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Submission on Options Paper: Review of the Financial Advisers Act 2008 and the Financial Service Providers (Registration and Dispute Resolution) Act 2008

Background

Medical Assurance Society ("MAS") was established in 1921 by a group of doctors in Napier who felt that existing insurance companies were not adequately meeting their needs. Today MAS provides a range of financial services including insurance, lending and investments. Our Members remain predominantly doctors, dentists and veterinary professionals. We also provide financial services to other professional groups, including accountants, architects, engineers and lawyers.

MAS is licensed as a Qualifying Financial Entity ("QFE") and provides services through a face-to-face network of salaried advisers (made up of both AFA and QFE advisers) supported by a national Call Centre. Our advisers do not receive commissions or incentive based remuneration, and are all employed by MAS. Their performance is assessed on the provision of 'outrageously good service' to our Members which includes the quality of advice provided.

Financial advice is provided by MAS AFAs and QFE advisers in respect of MAS issued products only. These products include a category one KiwiSaver scheme, superannuation scheme and debenture stock term investments. The remaining products are category two and include fire and general insurance, life and disability insurance, business and personal lending, a PIE fund (with term and on-call options) and an on-call debt security savings account.

Not all of the questions raised in the Options Paper are relevant to MAS. This submission will largely concentrate on those questions that are relevant to our business model. Comment will also be made where we hold an opinion on what we feel is good for the advice industry as a whole.

CHAPTER 3: BARRIERS TO ACHIEVING THE OUTCOMES

Q.1: Do you agree with the barriers outlined below? If not, why not?

Yes. MAS's view is that the identified barriers, and goals of overcoming them, work symbiotically with each other. However, we see increasing public confidence in the professionalism of advisers as being the paramount goal.

Q.2: Is there evidence of other major barriers not captured here? If so, please explain.

One further barrier that should be considered with greater attention are boundary issues (such as line between financial advice and an investment planning service, class and personalised advice, and taking into account relevant financial situation and goals) which contribute to risk aversion amongst advisers and which flow on to potentially negative implications for consumers.

CHAPTER 4: DISCRETE ELEMENTS

Q.3: Which options will be most effective in achieving the desired outcomes and why?

Limitations on the provision of advice:

- There should be a single category of financial adviser, and clear distinction from salespersons, so that consumers are not faced with any doubt as to who can provide advice.
- There should be a single category of financial product. Advisers should be competent for the products they provide advice on and apply a consistent duty of care.

Ethical and competency requirements:

- All advisers should be required adhere to the same standard of duty of care in providing adviser services.
- Competency should be a built around principles-based competency appropriate for the business and continuing professional development.
- All adviser businesses should be subject to licensing to ensure effective regulatory oversight.

Consumer experience:

- Should be built around a common form of disclosure for all advisers.
- Information about how to access adviser services, and education for consumers should be centralised into a consumer friendly online portal.
- Consumers themselves need to have input into what will be effective for them.

Q.4: What would the costs and benefits of the various options be for different participants (consumers, financial advisers, businesses)?

Consumers will seek the lowest cost advice, which could limit the access they have to a broad range of products. They also may not understand the risks associated, or impacts on suitability of the advice that they will receive, in seeking out advisers based on selecting the lowest cost to access their services.

The greater the compliance burden on advisers and businesses, and complexity of the regime, the greater the cost that will be passed on to consumers. This could turn some consumers away from seeking financial advice, or they could seek out advice from unregulated sources.

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

No.

4.1 RESTRICTIONS ON WHO CAN PROVIDE CERTAIN ADVICE

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

Removing the distinction between class and personalised advice should make it easier for consumers to understand what type of service they are receiving. In essence, class advice is formed around factual information about a product. Therefore it should be reflected in the FA Act as the provision of information and not advice. This will aid in providing clarity to advisers as to the boundary between advice and information which is an important consideration in addressing the perverse outcomes raised in the options paper as well as make it clear to consumers what service they will be receiving. How an adviser would respond, would be based upon the service that the client is requesting.

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

All advisers should be limited to providing advice only in areas that they are appropriately qualified and competent to do so. As one of the barriers that the regime is trying to overcome is lifting consumer confidence in the advice industry, ideally advisers should be required to be consistent in their approach and standard of care in providing a financial advice service.

The current two tier categorisation of financial products is flawed. For example the complexity and risks associated with KiwiSaver (a category 1 product) can vary significantly – from relatively simple in the case of a young person entering the workforce for the first time but could be complex for someone with a number of assets and who is reaching the point of decumulation. In addition, the current categorisation of insurance products as category 2 creates a perception that such products are 'low risk' and not complex. However, the financial consequences of being under insured in the

event of a claim can easily be as adversely material to a client's financial situation as the consequences of receiving poor investment advice.

A second flaw is that the current regime focuses on whether financial products are deemed to be complex or not. Just as relevant is the complexity associated with a client as a result of their life stage, asset accumulation or how they have structured their personal and financial affairs, irrespective of what products that they hold or are seeking advice on. The regime should reflect this.

Q.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?

From a logical consumer protection perspective, it seems appropriate for someone to be required to make a conscious decision to 'opt-in' to being a wholesale client rather than be required to 'opt-out' Whilst a consumer may meet the criteria of being a "sophisticated" investor they may not in reality have the level of sophistication to adequately understand the implications and risks that come with being categorised as a wholesale client.

4.2 ADVICE THROUGH TECHNOLOGICAL CHANNELS

Q.9: What ethical and other entry requirements should apply to platforms?

The use of, and appetite for, technological channels is increasing at a pace that the legislative environment is not currently keeping pace with. This will continue to be the case if legislative and regulatory barriers are set too high.

If appropriate channels are unable to be provided for the local advice market then the risk continues that consumers will still seek advice from elsewhere online without adequate understanding of the risks in doing so, and without the protection of New Zealand law.

Online platforms should only be provided by appropriately licensed entities. An efficient licensing regime should provide for both industry and regulators to be able to achieve the flexibility required to keep pace with rapid changes in technology and consumer demand for alternative channels.

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

The principles of the FA Act, and the Code Standards should apply to both traditional and online advice channels.

Q.11: Are the options suggested sufficient to enable innovation in the adviser industry? What other changes might need to be made?

Option 1 presented under section 4.2 of the options paper appears to strike the best balance for opening up the adviser industry to technological innovation whilst maintaining adequate consumer protections and regulatory oversight through entity licensing.

4.3 ETHICAL AND CLIENT-CARE OBLIGATIONS

Q.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?

Having different ethical obligations for different advisers as is currently the case with the AFA code of professional conduct over and above the acting with skill, care and diligence requirements of the FA Act sends the wrong message to consumers. To instil confidence in the advice industry, it is important for consumers to be able to expect consistency in the duty of care to be applied to all advice.

The current system of AFA and QFE complaints reporting to the FMA provides an efficient mechanism for the monitoring of effectiveness and provides an incentive for businesses to have in place their own internal monitoring of advice engagements to maintain quality service standards.

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

Any terminology used to distinguish sales should avoid any use of the term "advice". As it is likely that a salesperson would be providing class advice as it is currently defined in order to meet the suitability requirement, it is desirable that this be re-termed as "information" which is a term more closely aligned with what it is.

If salespeople are not required to act in a client's best interests then they should need to meet a suitability requirement. But this is already the case to some extent. Knowingly selling someone a product that is unsuitable is likely to contravene existing consumer legislation. Both the FMCA and the Fair Trading Act have provisions that prohibit making false representations or engaging in misleading conduct. It is therefore difficult to agree that further requirements for suitability being included for sales under the FA Act would add any further level of consumer protection.

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

Although MAS would not expect to be directly impacted by any restriction on conflicted remuneration, we do feel that any such restrictive measures may impact negatively on consumer access to financial advice. For example, a consequence of restricting the remuneration of advisers by way of commission is a likely increase in fee based advice services. The increased costs that

consumers would face to access advice are contrary to the barriers that this review is trying to overcome.

Strengthening of the disclosure model should include a requirement. Clear disclosure of soft commissions (e.g. sales target travel/gift incentives) should be required so that consumers have greater visibility of what remuneration may give rise to a conflict of interest for an adviser.

4.4 COMPETENCY OBLIGATIONS

Q.15: How can competency requirements be designed to lift capability, without becoming an undue barrier to entry and continuation in the profession?

Generally MAS supports lifting levels of professionalism in the adviser industry and ensuring that adequate ethical and educational standards are in place for advisers to facilitate the delivery of high quality financial advice.

We agree that industry should work to lift the competency of advisers, and staff selling financial products. However the more prescriptive level of qualification required then the greater the barrier to entry for new advisers, and potentially cost passed on to consumers for accessing advice. Another problem with implementing a prescribed qualification as an entry mark is that it then becomes difficult to encourage advisers to achieve higher levels of formal qualification.

We support principles based requirements that oblige advisers to be competent to provide the services that they do and that advisers must demonstrate how this competency is maintained. The emphasis would be on businesses to have greater engagement with the FMA on what these competencies should be through the licensing process. The business models used in the advice industry are diverse and this approach ensures that competency can be linked more directly to the products and services that licensed businesses are providing as opposed to a one qualification fits all approach.

Q.16: Should all advisers be subject to minimum entry requirements (Option 1)? What should those requirements include? If not, how should requirements differ for different types of advisers?

We support an approach that is more aligned with Option 4. That is all advisers should be subject to a minimum entry requirement to the extent that they meet the competency requirements applicable to the products and services that they provide. This would be a principles based obligation set through the licensing process.

All advisers should be subject to mandatory CPD to ensure that they can demonstrate how they have maintained competency.

4.5 TOOLS FOR ENSURING COMPLIANCE WITH THE ETHICAL AND COMPETENCY REQUIREMENTS

Q.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?

MAS is a QFE and therefore subject to an entity based licensing regime already. We are also in the position of employing a number of AFA advisers who are individually licensed. From an efficiency perspective (across both compliance cost and consistency of service delivery) it would be strongly desirable for licensed entities to be able to discharge an increased range of obligations.

Where an individual is subject to licensing (i.e. as an AFA currently is) and they are also an employee of a licensed entity, then they should be able to rely on the entity to discharge some, if not all, of their regulatory obligations (disclosure, ABS, FSP registration, annual reporting, etc.) on their behalf. In an employer/employee situation, it is the entity employing the adviser that sets and monitors the processes and controls in place for the delivery of advice services and the regime could better reflect this.

Q.18: What suggestions do you have for the roles of different industry and regulatory bodies?

The traditional role that industry bodies have played in self-regulating their respective industries through the setting of ethical and practice standards becomes diluted as the environment becomes increasingly subject to greater regulatory compliance and oversight. Therefore some of the traditional drivers for becoming an industry body member fall away.

Allowing industry bodies to become entity licensed could provide opportunities for individual advisers who are members of a licensed industry group to mitigate some of their compliance costs.

Industry bodies could still retain an important role in facilitating CPD opportunities for advisers.

4.6 DISCLOSURE

Q.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?

The disclosure requirements should be standardised across all advisers. The current different requirements for AFAs, QFEs and RFAs and the multiple forms of disclosure for AFAs are not conducive to being easily understood by consumers. Anecdotally, it is believed that very few consumers actually read written disclosures provided to them therefore the current requirements around written disclosure can't be deemed to be effective.

One option could be for high level important information to be delivered in verbal or written form with clear instructions provided on where to obtain more detailed information. The detail can be kept either on an adviser's website or a centralised portal of adviser information (i.e. an enhanced FSPR).

However, it is consumers who are the end users of disclosure and therefore it is essential that consumers are canvassed for their opinions on the most effective delivery of important information.

Q.20: Would a common disclosure document for all advisers work in practice?

A common disclosure document is desirable for the reason of minimising potential consumer confusion that currently exists with multiple forms of disclosure across the different types of advisers. However, one risk of having a common disclosure document is that it becomes overly prescribed through regulation.

An example of this in the current regime is the AFA primary disclosure statement. As form prescribed by regulation, there is little flexibility for advisers to describe their situation when they fall outside the parameters that are set out. For example, in its current prescribed form the AFA primary disclosure statement section "How do I get paid for the services that I provide to you?" makes no allowance for AFAs whose sole form of remuneration is by way of salary paid to them by their employer. This is the case for MAS and its salaried adviser staff. Because the form is prescribed in regulation, the closest acceptable solution is to tick "fees" which covers the fees that the client pays (zero), as well as "in other ways". This is totally ineffective in providing a consumer with an accurate idea of how the adviser is paid.

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

Advisers and entities involved in the provision of advice services should be compelled to provide full details of the source, nature and extent of remuneration (including 'soft' remuneration) for there to be an effective disclosure of conflicts of interest to consumers.

The use of visual graphics to illustrate how an adviser is remunerated could be an effective tool to present important remuneration information in a way that effectively enables consumer understanding.

4.7 DISPUTE RESOLUTION

Q.22: Is there any evidence that the existence of multiple schemes is leading to poor outcomes for consumers?

No.

We are aware of a previous issue whereby one scheme differentiated itself by offering a lower cap for disputes that could be considered. This created a competitive advantage over rival schemes, but was not in the interests of consumers who would be unlikely to be aware of such a difference. It is

our understanding that this anomaly between schemes was subsequently addressed and is no longer an issue.

Q.23: Assuming that the multiple scheme model is retained, should there be greater consistency between scheme rules and processes? If so, what particular elements should be consistent?

Rules should be consistent between schemes.

Q.24: Should professional indemnity insurance apply to all financial service providers?

Making professional indemnity insurance mandatory for all financial service providers may not be an effective tool for overcoming the barriers that are wanting to be addressed. Some risks are uninsurable and the cost of insurance may create a barrier to entry for some financial service providers, or force some out of the industry.

One approach may include indemnity insurance in the disclosure requirements and have financial service providers disclose whether or not they have professional indemnity cover, and what level of that cover is in place.

4.8 FINDING AN ADVISER

Q.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)?

Education for consumers on how to access adviser services and important information that they should consider in choosing an adviser is something that is lacking and needs to be improved if the regime is to achieve its objectives. Within a regulated industry the government/regulator is best placed to also provide the necessary education to consumers. Whilst industry could play a small role, they should take the lead as it would be difficult for industry to overcome the credibility barriers that currently exist. This is because industry may be perceived to be insufficiently independent to provide objective education to consumers.

We support Option 1, establishing a portal with information for consumers on financial advisers. This could be a new website (replacing the FSPR) or an enhancement to the FSPR. It should be noted though that the FSPR in its current form is cumbersome and ineffective to be useful in achieving this objective. It would not be desirable from an administrative perspective to have to keep multiple platforms up to date (i.e. the FSPR and a new information portal), instead it would be more efficient for any platform to incorporate the features of the FSPR and add functionality and usability.

Q.26: What terminology do you think would be more meaningful to consumers?

AFAs already have an obligation to communicate clearly, concisely and effectively (code standard 6). Such a standard should be extended to all providers of advice services and as such all disclosures and important information should be communicated in 'plain English' terms.

With this in mind, the FA Act itself should seek to avoid jargon and address the issues that currently exist with terminology that is potentially confusing and not meaningful to consumers. Option 2, working with consumers and advisers to identify useful terminology, sets out the issues that currently exist with jargon that should be addressed.

4.9 OTHER ELEMENTS WHERE NO CHANGES ARE PROPOSED

Q.27: Do you have any comments on the proposal to retain the current definitions of financial adviser and financial adviser service?

No.

Q.28: Are those currently exempt from the regime posing undue risk to consumers through the provision of financial advice in the normal course of their business? If possible, please provide evidence.

No comment.

Q.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?

No comment.

Q.30: How can we better facilitate the export of New Zealand financial advice?

No comment.

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

No.

CHAPTER 5: POTENTIAL PACKAGES OF OPTIONS

Q.32: What are the costs and benefits of the packages of options described below?

Package 1: offers the lowest cost of change but also comes with the least benefit to consumers by not effectively addressing the barriers that have been identified.

Package 2: the main costs would be in ensuring that employee advisers are raised to any new standard of qualification and competency. As MAS is already licensed as an entity (QFE) we wouldn't expect any material change in cost due to the introduction of broader entity licensing.

Package 3: provides the best fit with MAS's vertical distribution model. A clear distinction between advice and sales benefits consumers by removing the current issues as to the types of advice service (class or personalised) being potentially confusing, and should also address any boundary issues creating risk aversion amongst advisers.

Q.33: How effective is each package in addressing the barriers described in Chapter 3?

Package 1: Is too light touch and on face value doesn't go far enough to materially improve outcomes for consumers.

Package 2: Could be workable for our organisation but is still flawed by addressing some issues replaces them with others. For example, it is clear that having multiple types of advisers, or multiple complexities of product, is potentially confusing for consumers. It is therefore difficult to support the logic in a proposed "expert" adviser that is somehow different to what an AFA currently is, or to introduce a new category of "complex" or "high risk" product.

Package 3: Strikes the best balance between simplification and protection.

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

No comment.

Q.35: Can you suggest any alternative packages of options that might work more effectively?

No.

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