CHAPMAN TRIPP

SUBMISSION ON REVIEW OF THE FINANCIAL ADVISERS ACT 2008 REFORM OPTIONS

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INTRODUCTION

1 The Ministry of Business, Innovation and Employment (*MBIE*) has sought feedback on proposals to reform the Financial Advisers Act 2008 (*FAA*) (*Options Paper*). This submission is from Chapman Tripp, PO Box 993, Wellington 6140.

2 We have separately responded to the proposals to reform the financial service providers registration requirements contained in the Financial Service Providers (Registration and Dispute Resolution) Act 2008 (*FSPA*). We have also submitted on the Issues Paper: Review of the Financial Advisers Act 2008 and the Financial Service Providers (Registration and Dispute Resolution Act) 2008 (*Earlier Submission*).

3 Chapman Tripp is a leading New Zealand full service law firm with a strong practice in financial services, funds management, KiwiSaver, superannuation, insurance, banking and general corporate, commercial, property and tax advice. This submission primarily reflects the views of Bradley Kidd, Roger Wallis and Natan Karon, specialists in our financial sector regulation team.

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ABOUT CHAPMAN TRIPP

4 We have been at the forefront of advising on the FAA and FSPA, as well as the Financial Markets Conduct Act 2013 (*FMCA*). Our clients include major banks, brokers, insurance companies and adviser networks. As a result, we have been exposed to the full spectrum of the compliance outcomes the FAA and FSPA have driven, and have a deep insight into the issues, challenges and frustrations the industry has faced.

5 We have discerned a number of themes from our experience, many of which we covered in our Earlier Submission. We summarise those themes in the "Key Points" section below, before turning to answer the questions in the Options Paper in the **Schedule** to our submission.

SUMMARY OF KEY POINTS

6 **Complexity**
One of the concerns we had at the outset of the FAA regime, and which we noted in our Earlier Submission, was the complexity created by the multiple "filters" in the regime (different service types; category 1/category 2; class/personalised; wholesale/retail).

We believe that the review presents a unique opportunity to address that complexity to the benefit of consumers, and many of our submissions are targeted at that objective. We therefore support removal of the product category and class/personalised filters, and we elaborate on that in our submission below

7 **Key points**

(a) **Consider separating consumer protection and industry regulation.** We ask the review to consider separating the industry regulation components of the FAA from the consumer protection components. We believe that the interplay between these parallel (and often conflicting) features has contributed to some of the current difficulties with the FAA.

More specifically, we believe that MBIE should consider:

- integrating the consumer protection elements of the FAA into the FMCA, especially if entity licensing is the preferred model (which we support, as described below). The requisite entity licence could be simply another category of "market services licence" under Part 6 of the

FMCA

- legislating separately to set minimum qualifications, a code of ethics and CPD requirements for persons who wish to hold themselves out as certain types of financial adviser. This legislation could also be the "gateway" for compliance for licensed entities.

This would have the benefit of clearly separating industry regulation, while not compromising consumer protection.

If this proposal is pursued, it will be very important to gather industry feedback, as it does represent a significant departure from the current regulatory position.

(b) **Entity licensing model preferable.** We support an entity licensing regime, along the following lines:

- entity level licensing, with the licence being another category of Market Services Licence under Part 6 of the FMCA
- some concessions from the requirement to have a licence (or possibly a more relaxed set of conditions attaching to the licence), for example for smaller businesses and for lower level types of financial advice (such as research notes and financial commentary where the existing Part 2 fair dealing regime under the FMCA, supplemented by the Fair Trading Act 1986, is sufficient)
- a general obligation on the entity to ensure that advisers only advise on products for which they are qualified, with consequences for the entity if that is breached
- a more refined version of the current Code of Conduct for financial advisers in the form of a code of ethics (with the consequences for breach resting with the individual, not the entity)
- individual licensing in exceptional cases: for example, sole traders and investment planning services which are limited to persons who are certified financial planners (a qualification which we understand is well recognised)

- regulation at the entity level of appropriate qualification levels for different types of advisers, depending upon the complexity of the advice and product, supported by entity level consequences if advice is not provided by an appropriately qualified individual.

For further detail see our answer to Question 17 below.

(c) **Support for Package 3, with some modifications.** – We support Package 3, on the basis that:

- entity level licensing is preferred, with only (very) limited requirements for individual licensing (see (b) above and our answer to Question 17 below)

- there is a more efficient and streamlined disclosure regime, with responsibility for disclosure resting with the entity (see our answers to Questions 19-21 below)

- sales persons are permitted to sell the products of other market participants (i.e. they are not limited to selling their "own" financial products.

However, we acknowledge that, of the three Packages, Package 3 represents the most significant change, and would come with the greatest cost. For that reason, it will be critical to gather industry feedback on the three Packages, and the Options within those Packages, to ensure an optimal outcome for the industry.

(d) **Other changes are necessary.** We believe that change in the following areas is critical:

Wholesale/retail divide. Different wholesale/retail tests apply under the FAA, FSPA, FMCA and Financial Advisers (Custodians of FMCA Financial Products) Regulations 2013 (FAA Custody Regulations). In our view:

- the tests should be rationalised so that there is a consistent definition of the wholesale/retail boundary

- the FAA should regulate financial advice to retail clients only – with the Part 2 fair dealing provisions of the FMCA being sufficient for

financial advice provided to wholesale clients, and

- the wholesale/retail boundary in the FAA Custody Regulations should be extended to include all categories of wholesale client in clauses 3(2) and 3(3) of Schedule 1 to the FMCA.

DIMS. We support shifting the regulation of personalised DIMS wholly to the FMCA and requiring that it be provided by a licensed person under a generic DIMS licence. This would also remove duplication and any regulatory arbitrage between the two regimes.

Broking services/custody. The "broking services" regime is difficult to comprehend, advise on and implement. This is particularly the case where (as is common) there is a split between the customer facing entity providing the advice and undertaking the trading activity, and a third party custodian. At present, the situation is that:

- the customer facing entity has obligations as a "broker" and must procure the compliance of any third party custodian, even where it does not hold, in the ownership sense, the financial products in question
- the third party custodian does not have direct obligations as such but is still required to register as a broker.

We believe that this issue should be addressed.

Territorial scope. The territorial scope of the FAA should be amended by creating an "approved list" of offshore jurisdictions the characteristics of which are recognised in New Zealand so that qualified providers located in those jurisdictions do not have to comply with the additional requirements under New Zealand law (with some tolerance for where the offshore requirements may differ from New Zealand requirements – for example, European jurisdictions where the concept of holding assets "on trust" does not exist).

We believe that the creation of an "approved list" of this nature will recognise that, in many cases, consumers can be adequately protected under the rules of foreign jurisdictions, and the requirement for approval means that New Zealand consumers will still be protected by New Zealand regulation where a

country is not on the approved list.

We would also support a move to targeted exemptions for dealing with certain "false positives" resulting from the territoriality scope, for example relieving the need for compliance when a client is in New Zealand on a temporary basis only.

Boundary issues. The boundary between an "investment planning service" and "financial advice" is unclear, and has given rise to issues in the advisory community (for example, whether an AFA requires authorisation to provide an investment planning service). We would endorse an approach which consolidates the two services, with perhaps the boundary used only as a tool requiring competencies.

TRANSITIONAL ISSUES

8 While we see the review as a positive opportunity for meaningful change, it is important to appreciate that many of the entities which will be most affected by any changes to the FAA are also currently transitioning their product and service offerings under the FMCA.

The level of change being driven by the implementation of the FMCA is such that providers have limited capacity to either engage in the current review or absorb any further change into their businesses in the near future.

For that reason, as we did on our Earlier Submission, we submit that the review should allow providers to continue to operate under the current regime for an extended period beyond the end of 2016.

SCHEDULE – ANSWERS TO QUESTIONS

Chapter 3 – Barriers to achieving the outcomes

1) Do you agree with the barriers outlined in the Options Paper? If not, why not?

We broadly agree with the barriers identified in the issues paper, although we have some specific comments on two of the barriers below.

Barrier: Hard for consumers to know where to seek financial advice from
While we agree that "[i]t is hard for consumers to know where to seek financial advice from", the low level of advice received by consumers may also be a result of consumers not knowing when it is appropriate to seek advice, or not valuing it sufficiently to pay for it.

It is difficult to assess whether this issue can be addressed by regulation, or whether the solution lies in the ongoing efforts to increase financial literacy in New Zealand. It may be that the best that can be achieved in the context of regulation is to make it an express purpose of the FAA to increase financial literacy in New Zealand.

Barrier: Certain types of advice aren't being provided
We consider that the FAA has disincentivised the provision of some types of advice.

We also note that the current uncertainty as to the regulatory characterisation and consequent treatment of interactions between providers and consumers has:

- driven very cautious behaviour on the part of service providers as they are unsure whether any interaction with a consumer will stray into areas on which they cannot advise e.g. a class service strays into being a personalised service
- resulted in service providers making decisions on what services to provide consumers based in large part on the regulatory cost imposed on the provision of that type of service. Put another way, providers may choose the lower cost "class advice" or "no advice" business models, rather than risk exposure to the higher regulatory cost of providing personalised advice.

We also consider that the barriers identified may not adequately reflect the need for a balance between consumer protection and disproportionate compliance costs. Without due weight being given to compliance costs – and the potential that providers will choose a lower cost/lower risk option – there is a risk that the regulation may not foster an "environment" which encourages the provision of fit for purpose advice where needed.

Chapter 4 – Discrete elements

3) Which options will be most effective in achieving the desired outcomes and why?

Option 1 - Remove the distinction between class and personalised advice
We support the removal of the class/personalised advice divide, but with greater exceptions for publications, journalism, sales processes and simple advice.

The distinction between class and personalised advice in the FAA has always been difficult, for both advisers and consumers.

Advisers cannot know with certainty how any engagement with a consumer will be categorised. This problem arises because the question as to whether or not a service is personalised is in part determined by the expectations of the consumer. This means that an adviser can begin an engagement on the basis that s/he will be providing a class service, but a client can (by asking various questions and volunteering information about themselves) potentially turn that service into a personalised service.

However, the original purpose for which the class/personalised distinction was introduced – so that entities can produce research notes etc without a need to attribute them to individuals – remains valid. Provided that the removal of the distinction between class and personalised advice is coupled (as is the suggestion in the Options Paper) with the ability for entities to provide all types of advice, then we do not see any issues with the removal of this distinction.

The implementation of this change, including the proposed requirement that the service "matches" the consumer's demands, will need to be carefully considered because:

- the requirement for "matching" a consumer's demand could, as was the case with Code Standard 8 of the Code of Professional Conduct for AFAs (*Code*), inadvertently drive advisers to feel compelled to undertake a detailed needs analysis of the consumer (even though the client may not need or want this level of service)

- in the case of Robo-advice, the automated system can only produce a series of pre-defined results for consumers. All outcomes are determined prior to the client receiving any advice. If such a service does not "match" the consumer's demands, the system would be incapable of providing a different service.

As we submitted in our Earlier Submission, we believe the FAA should regulate independent advice to retail clients, however categorised. If this proposal is adopted, there should be greater exceptions to allow for publications, journalism, sales processes and simple advice (such as that contained in research notes), without the need for that to be regulated in the same way as other types of advice. This type of advice is, in our view, appropriately regulated through the Part 2 fair dealing provisions of the FMCA.

Option 2 - Remove any distinction based on product category
We support the removal of the distinction between classes of financial products. The key principle should be that advisers must be competent to advise on the products on which they in fact provide advice.

The use of category 1 and category 2 products in setting restrictions is a broad based tool which does not recognise the breadth of those categories or the nature of the advice being provided. We are aware of situations where products which are reasonably well understood have been regulated as complex products (e.g. medium term notes which in economic substance are identical to term deposits or KiwiSaver) and where products with reasonably complicated features have been regulated as less complex products (e.g. cross guarantees and some contracts of insurance).

In addition, the current broad division of products means that advisers could well be permitted to advise on products of which they have no knowledge. For example a residential mortgage broker may have no knowledge about life insurance but as life insurance is a category 2 product the broker would be able to advise on it.

From a consumer perspective, there is little practical utility in categorising financial products for the purposes of who can advise on them. Our perception is that consumers are unlikely to appreciate the distinction between product categories, but instead expect that the adviser advising on a product is appropriately qualified to do so.

We believe the solution is to:

- retain the product categories but **outside** the legislation, as a tool for differentiating the baseline competency requirements for advisers (possibly within a qualification framework) and not as a consumer facing compliance filter

- introduce a general requirement that advisers must have that minimum competency before they can advise on a product (e.g. to address the mortgage broker advising on insurance scenario, as described above), and

- remove the requirement to distinguish between categories when dealing with consumers (because adequate consumer protection is achieved through the baseline requirement for minimum competency to advise on the product concerned).

Note: The status of certain products as category 2 products is a filter used in certain exclusions from the offer disclosure regime in the FMCA. The "knock-on" effects for the FMCA resulting from removal of this product categorisation will need to be carefully considered.

Option 3 - Restrict the provision of certain complex or high-risk services to certain advisers
We support the proposal that only advisers competent to provide complex or high-risk services should be able to provide those services. However, we do not support any requirement for a separate licence to be obtained to allow an individual to provide complex or high risk services, except in very limited circumstances (the only one we

can identify at present is a "financial planner", which we understand is an industry-recognised category).

Rather, if a provider does provide complex or high risk services, it must do so through appropriately qualified employees. Any failure to do so would be a breach of the provider's requirement to exercise care, diligence and skill (and most likely a breach of the entity licence).

Option 4 - Require a client to opt-in before being considered a wholesale client

We are strongly opposed to the suggestion that clients be required to opt-in to being a wholesale client.

In many instances whether a client meets the requirements to be treated as a wholesale client is objectively ascertainable (e.g. the client is a registered entity) without reference back to the client. Requiring the client to opt into wholesale treatment will merely add a layer of complexity when first engaging with a client.

It is also inconsistent with the approach adopted in the FMCA and to our knowledge globally. This could result in overseas businesses routinely breaching New Zealand law when they engage with New Zealand clients which are incontrovertibly wholesale (e.g. retail banks) but fail to have those clients certify as to their wholesale status.

5) Are there any other viable options? If so, please provide details.

Consider separating industry regulation from consumer protection

An option not canvassed in the Options Paper would be to separate the industry regulation components of the FAA from the consumer protection components.

- We believe that it would be possible to integrate the consumer protection elements of the FAA into the FMCA, especially if entity licensing is the preferred model (which we support, as described below). The requisite entity licence could be simply another category of "market services licence" under Part 6 of the FMCA, with conduct and disclosure being regulated through the licensing regime (whether through the Financial Market Conduct Regulations or as licence conditions).
- For those categories of services where a particular qualification is required, a separate piece of industry regulation legislation could set minimum qualifications, a code of ethics and a CPD requirement. This legislation could also be the "gateway" for compliance for licensed entities – making it easier for the licensed entity to have confidence that the personnel acting on their behalf (and for whom they are responsible) meet the standards required.

This would have the benefit of clearly separating industry regulation and consumer protection.

However, it would be very important to gather industry feedback on this proposal, as it does represent a significant departure from the current regulatory position.

Allow unaligned sales

We support a bright line exclusion from the FAA for "sales" type activities. We consider that the current exclusions in the FAA (i.e. the so called "no advice" boundary) are at times ambiguous and create a risk that a person may inadvertently provide financial advice.

However, the Options Paper links the ability to sell a product (as opposed to provide advice on that product) to alignment between the sales person and the provider of the product – as Package 3 clearly indicates that a sales person may only sell their "own" financial products.

This requirement cuts across current market practice where advisers sell products issued by multiple organisations.

In addition, any such restriction would potentially compromise the common practice of "white labelling" i.e., where an organisation rebrands ("white labels") the products provided by other organisations and then provides them to their clients. This is particularly prevalent in the insurance industry.

We therefore would support a regime which allows a sales person to sell unaligned products, rather than a restriction which means that sales persons can only sell their "own" products.

4.1 Restrictions on who can provide certain advice

6) What implications would removing the distinction between class and personalised advice have on access to advice?

Removing the distinction between class and personalised services, coupled with a principles based relaxation of who can provide advice, will improve the confidence of financial advisers to provide advice. We say this because:

- advisers will have certainty as to the regulatory treatment of the advice they are providing; and
- advisers will not have to concern themselves with subtle distinctions between class and personalised advice, and importantly will not have to monitor or moderate their behaviour to address the risk that they stray from class into personalised advice (as happens at present).

However, as discussed above, it will be important to ensure that the prevailing requirement to "match" the consumers demands does not inadvertently result in advisers being unsure as to how much information they need to gather on a client, and defaulting back to a full needs analysis when that may not be warranted by the circumstances.

7) Should high-risk services be restricted to certain advisers? Why or why not?

Refer to our response to question 3, option 3.

8) Would requiring a client to 'opt-in' to being a wholesale investor have negative implications on advisers? If so, how could this be mitigated?

Refer to our response to question 3, option 4.

A possible alternative to requiring clients to 'opt-in' to being a wholesale investor is to require advisers to notify clients that the service they are receiving is a wholesale service. This is consistent with the requirement of DIMS providers under the FMCA to disclose to clients when a service is not a retail service.

4.2 Advice through technological channels

9) What ethical and other entry requirements should apply to advice platforms?

In principle, the same ethical and professional responsibilities, and entry requirements, should apply to the providers of Robo advice as other advisers.

However:

- systems providing Robo-advice can only produce a series of pre-defined results for consumers. Outcomes are currently determined prior to the consumer receiving any advice and the process the consumer undertakes is merely one of identifying which pre-prepared advice applies to them
- the approach of using pre-defined criteria to filter a consumer's unique personal circumstances runs the risk of consumers not receiving appropriate advice. In particular, computer systems may not be able to recognise when information is inconsistent or inaccurate and may not be designed to ask clarificatory questions
- a Robo adviser is particularly susceptible to bias in its design. For example, the programme may only be able to advise on products from a single provider. This could run contrary to the duty to prefer the interests of consumers in the case of a conflict of interest between the adviser and the consumer.

These issues mean that the ethical obligations of the providers of Robo advice are most relevant at the system design phase. However, we think that Robo advice can be accommodated within a technology neutral legislative framework.

In terms of entry criteria, we believe that the provider of a Robo advice offering would (like any other entity) be required to have an entity level licence.

10) How, if at all, should requirements differ between traditional and online financial advice?

We consider that, for the reasons set out in our answer to question 9 above, the providers of Robo advice should be required to:

- exercise the appropriate levels of care, diligence and skill when creating the Robo advice system as opposed to exercising appropriate levels of care, diligence and skill every time advice is given by the system; and

- provide a prescribed warning statement to the consumer identifying the deficiencies of Robo advice, as part of the overall disclosure regime.

4.3 Ethical and client-care obligations

12) If the ethical obligation to put the consumers' interests first was extended, what would the right obligation be? How could this be monitored and enforced?

We support an obligation to put consumer interests first, with qualifications. It should not be mandatory for an adviser to consider all product offerings in the market and then formulate the best option for the client in the circumstances. That would be an impossible duty to fulfil. Sales in contrast should be regulated solely by the Part 2 fair dealing provisions in the FMCA, provided it is clear that the adviser is acting as a sales person only.

The Australian Corporations Act 2001 (at section 961B) sets out a 'safe harbour' for complying with the best interests duty. Showing that all of the elements in this test have been met is one way for an adviser to satisfy their duty to act in the best interests of the client.

The safe harbour requires an adviser to:

- identify the objectives, financial situation and needs of the client that were disclosed by the client through instructions;
- identify:
  - the subject matter of the advice sought by the client (whether explicitly or implicitly); and
  - the objectives, financial situation and needs of the client that would reasonably be considered relevant to advice sought on that subject matter (client's relevant circumstances);
- if it is reasonably apparent that information relating to the client's relevant circumstances is incomplete or inaccurate, make reasonable inquiries to obtain complete and accurate information;
- assess whether the advice provider has the expertise required to provide the client with advice on the subject matter sought and, if not, decline to provide the advice;
- if it would be reasonable to consider recommending a financial product:
  - conduct a reasonable investigation into the financial products that might achieve the objectives and meet the needs of the client that would reasonably be considered relevant to advice on that subject matter; and
  - assess the information gathered in the investigation;

- base all judgements in advising the client on the client's relevant circumstances; and

- take any other step that, at the time the advice is provided, would reasonably be regarded as being in the best interests of the client, given the client's relevant circumstances.

Importantly this duty is limited to the first three limbs of the test in respect of:

- certain banking products being distributed by a bank; and

- general insurance products.

Further information about this can be found in ASIC Regulatory Guide 175: Licensing: Financial product advisers—Conduct and disclosure.

While we do not believe that we need to import all of the elements of the Australian model, it is a useful point of comparison for formulating the relevant duty in New Zealand.

The safe harbour should not apply to simple products distributed by a bank or insurer as this would place an undue burden on those providers and would not reflect the realities of the market. For example, a bank should not be in breach of its duty to act in the best interests of a consumer if it fails to draw the consumer's attention to a higher term deposit rate at a competitor bank.

13) What would be some practical ways of distinguishing 'sales' and 'advice'? What obligations should salespeople have?

We consider that the best way to provide for a legislative distinction between sales and advice is to allow "sales people" to clearly disclose that they are "sales people" not acting in the capacity of a "financial / entity adviser" or as the representative of a licensed entity.

This could be achieved by including an express inclusion in the list of activities which do not constitute advice for:

> *"where a person makes a recommendation or gives an opinion about acquiring or disposing of (including refraining from acquiring or disposing of) a financial product where that statement is accompanied by a statement in the prescribed form or that statement is displayed in a prominent fashion,"*

The prescribed statement could be framed along the following lines:

> *Warning*
>
> *I am a [sales person] and am not providing you with financial advice.*
>
> *The law normally requires people who provide financial advice to comply with certain duties. These duties do not apply to me.*

Ask questions, read all documents carefully, and seek independent financial advice before committing yourself.

We do not believe that this type of disclosure should be required for certain types of simple financial products (in particular cash and term deposits), given how common these products are and the ways in which they are provided.

Neither should the duties to act in the best interests of a customer apply where there is no legitimate expectation on the customer's behalf that the adviser will act in their best interests. For example, where a consumer contacts a sales person to acquire a specific financial product, the sales person should not be under an obligation to determine if that product satisfies the consumer's demands.

14) If there was a ban or restriction on conflicted remuneration who and what should it cover?

We do not support a ban on conflicted remuneration.

If commissions were restricted, advisers or sales people currently remunerated in this way would need to be remunerated by other means - probably by fees charged to the client. This would likely lead to a significant decline in advice being sought, to the detriment of consumers, financial literacy and an informed market.

4.5 Tools for ensuring compliance with the ethical and competency requirements

17) What are the benefits and costs of shifting to an entity licensing model whereby the business is accountable for meeting obligations (Option 1)? If some individual advisers are also licensed (Option 2), what specific obligations should these advisers be accountable for?

The current liability settings in the FAA mean AFAs and RFAs share liability with their employers in some cases. This is confusing, and in our view, difficult to justify as a matter of principle. Where an individual is acting on behalf of the business of their employer, liability should rest with the employer, except in cases where an ethical obligation that applies to that individual personally has been breached.

We therefore support Option 1 – Entity Licensing ahead of all other options. In our mind the appropriate regulatory package would be along the following lines.

- entity level licensing, with the licence being another category of Market Services Licence under Part 6 of the FMCA
- some concessions from the requirement to have a licence (or possibly a more relaxed set of conditions attaching to the licence), for example for:
  - smaller businesses where the compliance burden of having a licence (or a licence with "full" conditions) would be disproportionate, and

  - low level types of financial advice (for example, research notes and financial commentary where the existing Part 2 fair dealing regime under the FMCA, supplemented by the Fair Trading Act 1986, is sufficient)

- a general obligation on the entity to ensure that advisers only advise on products for which they are qualified, with consequences for the entity if that is breached

- a more refined version of the current Code of Conduct for financial advisers in the form of a code of ethics (with the consequences for breach resting with the entity, not the individual) – so that a breach by an individual would have consequences solely in respect of the individual's employment, rather than the individual being personally liable for the breach

- individual licensing in exceptional cases only, for example, sole traders and investment planning services which are limited to persons who are certified financial planners (a qualification which we understand is well recognised)

- regulation at the entity level of appropriate qualification levels for different types of advisers depending upon the complexity of the advice and product concerned – supported by entity level consequences if advice is not provided by an appropriately qualified individual.

The important point in this context is that these measures are all directed at consumer protection, which in our mind is the appropriate way to calibrate legislation in the financial markets arena.

If industry regulation is still considered necessary, it could be provided through a separate statute as is the case for many other professions. That separate statute would impose stand-alone qualification levels and competency requirements, supported by a code of ethics and enforced by a disciplinary committee (which would not necessarily be part of the FMA).

This package of measures could:

- appropriately segregate the consumer protection and industry regulation components of the FAA

- create a level playing field between all entity types so that entities meeting the licensing standard would be in a similar position as existing QFEs

- retain the QFE model, which from our observation has worked well, and

- retain the ability for the advisory community to identify itself as an industry, in that employers must ensure that advisers are appropriately qualified.

For these reasons we would not support any of the other options in section 4.5 of the Options Paper. As mentioned above, any move to separate the consumer protection and industry regulation components of the FAA would require industry consultation

4.6 Disclosure

19) What do you think is the most effective way to disclose information to consumers (e.g. written, verbal, online) to help them make more effective decisions?

We support a mixture of brief, upfront written disclosure, more detail on the Financial Service Providers Register and much more flexibility on fee disclosure (for example, where it is not possible to give percentage based fees upfront, disclosure on a transaction by transaction basis should be allowed, as is currently the industry norm for brokers through the use of "contract notes").

Upfront written disclosure should be provided to consumers at the point they engage directly with an adviser or as soon as practicable. This disclosure should contain information which is directly relevant to the products being advised on, together with a reference to a website where more generic information such as the availability of a dispute resolution service and the full range of products on which an adviser can advise on are maintained. See our answer to question 20 below for suggestions on the disclosure content.

Importantly:

- disclosure would be a **licensee** obligation not an individual obligation;
- there should be a level of prescription in the disclosure required; and
- the fee disclosure regime should be "right-sized" to recognise the fact that quantifying fees upfront is impossible in adviser models which charge a percentage of assets under management, with one-off fees for trading and similar activities.

Verbal disclosure – retain for flexibility

The ability to provide verbal disclosure needs to be retained to accommodate the fact that advice is in many cases provided by telephone – as when a consumer calls a product provider, asks which of their products they should acquire and buys them over the phone.

20) Would a common disclosure document for all advisers work in practice?

We support the adoption of a common disclosure document for all advisers, but with some flexibility as described in our answer to Question 19.

The entity would have the disclosure obligations, not the individual adviser.

Key relevant information would include:

- details of the entity's licence;
- details of the entity's dispute resolution service;

- any conflicts of interest the entity may have in relation to any product that may be provided to consumers; and

- disclosure of the way the entity remunerates its staff – i.e. an indication that commissions may be payable in the case of certain products on which advice is provided by employees.

21) How could remuneration details be disclosed in a way that would be meaningful to consumers yet relatively simple for advisers to produce?

It will be up to the entity to determine how best to disclose remuneration details in disclosure statements. At a general level:

- where an adviser would receive a percentage based commission on a transaction the adviser should not be required to disclose the dollar amount of that commission but rather the percentage amount

- where advisers receive a stepped commission (increasing commissions depending on the level of sales) advisers should be required to disclose the fact of their commission and its stepped nature not the specific step they are on at any given time

- if advisers are required to change their disclosure materials on a client by client basis, this will impose a significant burden and a risk that consumers will be inadvertently provided with incorrect information.

The views of industry will be critical here. We are attracted to an approach which requires an entity to disclose that its employees may have an element of their remuneration linked to the sale of particular products and that the entity (or the advisers) may receive commission in relation to products. However, we think that the actual disclosure of any commission rates would logically be in a fee disclosure document – and as described above we would see the need for sufficient flexibility to ensure that the appropriate details are able to be disclosed in a clear, concise and effective manner.

24) Should professional indemnity insurance apply to all financial service providers?

While professional indemnity insurance is often taken out by financial service providers as part of their governance arrangements, we consider that requiring all financial service providers to have such insurance is unwarranted. In any event, we expect that FMA would take into account the level of professional indemnity coverage held by a provider when assessing that provider's eligibility for a licence.

As identified by the Options Paper the cost of obtaining this insurance will ultimately be borne by consumers. In addition, the cost of obtaining this insurance will serve as a barrier to entry for smaller entrants into the industry.

4.8 Finding an adviser

25) What is the best way to get information to consumers? Who is best placed to provide this information (e.g. Government, industry, consumer groups)?

A central electronic portal, possibly bolted on to the FSPR, could be provided to allow consumers to search for advisers able to advise them on particular products.

We consider that where advice is provided by an entity rather than a sole trader only the entity should be required to maintain a registry entry on this portal. For example:

> *XYZ Limited is able to provide advice on the following types of products it provides:*
>
> - *Loans*
> - *Deposits (e.g. term deposits and on-call accounts)*
> - *Credit cards, and*
> - *Insurance*
>
> *XYZ Limited is able to provide advice about the following types of products provided by other entities:*
>
> - *Credit cards, and*
> - *Insurance.*

The key here would be to ensure that the register entry is very simple and does not require extensive routine maintenance. The views of industry will be important here – as many industry participants are already subject to a range of registration requirements, and may find any additional registration requirement unnecessary and unwieldy.

4.9 Other elements where no changes are proposed

The definitions of 'financial adviser' and 'financial adviser service'

27) Do you have any comments on the proposal to retain the current definitions of 'financial adviser' and 'financial adviser service'?

We set out our comments below, which are drawn from our Earlier Submission.

Boundary between an "investment planning service" and "financial advice" is unclear

While we consider that the definitions of "financial adviser" and "financial adviser service" are generally understood, in our view the boundary between an "investment planning service" and "financial advice" is unclear.

This lack of clarity has given rise to issues in the advisory community (for example, whether an AFA requires authorisation to provide an investment planning service). This confusion is exacerbated by AFA Code Standard 8, which requires AFAs to have an up to date understanding of the client's "financial situation, financial needs, financial goals and risk profile" before providing financial advice. In complying with that standard, it becomes almost impossible not to provide an investment planning service when providing financial advice that is more than purely one-off. We endorse an approach which consolidates the two services, with perhaps the boundary used only as a tool requiring competencies.

Alternatively, we consider that the definition of an investment planning service needs to be amended to create a distinction between the provision of an investment planning service and the requirements of Code Standard 8 of the Code should that be retained.

Our suggestion

We would support abandoning the concept of "investment planning service" unless industry is of the view that the concept should be retained. If so, then we believe it would be appropriate to consider whether only qualified "Financial Planners" are allowed to provide an investment planning service.

If the definition is retained, however, it is critical that the boundary issues described above are adequately addressed.

Clarify status of exclusions from 'financial adviser service' for no advice services

One of the most tortuous questions affecting the industry has been how to distinguish between personalised advice, class advice and no advice. This question gave rise to a 27 page guidance note from FMA, which (while well intentioned) has proven difficult to implement and has led to some advisers defaulting to giving no advice.

We believe that any reforms should look to address the confusion that currently exists in this context.

29) How can the FA Act better facilitate the provision of international financial advice to New Zealanders, without compromising consumer protection? Are there other changes that may be needed to aid this, beyond the technological options outlined in Chapter 4.2?

Territorial scope

The territorial scope of the FAA has meant that overseas providers, whose only connection with New Zealand is the location of clients, are caught by the FAA's territorial scope (on the basis that a service is "received by a client in New Zealand").

This is despite the fact that all other aspects of the service are provided offshore, and are regulated in those offshore jurisdictions – resulting in dual regulation and increased (and unnecessary) compliance costs.

We believe that this issue could be addressed by creating an "approved list" of offshore jurisdictions whose characteristics are recognised in New Zealand law (with some tolerance where offshore requirements differ from New Zealand requirements – for example, European jurisdictions where the concept of holding assets "on trust" does not exist). While there is relief already for Australian AFAs, this has been achieved through the use of two exemptions. We see this as a matter that should be dealt with as part of the regulatory framework, not sporadically through exemptions.

We believe that the creation of an "approved list" of this nature will recognise that, in many cases, consumers can be adequately protected under the rules of foreign jurisdictions, and the requirement for approval means that New Zealand consumers will still be protected by New Zealand regulation where a country is not on the approved list.

We would also support a move to targeted exemptions for dealing with certain "false positives" resulting from the territoriality scope, for example:

- a person who may be receiving a financial adviser service or custody service regulated in another jurisdiction automatically becomes entitled to the protections under New Zealand law if s/he sets foot in New Zealand – because that person would have "received the service in New Zealand". We therefore believe there is a case for a "temporary mover/resident" exemption, to address this issue; and

- with specific regard to custody, it should not be necessary to afford the full custody protections to wholesale clients – and for the reasons given below we believe that the retail/wholesale boundary is calibrated incorrectly for custody in this context.

The regulation of brokers and custodians

31) Do you have any comments on the proposal to retain the current approach to regulating broking and custodial services?

Wholesale/retail divide.

Currently different tests for the wholesale/retail divide apply under the FAA, FSPA, FMCA and Financial Advisers (Custodians of FMCA Financial Products) Regulations 2013 (*FAA Custody Regulations*). In our view, a consistent test should apply across all of the legislation.

We are aware of businesses choosing not to engage with clients on a wholesale basis under one regime, despite the client qualifying for that treatment, and instead electing to treat that client as retail in order to achieve consistency. That is, in order to be eligible for wholesale treatment a client needs to be wholesale for all purposes.

The misalignment across the legislation also makes it very difficult to draft clear, concise and effective safe harbour and eligible investor certificates, and often makes it necessary to prepare multiple certificates. The certificate requirements for eligible investors in the FMCA and FAA should be aligned to enable a client to certify in a single document as to their status under each regime.

We consider the solution to be as follows:

- the wholesale/retail tests should be rationalised across the FAA, FSPA, FMCA and FAA Custody Regulations so that there is a consistent wholesale/retail boundary across all of the legislation; and
- more specifically, the wholesale/retail boundary in the FAA Custody Regulations should be extended to include all categories of wholesale client in clauses 3(2) and 3(3) of Schedule 1 to the FMCA.

Currently this boundary means that some categories of investor are eligible to acquire products on the basis of being a wholesale client but are then ineligible to have those products held for them in custody as though they are a wholesale client – which we see as a perverse outcome.

The issues canvassed above can best be captured in tabular form – and to that end we attach (as the Appendix) an extract from a presentation we have given to clients which demonstrates how "few" wholesale client categories actually result in a client being able to be treated as wholesale across all legislation. This table also demonstrates the differences in wholesale categories across the FAA and FMCA which (for the reasons given above) we see as suboptimal.

Tainting of wholesale custody services by retail clients

At present the FAA Custody Regulations do not apply to a custodial service if **all** of the clients for that service fall within certain categories of wholesale client under the FMCA (*Core Wholesale*). Where the FAA Custody Regulations apply certain consumer protections which otherwise would not apply to wholesale clients under the FAA are activated.

The outworking of this is that if a single client of an otherwise wholesale service does not fall within a Core Wholesale category then the provider of that service is obliged to provide the retail level custody protections to all clients, including Core Wholesale Clients.

We consider that this "tainting" of wholesale clients by retail clients is unwarranted and difficult to justify as a matter of principle. If this is a concern then it should be possible to deal with it by requiring disclosure to wholesale clients that they do not have the benefit of the protections under the FAA Custody Regulations, rather than the provider having to provide the retail level protections to those wholesale clients.

Chapter 5 – Potential packages of options

32) What are the costs and benefits of the packages of options described in this chapter?

Package 1

We consider that the cost of implementing Package 1 would be reasonably minimal as it largely mirrors the current regime.

However, the benefits are also reasonably minimal as much of the complexity of the current regime is maintained - and this complexity drives many of the barriers identified in the Options Paper.

The ability of entities to provide Robo advice should go some way to filling the advice "gap" identified in the Options Paper.

We generally support the application of duties on advisers to act properly in providing advice. However any such duties will need to be calibrated carefully to ensure that they do not result in "paralysis by analysis". For example, the duty to act in a client's best interests should not require an adviser to consider all possible options in the market.

We also query the suggestion that an adviser could recommend that a consumer replace an existing product without undertaking an assessment of whether the replacement product will make the consumer better off, and still be compliant with the duty to act in the client's best interests.

Package 2

We consider that the cost of implementing Package 2 would be considerable. We do, however, support the move to a licensed environment and a separation between industry regulation and consumer protection.

We consider that the model of creating a list of products or services on which only "Expert Financial Advisers" can advise is flawed. As indicated earlier in our submission, any list of "complex" products is susceptible to failing to capture products which are truly complex or have complex features. While this could be addressed by supplementary regulations as was the original intention of the FAA, this has not happened to any significant degree.

Our experience is that licensing processes under the FMCA require substantial resources. In addition to these upfront costs businesses would also incur costs in reconfiguring their practices to align with the new thresholds in Package 2.

The extent to which Package 2 will benefit consumers will in many respects depend on the details of that proposal - e.g. the extent to which services are required to be provided by "Expert Financial Advisers".

Package 3

We consider that the cost of implementing Package 3 would be substantial.

Businesses would be required to devote considerable resource to understanding and implementing this new regime, after already expending significant resources on compliance with the current regime.

However, of the Packages presented, we consider that this package goes the furthest to addressing the barriers described in Chapter 3.

34) What changes could be made to any of the packages to improve how its elements work together?

Allow unaligned sales

We support the inclusion of a bright line exclusion from the FAA for "sales" type activities. We consider that the current exclusions in the FAA are at times ambiguous and create a risk that a person may inadvertently provide financial advice. However, the Options Paper links the ability to sell a product (as opposed to provide advice on it) to alignment between the sales person and the provider of the product (i.e. advisers must be **selling their own product**).

This requirement cuts across current market practice where advisers sell the products issued by multiple organisations.

In addition, any such restriction would need to be carefully calibrated to take account of the fact that many organisations rebrand the products provided by other organisations and then provide them to their clients. This is particularly prevalent in the insurance industry.

Accordingly, we believe sales persons should be able to sell the products of other market participants.

35) Can you suggest any alternative packages of options that might work more effectively?

As we have explained above, much of the complexity of the FAA is due to the fact that it seeks to combine both industry regulation and consumer protection within a single framework.

This results in multiple filters which need to be applied to any situation to determine its regulatory treatment.

We believe it would be appropriate to consider a solution which:

- makes use of the existing licensing FMCA regime to license organisations and individuals who provide financial advice; and
- implements an industry statute which prescribes minimum standards – but (critically) does not impose consumer protection duties or obligations on the individuals concerned.

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Appendix – Wholesale Categories

FMCA		FAA[1]		CUSTODY REGULATIONS
Primary/secondary offer	**(Class) DIMS**	**General (excl DIMS)**	**(Personalised) DIMS**	**Custody**
Government agencies	Government agencies	Government agencies	Government agencies	Government agencies
Investment businesses	Investment businesses	Investment businesses	Investment businesses	Investment businesses
Large entities	Large entities	Large entities	Large entities	Large entities
Investment activity	Investment activity	Investment activity	Investment activity	
Eligible investor	Eligible investor	**PLUS**	**PLUS**	
$750k / $5m derivatives		Other FAs/brokers/FSPs	Other FAs/brokers/FSPs	
Underwriter		Entities with $1m net assets/turnover	Eligible investor (under FAA)	
		Eligible investor (under FAA)	**PLUS**	
			Eligible investor (under FMCA) – if service relates to DIMS facility	

[1] Excludes close business associate / relative category
[2] Excludes offer specific exceptions