relating to types of product and client

10.2 List of professional associations

Financial advisers belong to a wide range of professional association. The list below is non-exhaustive.

Adviser & Adviser Business Association
Adviser Business Association; AXA Advisers Association
Allied Kiwi Mortgage and Insurance Aggregation Group
AMP Advisers Association
Estate & Tax Planning Council
Fellow of the Chartered Institute of Secretaries & Administrators
Financial Markets Association
Financial Services Federation
Financial Services Institute of Australasia
Institute of Finance Professionals
Institute of Directors
Institute of Financial Advisers"
Insurance Advisernet New Zealand
Insurance Brokers Association
Insurance Institute
Life Brokers Association
NZ Bankers Association; Australasian Banking Institute
NZ Law Society
NZ Mortgage Brokers Association
Professional Advisers Association
Risk Management Institute
Society of Independent Financial Advisers

10.3 Survey of financial advisers

MED commissioned research to obtain data on financial advisers in New Zealand and describe some of their characteristics. A questionnaire of financial advisers was developed in conjunction with Andrew Fletcher Consulting. There were two aspects to the research - an electronic survey, which mainly gathered quantitative information from financial advisers and more in-depth interviews.

The target sample size for the survey was 300 financial advisers. The survey was online from 9 to 30 May 2011. Invitations to participate in the survey were sent from 9th to 11th May 2011 to a cross section of people within the financial services industry, using a database compiled from multiple sources. These sources ensured an adequately diverse representation of the audience of interest. Lists of named individuals and contact details were provided from the Companies Office Financial Services Provider Register and also obtained from industry associations' web sites. Information about the survey was included on MED's website and several additional participants asked to be included in the survey. A final response of 325 was achieved.[39]

[39] 79% of the MED survey participants were located in the North Island. Based on comments provided by people invited to participate in the survey, it is likely that the relatively low response rate for Christchurch was adversely affected by the after effects of the earthquakes.

23 in person and telephone interviews were conducted with financial advisers. These numbers allowed for diverse sub-groups of interest to be included and MED provided assistance with identifying potential participants and obtaining their contact details. Each interview was of around 45 minutes duration, with the majority of interviews conducted at the participant's place of work. Interviews outside Auckland and Wellington were conducted by telephone. The first four interviews were completed as a pilot, which allowed the initial questionnaire to be amended and finalised before the launch of the online quantitative survey.

The total sample size from the online survey and the interviews was 348. The total sample size from the online survey and the interviews was 348. The margin of error on a sample of 348 drawn from a population of 5,500 is +/- 5.1%.

MED questionnaire

Financial Advisers Act 2008 Survey

The Ministry of Economic Development is undertaking an evaluation of the effects the Financial Advisers Act 2008 is having on the Financial Adviser industry. The Ministry has appointed Andrew Fletcher Consulting to undertake this survey to assist with this evaluation. The survey will take 10-15 minutes of your time.
All your responses will be treated in confidence. Andrew Fletcher Consulting will be reporting to the Ministry in an aggregated form and the people taking part will not be identified.
We hope you will participate in this survey - we all potentially benefit if the agencies that provide policy advice and input into the development of legislation are fully informed about the effects of this legislation on the industries it affects.

Current Status

Is your principal economic activity ...
Giving financial advice
Providing a broking service
Other:

Are you, or have you applied to become, a ... (TICK ALL THAT APPLY)
Registered Financial Adviser
Authorised Financial Adviser
QFE Adviser (employee or representative of a QFE)
Qualifying Financial Entity (business)
Non-QFE business (employing AFAs or RFAs)
Exempt from the provisions of FAA 2008, e.g. lawyer, chartered accountant, real estate agent
Applied for exemption
None of these apply

Comments, e.g. reasons for choosing or not choosing this status

Understanding of Registration Process

The Securities Commission and the Companies Office provide information about the registration process, for example whether you have to register, whether you also need to be authorised, and the responsibilities of Qualifying Financial Entity (QFE) status.

How much do you agree or disagree that the information they provided helped you or your organisation to decide whether
... you have to register?
... you need to be authorised?
... to apply for QFE status?

Comments on information provided

Efficiency of Registration Process

How much do you agree or disagree that the time and money you spent on the following was appropriate, given the purpose stated in the financial adviser regulation?
Gathering information for the registration
Training required for the registration/AFA authorisation
The registration process itself
The AFA authorisation
Joining a dispute resolution scheme

How much do you agree or disagree that the overall process of implementing the Financial Advisers regulation was efficient?
Comments on time and cost being appropriate/efficiency of registration process

Benefits of Registration

How much do you agree or disagree that ...
... becoming an RFA/AFA/QFE will help you?
... becoming an RFA/AFA/QFE will help your clients?

Comments on helpfulness of registration as RFA/AFA/QFE

Benefits of Registration as RFA or QFE

In what ways do you feel your business will benefit from being an RFA or QFE? TICK ALL THAT APPLY
Increased growth/turnover
Increased margin/profits
Higher willingness of clients to pay for services
Higher trust in your business

Better reputation of your business
No benefit
Other:

And what do you expect to be the benefits to your clients from your registration as an RFA or QFE? TICK ALL THAT APPLY
Better service quality
Greater transparency
Dispute resolution
Better informed decisions whether to use the financial adviser or broker
No benefit
Other:

Comments on benefits of registration as an RFA or QFE

Benefits of Authorisation as an AFA

In what ways do you feel your business will benefit from you being authorised as an AFA ? TICK ALL THAT APPLY
Increased growth/turnover
Increased margin/profits
Higher willingness of clients to pay for services
Higher trust in your business
Better reputation of your business
No benefit
Other:

And what do you expect to be the benefits to your clients from your authorisation as AFA? TICK ALL THAT APPLY
Better service quality
Greater transparency
Dispute resolution
Better informed decisions whether to use the financial adviser or broker
No benefit
Other:

Comments on benefits of authorisation as an AFA

Skills and Experience

How long have you been offering financial advice, or advice in your current field?
Less than 2 years
2 - 4 years
5 - 9 years
10 - 19 years
20 years or more

Before you started working as a financial adviser, what was your highest qualification?

School qualification
Vocational qualification
Bachelor's degree
Higher degree
Other:

Comments on skills and experience

In a typical year before FAA 2008, how much time and money did you spend on developing your professional skills ...
... in structured training
... in unstructured education such as reading industry magazines

And in the last 12 months how much time and money did you spend on developing your professional skills ...

... in structured training
... in unstructured education such as reading industry magazines

Comments on continuing professional development

Changing Role

In this section of the survey we would like to find out how your role, or for QFEs your firm's role, has changed since FAA 2008.

In the list below please indicate the main tasks you did in a typical year before FAA and the main tasks you do now.

Work as a financial adviser
Give advice on a broad range of investments (as opposed to a specific product such as life insurance)
Give advice on complex products (FAA category 1 products)
Give advice on simple products (FAA category 2 products)
Refer clients to an appropriate professional when they ask for advice outside your core competencies
Give advice on investment products from several companies
Specialise in any area
Work with wholesale clients
Work with retail clients
Provide a comprehensive written analysis of the client's financial situation and recommendations
Provide modular advice if a comprehensive plan was not sought
Include recommendations for specific financial products
Engage in any other business, either as a proprietor, partner, employee, trustee, agent or otherwise
Undertake any activities to improve consumer trust
Before FAA 2011
How many clients did you/do you work with?

Comments on how role has changed

Advice Offered or Service Provided

Which of the following did you / do you mainly provide or offer advice on?

Class advice/service, e.g. brochures, seminars and internet material
Cash management/budgeting
Tax planning
Investment review and planning
KiwiSaver schemes and funds

Managed investment funds
Direct investment, shares, bonds
Retirement planning (more broadly)
Estate planning
Insurance needs
Education funding
Broking service
Supply/clarification of product information only
Manage a client's portfolio/discretionary investment management service
Other

Comments on advice offered

Research

In providing advice to clients, to what extent do you or your organisation purchase or otherwise obtain expert information?
Purchase information
Undertake in-house research and analysis

To what extent do you expect the amount of research you undertake will change as a result of the Financial Advisers Act 2008?
Increase substantially
Increase
Stay the same
Decrease
Decrease substantially

Comments on research

Do you serve the KiwiSaver market?

KiwiSaver

How do you serve the KiwiSaver market? TICK ALL THAT APPLY
Inform clients more broadly on scheme providers
Advise clients on choosing a scheme and provider
Advise on choosing funds of a particular scheme and provider
Advise on performance and risk level of funds
Inform on fund features, e.g. ethical/socially responsible investment options or make additional lump sum contributions
Inform on fees and charges of different schemes and funds
Assess client's risk profile
Give class advice/service, e.g. brochures, seminars and internet material
Other (please specify below)

Comments on KiwiSaver

Information Disclosure

We are also interested in seeing how information disclosure has changed since FAA 2008.

In addition to what you are legally required to disclose, what type of information did you / do you provide voluntarily?
Disclosure of conflicts of interest
Written statement of the total fees and commissions earned by you and any affiliated organisations before engagement
An agreement describing your compensation
Details of indemnity insurance
Details of your professional or business experience
References from clients who have worked with you or your firm
Other (please specify below)

Comments on Information Disclosure

Fee Structure

Comparing before FAA and 2011, how was / is your firm compensated?
Fee only
Commission only
Fee and commissions
Volume based compensation
Hourly rate for advice
Referral fees from other professionals
Other (please specify below)

Comments on firm's fee structure

How was / is your personal compensation calculated?
Hourly fee
Flat fee

Percentage fee
Commission
Bonuses based on volume
Bonuses based on other standards, e.g. low level of complaints
Fixed salary

Comments on personal compensation

Do you, or any party in which you have a financial interest or other benefits, receive ...
... any compensation that is contingent upon a client's purchase or sale of a product?
... financial incentives for you to recommend certain products?

Comments on incentives

Barriers to Entry / Reasons for Not Registering

When you or your firm entered the market of financial advice what was the most difficult issue?
Finding clients
Spending on advertising
Competition from established firms
Customer loyalty
Finding capital to start up
Other:

Comments on barriers to entry

Professional Conduct

To what extent do you agree or disagree that the Code of Professional Conduct will result in advisers ...
... improving their ethical behaviour
... promoting client care
... increasing their competence, knowledge and skills
... ensuring continuing professional training

Comments on Code of Professional Conduct

Accountability

Comparing the current situation with before FAA 2008, did you / do you ...
... have professional indemnity insurance?
... declare to act in good faith and in the best interests of the client?
... have a business continuity plan?
... offer continuous, ongoing advice regarding a client's financial affairs?
... hold clients' money on trust

Comments

Demographics

Finally, to help with our analysis ...

Are you
Male
Female

To what age group do you belong?
Under 30
30 - 39
40 - 49
50 - 59
60 - 69
70 +

Where are you located?
Auckland region
Wellington region
Other North Island
Christchurch region
Other South Island

How many people are employed by your firm in New Zealand?
0
1 - 5
6 - 9
10 - 19
20 - 49
50 - 99
100+

To what professional associations do you belong?
Institute of Financial Advisers
Professional Advisers Association
Society of Independent Financial Advisers
Life Brokers Association
Insurance Brokers Association
NZ Mortgage Brokers Association
None
Other:

Final Comments

Thank you for providing this feedback on the Financial Advisers Act 2008. Your answers have been added anonymously to our survey database and will be very helpful to the Ministry in its evaluation of the effects of the Act on the financial services industry.

Additional analysis of MED survey data

Table 10-2: Comparisons of financial advisers whose principal economic activity is either giving financial advice or broking service

	Giving financial advice	Providing a broking service
Bachelor or higher degree	43%	31%
Applied for Authorised Financial Adviser	59%	21%
Less than 30 hours in structured training	54%	67%
Purchase information for research	41%	17%
Do in-house research or analysis	73%	47%

Source: MED

The survey asked participants what was the most difficult issue when entering the market of financial advice. Compared to financial advisers brokers mention more often “competition from established firms” and “customer loyalty” as most difficult issue when the firm entered the market of financial advice.

10.4 RaboDirect Financial Confidence Index (FCI)

The RaboDirect financial Confidence Index is a nationwide survey that aims to measure public confidence in the financial sector. The survey is conducted online by RaboDirect in conjunction with research company TNS, with a random sample of 1,000 New Zealanders. The RaboDirect Financial Confidence Index was first conducted in August 2009 and RaboDirect reports survey results every six months.

In the survey respondents are asked to rate various items relating to the following financial institutions and service providers:

- Deposit taking institutions (Banks, Finance companies, Credit Unions and Building Societies)
- Insurers (Life insurance, House, contents and car insurance, Health insurance
- Investment managers and advisors (Managed funds (including KiwiSaver providers), Share brokers, Financial advisors)

A series of similar questions were asked for each institution type and rated on a 5 point Strongly Agree - Strongly Disagree scale.

- They provide good products and services
- They act fairly and with integrity
- They provide good information to help you make your financial decisions
- Interest rate returns/ Investment returns are acceptable given the level of risk involved
- You feel confident your money is safe there/ in their financial ability to pay claims
- Their fees/premiums are reasonable for the services provided (Share Brokers)
- Overall you have confidence in …

Responses to each of the overall questions were weighted to calculate a single score scaled between -100 and +100 for each category.

10.5 Consumer Survey

The Ministry of Consumer Affairs carries out research on New Zealand consumer awareness, experience and perceptions of consumer matters and legislation through a national face-to-face survey (National Consumer Survey). For the last survey 1,000 face-to-face interviews with New Zealanders aged 18 years or over were carried out between 13 June and 16 August 2009. There were questions in the survey around the use and usefulness of financial advice and awareness of and confidence in New Zealand's consumer rights legislation.

10.6 Financial Service Providers Register

The Financial Service Providers Register (FSPR) opened to accept applications on 16 August 2010. Registration for most financial service providers (FSPs) became compulsory on 1 December 2010, after which date most FSPs needed to be registered to legally provide their services. Financial advisers had until 31 March 2011 to be registered and apply for authorisation. All authorised financial advisers (AFAs) needed to be authorised by 30 June 2011. Canterbury earthquake financial advisers had a registration extension until 30 June and authorisation deadline of 30 September.

Entities and individuals who:

- live or have a place of business in New Zealand; and
- are in the business of providing financial services (in New Zealand or overseas)

must register on the FSPR to provide that particular financial service.

In order to register as an FSP, applicants have to pass a criminal conviction background check, and those who provide services to retail clients have to join an approved consumer dispute resolution scheme.

10.7 Flowchart Financial Advisor