Institute of Finance Professionals New Zealand Inc.

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By Email

INFINZ Submission on MBIE's Issues Paper – Review of the Financial Advisers Act 2008 and the Financial Service Providers (Registration and Dispute Resolution) Act 2008

The Institute of Finance Professionals New Zealand Inc (INFINZ) provides this submission in response to MBIE's request for submissions on the issues raised in its Issues Paper on the Review of the Financial Advisers Act 2008 (FA Act) and the Financial Service Providers (Registration and Dispute Resolution) Act 2008 (FSP Act) (together Acts).

About INFINZ

INFINZ is the peak industry body for capital markets professionals in New Zealand. INFINZ has a membership of approximately 950 individuals drawn from across the capital markets and includes treasury professionals, investment analysts, fund managers, bankers, lawyers and students. One of the objects of INFINZ is "to promote the proper control and regulation of the New Zealand finance and capital markets."

Introductory comments

INFINZ is pleased to have the opportunity to contribute to the review and considers the effective and efficient operation of the FA Act and FSP Act to be key building blocks in promoting confidence in New Zealand's capital and financial markets.

As the industry body for professionals working and participating in New Zealand's wholesale finance and capital markets, we will focus our submissions on only those questions relating to the issues we consider most significantly impact:

- the effective distribution of capital markets offers to retail investors; and
- the confident participation of wholesale and retail investors in the capital markets.

The issues and questions raised in the Issues Paper are relatively high level and accordingly we have prepared high level submissions. If MBIE and the FMA would find it helpful, we will be happy to bring together a group of advisory professionals from our membership base to walk through some of the more detailed issues they see value in addressing, as your review progresses to the more detailed policy development and legislative drafting stage.

General submissions

The regime is only four years old. The finance sector is still assimilating the bulk of the reform programme of which the FA Act and the FSP Act is part with the implementation of the Financial Markets Conduct Act.

While there are clearly some refinements that can and should be made at this stage, we do not consider that a material change of direction – with the direct and indirect costs this creates for investors – is merited at this stage.

The major issues we see are:

- The aspects of the regime that make it difficult for investors to understand the status of the people who can provide them with advice and the status of that advice. Particularly of the types of financial advisers and the distinction between 'sales' and 'advice'.

- Availability of advice to 'middle' retail investors. This is exacerbated by the sector's still early stage understanding of the regime and consequently its (and the FMA's) expectations of financial advisers. Particularly the over-engineering of compliance responses which result in voluminous paperwork provided to investors, and uncertainty among advisers as to their ability to provide scaled (or 'right sized') advice.

- The status of the people who have registered on the Register of Financial Service Providers and use of the term 'Registered Financial Advisers' (RFA) to describe them. Particularly, the confusion this creates in the minds of NZ investors and the reputational risk this creates from unscrupulous offshore service providers.

Beyond those issues, much could be achieved by FMA re-energising and re-focusing its approach to supervision and enforcement of advisers and their performance of their obligations. Guidance, education, warnings, administrative actions (such as cancellation of licence or imposition of licence conditions) and proceedings before the Financial Advisers Disciplinary Committee are often most effective both at a micro (individual adviser) and macro (market messaging) level.

Finally, we suggest that MBIE carry out a holistic review of the effectiveness of the overall regime, and the part the Acts play in it, once the sector has had a meaningful time to assimilate the overall regime of which the Acts form part.

We have set out our responses to selected Questions for Submission in the Appendix.

INFINZ would welcome further discussion

INFINZ has no objection to any publication of this submission.

As noted, INFINZ would welcome the opportunity to discuss this submission with you.

Regards

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Appendix – INFINZ Response to Questions for Submission

Chapter 5: How the FA works

Question 4: Is the distinction in the FA Act between wholesale and retail clients appropriate and effective? If not, what changes should be considered?

Yes, the current distinction is appropriate. The FA Act should continue to apply to those advising retail investors – wholesale participants are governed by the fair dealing provisions of the Financial Markets Conduct Act, not the FAA.

Chapter 6: Key FA Act questions for the review

Question 35: What changes should be considered to make the current regulatory regime simpler and easier for consumers to understand? For example, removing or clarifying the distinction between AFAs and RFAs.

Investors do not understand the regulatory framework. This is not surprising – it is complex. Complexities which particularly inhibit understanding include:

- While the concept of the Authorised Financial Adviser is clear, use of the term 'Registered Financial Adviser' is unfortunate and both masks and oversells the purpose and effect of the FSP Act. We understand the original purpose of the FSP Act was to:
    - Provide a relatively quick and cheap means of resolving disputes between retail customers and financial service providers; and
    - Meet the Financial Action Task Force's requirement for the New Zealand government to register its finance sector to enable it to undertake risk assessment and supervision for Anti-Money Laundering purposes.

From a retail investor perspective, therefore, registration brings only one benefit – access to a dispute resolution scheme. It does not provide the competency and capability requirements reassurance brought by the licensing requirements for AFAs. Use of the term RFA devalues the capability and competency of AFAs who have met, and must continue to meet, competency requirements to be able to use the term.

Use of the descriptor 'RFA' also allows unscrupulous or careless international financial service providers to shelter under the term and the apparent supervision of the FMA to sell their services, generally to offshore customers. This is damaging for New Zealand's reputation as a responsible member of the world financial community and for the reputation of the regulatory system at home.

The term has no statutory definition or substantive meaning, but has been largely adopted as a matter of convenience – even by the FMA – to refer to people who provide advice on category 2 products and who have registered on the register of financial service providers. In our view, there should be no distinction between category 1 and category 2 products, only AFAs should be able to provide advice to retail investors, on whatever product.

However, there are a number of steps that could be taken to avoid domestic and international confusion about the status of a person who is registered on the FSPR and provides advice including:

- Amending the Acts to prohibit use of the term 'Registered Financial Adviser' or RFA or reference to the fact of registration in a promotional context. Although use of the RFA term is less problematic in the prescribed disclosure statement, where a fuller description of the regulation applying to the RFA is included, this prescribed form could be amended to more clearly state that registration, in comparison with authorisation, is focused on dispute resolution.

- MBIE and the FMA cease using the terms 'Registered Financial Adviser' and RFA and use an alternative term, such as non-authorised financial adviser.

Another issue is the use of 'opaque' descriptors and overuse of acronyms. These include AFA, QFE, RFA, 'Category 1' and 'Category 2' products, and 'Qualifying Financial Entity'. As part of any review of terminology, we suggest that the selected terms be consumer tested for ease of understanding.

Question 36: To what extent do consumers understand that some financial advisers' primary roles may be selling financial products, rather than solely acting as an unbiased adviser to their clients?

Consumers do not understand that some financial advisers' primary role may be selling financial products, rather than providing independent advice. This concern relates particularly to the role of advisers employed by QFEs who can provide advice on Category 2 products and on Category 1 products of which their QFE is the issuer.

The FMA provided guidance for AFAs on the meaning of these distinctions in the context of sale and distribution of KiwiSaver products, and resources for investors, in 2012 – though the former is not readily accessed by reference to its subject matter on the FMA's new website.

We suggest that the FA Act be amended to require people whose primary role within a QFE structure is selling financial products to describe themselves by a name that clearly identifies them as aligned with the QFE and accurately identifies their role, such as '[*Name of QFE*] product sales representative'.

Again, as part of any review of terminology, we suggest that the selected terms be consumer tested for ease of understanding.

Question 42: Has the right balance been struck between ensuring advisers meet minimum quality standards and ensuring there is competition from a wide range of providers (and potential providers)?

We suggest much of the current 'over-engineering' is generated by the immaturity of the regulated market for advisers and can be addressed by the FMA working closely with advisers to provide guidance and support to enable them to respond proportionately to the regulatory requirements. For example ensuring visibility of guidance provided on important issues such as 'right sizing' the Statement of Advice, providing limited advice.

The FMA has provided guidance aimed at helping advisers navigate some of the interpretive issues that might inhibit delivery of proportional and appropriate advice - for example guidance about the level of analysis an AFA must undertake about a product before recommending it to a client and to assist AFAs who want to provide limited personalised advice. This is not readily accessed by reference to its subject matter on the FMA's new website.

Facilitation of delivery of financial advice through online and automated media must be a focus for this next stage of the development of the regime so that investors with non-complex investment needs can be served efficiently and effectively.

Chapter 10: Key FSP Act questions for the review

Question 76: What features or information would make the Register more useful for consumers?

We do not consider it necessary to change the FSPR or the FSP Act to make it more useful for investors. As discussed in relation to question 35 above, our understanding of the intent and purpose of the FSP Act was that it would:

- Provide a relatively quick and cheap means of resolving disputes between retail customers and financial service providers; and

- Meet the Financial Action Task Force's requirement for the New Zealand government to register its finance sector to enable it to undertake risk assessment and supervision for Anti Money Laundering purposes.

The FSPR provides the information investors need for this purpose – that is, information about the dispute resolution scheme to which the financial market participant belongs.

The other expectations investors may have of the FSPR – and which it, and registration on it, cannot satisfy – can be addressed through the communications approaches referred to in our answer to Question 35.

Question 78: Do you consider misuse of the Register by offshore financial service providers is a significant risk to New Zealand's reputation as a well-regulated jurisdiction and/or to New Zealand businesses?

Use of the descriptor 'RFA' and reference to the fact of registration, allows unscrupulous or careless international financial service providers to shelter under the term and the apparent supervision of the FMA to sell their services, generally to offshore customers. This is damaging for New Zealand's reputation as a responsible member of the world financial community and for the reputation of the regulatory system at home.

As discussed above, there are a number of steps that could be taken to avoid domestic and international confusion about the status of a person who is registered on the FSPR and provides advice including:

- Amending the Acts to prohibit use of the term 'Registered Financial Adviser', RFA or reference to registration, in a promotional context. As discussed above, the form of prescribed disclosure statement could also be amended to clarify what RFA means when used in the disclosure statement.

- MBIE and the FMA cease using the terms 'Registered Financial Adviser' and RFA and use an alternative term such as 'non-authorised financial adviser'.

The FMA now has power to direct the Registrar to remove companies from the FSPR where it is likely that a company is giving a false or misleading impression about the extent to which it is regulated in New Zealand.

Other techniques – such as subjecting companies that are registered as New Zealand financial service providers to AML/CFT requirements or requiring such companies to pay a bond in favour of their dispute resolution scheme – would also provide practical disincentives for such behaviour.

Question 79: Are there any changes to the scope of the registration requirements or the powers of regulators that should be considered in response to this issue?

A matter that requires review is the imprecision in the definition of "financial service" in section 5 of the FSP Act and its misalignment to the regime's overall objectives – in particular, in the potential for some aspects (eg credit contracts under s 5(1)(e)) to go beyond regulated (ie generally retail) financial services and potentially spill-over into wholesale activities. This was highlighted in the issues that recently arose about the application of section 99B of the CCCFA. Uncertainty in these areas has the potential to harm New Zealand's reputation in the international financial markets and reduce liquidity in New Zealand financial products, without a corresponding policy benefit.