How to have your say

Submissions process

The Ministry of Business, Innovation and Employment (MBIE) seeks written submissions on the issues raised in this document by **5pm on Friday 31 March 2017**.

Your submission may respond to any or all of these questions. We also encourage your input on any other relevant work. Where possible, please include evidence to support your views, for example references to independent research, facts and figures, or relevant examples.

Please include your name, or the name of your organisation, and contact details. You can make your submission:

- By attaching your submission as a Microsoft Word attachment and sending to *faareview@mbie.govt.nz*.
- By mailing your submission to:

  Financial Markets Policy
  Building, Resources and Markets
  Ministry of Business, Innovation & Employment
  PO Box 1473
  Wellington 6140
  New Zealand

Please direct any questions that you have in relation to the submissions process to: *faareview@mbie.govt.nz*.

Use of information

The information provided in submissions will be used to inform the development of the Financial Services Legislation Amendment Bill, decisions in relation to the outstanding policy matters, and advice to Ministers.

We may contact submitters directly if we require clarification of any matters in submissions.

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Part 1 of the Bill amends the definitions in the FMC Act

1. If an offer is through a financial advice provider, should it be allowed to be made in the course of, or because of, an unsolicited meeting with a potential client? Why or why not?

   Yes. Allowing financial advice providers to offer advice in the course of unsolicited meetings will increase access to financial advice. This approach is consistent with Goal 2 in the initial FAA review Issues Paper which was that the regulation of financial advice should enable accessibility of financial advice for consumers.

   Conversely, prohibiting financial advice providers from offering advice through unsolicited meetings adds an additional (and unnecessary) layer of client engagement to the process of providing financial advice. This additional engagement will reduce consumer access to financial advice by:

   - disincentivising consumers to access financial advice, as doing so will require two engagements (as opposed to one); and
   - increasing the cost of delivering financial advice for the provider, as two engagements will be necessary.

2. If the exception allowing financial advice providers to use unsolicited meetings to make offers is retained, should there be further restrictions placed upon it? If so, what

should they be?

Yes. As elaborated on below, we recognise that unsolicited advice should have added safeguards to protect the consumer, those being:

- a 'free look' period for any financial products purchased; and
- documented advice that complies with the duties and Code of Conduct.

These restrictions should apply in all cases. At the very least, however, they should apply in cases where the unsolicited advice relates to a type of product the client already holds (product replacement / replacement business).

Free look period

Financial products are often complex with their full terms written in surrounding policy documents and other contracts. This means that consumers may not have adequate time to read and digest important terms in an unsolicited meeting. Therefore, consumers should have a free look period to review all documents, during which the consumer can cancel the contract without penalty.

This could be implemented by ensuring that the 'uninvited direct sales' provisions in the Fair Trading Act 1986 (subpart 2 of Part 4A) apply to sales arising from unsolicited meetings. However, we also note that 5 days may not be enough given the complexity and length of many insurance contracts. At present, many insurance providers include a longer free look period of at least 15 days. We would support a mandatory free look period of this length for financial products sold in an unsolicited meeting.

Documented advice

If a financial advice provider offers consumers financial products during unsolicited meetings, we submit that there should be requirements to apply a documented advice process, adhere to the advice duties in the Draft Bill, and follow the Code of Conduct. This will ensure that the consumer has a written statement of how the financial product is suited to his / her individual needs. A written record would assist in ensuring that the consumer is aware of the details of the advice, and has a record of that advice.

Replacement advice

If a consumer already has a product of a type offered during an unsolicited meeting, the consumer is at risk of replacing an existing product with a new product that is less suited to his or her needs. We submit that in these situations, a documented advice process must be applied, the advice duties in the Draft Bill must be upheld, and the Code of Conduct must be adhered to. These extra safeguards reflect the greater risk to clients associated with replacement advice.

By way of example, it is possible that a consumer may have held a life insurance policy with a trauma benefit for ten years. Since that time, he or she may have developed a health condition that is covered under the existing policy, but will be excluded from a new policy as a pre-existing condition. It will be detrimental to the consumer to cancel his or her existing policy in these circumstances.

3. Do you have any other feedback on the drafting of Part 1 of the Bill?
   No.

Part 2 of the Bill sets out licensing requirements

4. Do you have any feedback on the drafting of Part 2 of the Bill?
   No.

Part 3 of the Bill sets out additional regulation of financial advice

5. Do you agree that the duty to put the client's interest first should apply both in giving the advice and doing anything in relation to the giving of advice? Does this make it clear that the duty does not only apply in the moment of giving advice?

   The duty to put the client's interest first should first and foremost apply to giving advice. The duty should also apply in some limited circumstances related to the giving of the advice. In this respect, we consider that the current drafting of the duty should be amended as, as it stands, the clause is too broad and uncertain in scope. We submit that the clause be redrafted to specifically identify the circumstances that are intended.

   Circumstances where the duty should apply

   The duty should apply to circumstances where a financial adviser, provider, or representative decides whether to offer advice, or to sell a product without advice.

   Extending the duty to this scenario removes the possibility of a financial adviser, provider or representative making a decision about whether to offer advice or sell a product on the basis of whether his or her interests are aligned with the client's interests.

   The situation of advisers being able to switch between giving advice or simply selling a product without advice creates a risk whereby consumers are sold products under the assumption they are receiving advice, when in reality they are not. Extending the client's first duty beyond the narrow circumstance of giving advice may assist in addressing this risk.

   In this respect, we note that FMA research into KiwiSaver sales in 2015 showed that only three of every 1000 bank sales were recorded as sold with personalised advice (Report 151117 Sales and advice report, p12). This demonstrates the high amount of sales that are made without advice.

   Circumstances when the duty should not apply

   The duty to put the client's interest first should not apply to a person who gives regulated financial advice when they refer a contact or customer to another financial advice provider. This is because, against the background of Goal 2 of the FAA review Issues Paper, people should not be put off referring their clients to another adviser who has different specialisms/products to their own. In this regard, we consider that there may be a perceived risk of making such referrals if the client's interest first duty applies. We note, however, that in this instance, the financial adviser should be required to disclose the full amounts of payments from providers (eg, commission), including any amounts shared with a referring financial adviser.

6. Do you have any comments on the proposed wording of the duty that a provider must not give a representative any kind of inappropriate payment or incentive? What impacts (both positive and negative) could this duty have?

   We agree with this policy and its wording.

   The further definition of 'inappropriate' in s 4310(2) defines the word sufficiently so that it is

clear what behaviour the clause captures. This duty will have a positive impact as, at present, QFE advisers are incentivised to drive up the volume of sales without advice, despite this not necessarily being in the client's best interests. For example, the FMA found that most KiwiSaver transfers are made without advice (Sales and Advice Report (151117)). This duty will therefore reduce the risk of financial advice representatives selling products on the basis of incentives, as opposed to on the basis of the client's best interests.

7. Do you support extending the client-first duty to providers who do not provide a retail service (i.e. those who only advise wholesale clients)? Why or why not?

No. We submit that the duty to put the client's interest first should be limited to retail clients.

(See our answer to Q14 below for our position on financial advice providers that have both wholesale and retail clients, and our answer to Q24 below for our position on the definition of wholesale client.)

Wholesale clients (if properly defined) do not need the same legal protections as retail clients as they have a sophisticated knowledge of financial products and services. As such, it would be disproportionate to regulate both retail and wholesale clients in the same way. This is consistent with the principles of best practice regulation, as espoused by the Treasury (see page 5 of the FAA Review Issues Paper).

Wholesale clients have the necessary protection they require through the contracts they have with financial service providers. Requiring financial advice providers to put wholesale clients' interests first would create an imbalance of power in favour of the wholesale client.

8. Do you have any other feedback on the drafting in Part 3 of the Bill?

We have six additional items of feedback on part 3 of the Bill, which are discussed below:

1. Advice without product recommendations
2. Clarity of exclusion for ancillary services
3. Prescribed format and time for disclosure
4. Advice for product replacement
5. Financial advisers who are engaged by multiple firms
6. The duty to put the client's interests first should not require a conflict of interest

1. Advice without product recommendations

The definition of financial advice in s 431B(1) includes the giving of an 'opinion' about acquiring or disposing of (or not acquiring or disposing of) a financial advice product, and designing an investment plan. It excludes designs of plans for other types of financial products.

This approach regulates current financial services, without considering future possibilities for financial advice. This has the potential to create an inconsistency in the legislation between designing investment plans and designing plans for other financial products.

By way of example, an investment plan is produced by reviewing a client's needs and investment goals, and recommending a specific mix of asset types to meet those needs and attain those goals. Clients are charged a fee for this service. The plans are created without giving recommendations or opinions about acquiring or disposing of (or not acquiring or disposing of) financial products, and so are not caught by s 431A(1)(a). They are caught by s 431A(1)(b).

It is likely that future business models could apply the same methodology to other (non-investment) financial products, such as life insurance. A financial adviser could charge a fee to

review the client's needs, and recommend a mix and value of each type of insurance product, without recommending specific products (and so not caught by s 431A(1)(a) and (b)). As the risks and harms of each of these types of planning advice would be similar, we submit they should be regulated in the same way.

2. Clarity of exclusion for ancillary services

We submit that parts of 'exclusions from regulated financial advice' are unclear (schedule 2, part 2, cl 7). Those being:

- cl 7(1) excludes 'an ancillary part of the business'. The parameters of what an 'ancillary part' might be is unclear.
- cl 7(3) excludes 'advice given in the ordinary course of' certain occupations. Again, it is unclear what is envisioned by this clause.

These clauses ought to be clarified, so that businesses are able to self-regulate within clear and certain parameters. Without such certainty, it is difficult both for businesses to self-regulate and for regulators to externally regulate.

3. Prescribed format and time for disclosure

Section 431L sets out the duty to make prescribed information available. It requires particular information to be made available in a manner prescribed by regulations, and (inter alia) at prescribed times or on prescribed events.

The wording suggests a disclosure process akin to current methods will be incorporated into regulations, ie, that a document (whether electronic or physical) will be required to be given to a client at a particular time during the process. Such a disclosure process may not, however, be appropriate for clients in all circumstances. For example, during the provision of robo-advice or in a situation where a flexible method of disclosure may be most effective.

By way of example, when giving robo-advice, MBIE has previously noted that disclosure is most effective when disclosed at the most relevant time during the automated process (Occasional Paper 15/01).

We recommend that thought is given to how s 431L or the examples below it could be amended to reflect the potential for flexibility within any later regulations.

4. Advice for product replacement

We submit that financial advice must be required when a financial advice provider recommends that a retail client replace a financial product he or she already holds with a substitute financial product. This is because the client faces a heightened risk in these instances. In these situations, a financial services provider should not be permitted to sell a financial product to a retail client unless the retail client proactively and expressly refuses advice, and signs a document to that effect.

This will address the risk that financial advice products are often similar, but with important differences that are difficult to detect. Unless product documentation is compared by an expert, there is a risk that retail clients will not make fully informed decisions, and be in a worse position with a substitute product.

There is a particular risk of this occurring in cases of life and health insurance. In many cases, a policy will cover the client for a condition that arose after the policy was purchased, but a new policy will not cover that condition, as it will be considered a pre-existing condition under the new policy. We set out two examples below to demonstrate this:

> Example 1: Client has a trauma policy. Five years after taking out the policy, she develops a skin condition. The existing policy covers the condition. If she changes her policy, the new insurer excludes (does not cover) the skin condition.
>
> Example 2: Client has a life insurance policy. A few years after taking out the policy, the client changes career and begins work as a peacekeeper in a DFAT level 4 country. The existing policy covers the client at work. The new policy does not cover travel to DFAT level 4 countries.

We submit that the risks to consumers of replacing financial products without advice are too great to permit it.

5. Financial advisers who are engaged by multiple firms

Financial advisers are sometimes engaged by multiple entities. For example, an adviser who generates some of his or her own leads and who is given other leads by another financial adviser firm will usually be engaged by both entities.

While the exposure draft does not restrict financial advisers being engaged by more than one firm, we are conscious that regulations and licensing processes may be drafted without taking this industry dynamic into account. We therefore wish to draw it to the attention of policy makers and drafters so that it can be factored in in due course.

6. The duty to put the client's interests first should not require a conflict of interest

The current drafting of s 431H in Part 3 of the Draft Bill requires that a person giving financial advice must have a conflict of interest with the person being advised in order for the duty to apply. In our view, a conflict of interest should not be a necessary precondition for the client first duty to apply.

The following are two examples where the current wording will not sufficiently protect retail customers:

- A financial advice representative employed by a bank who receives a salary or wage advises a client to buy a product of the bank. However, the product is not in the client's best interest, as the client has a more suitable product. Here, there is no conflict of interest, so the duty in s 431H does not arise. We submit that it should apply.

- A financial adviser recommends a product to a client, without considering the latest developments for that product. As such, the product is not in the best interests of the client. While there is no conflict of interest, the duty should still apply here.

We understand that in these scenarios, the adviser may have breached an alternative duty in the legislation. However, there is a risk that there are scenarios not captured by another duty. Moreover, the duty to put the client's interests first should be paramount, and should not be predicated on a conflict of interest.

Part 4 of the Bill sets out brokers' disclosure and conduct obligations

9. What would be the implications of removing the 'offering' concept from the definition of a broker?
   No comment.

10. Do you have any other feedback on the drafting of Part 4 of the Bill, for example any suggestions on how the drafting of broker provisions could be simplified or clarified?
    No.

Part 5 of the Bill makes miscellaneous amendments to the FMC Act

11. Should financial advisers have direct civil liability for breaches of their obligations, if the financial advice provider has met its obligations to support its advisers? Why or why not?

    Yes.

    We submit that civil liability should be extended to individual financial advisers who provide advice to retail clients in this situation. We consider this is necessary because Dispute Resolution Schemes are not capable of effectively meeting claims as they:

    - are generally limited to disputes of up to $200,000, or $1,500 per week, when often the loss to the client is greater;
    - often have unreasonable time limits on complaints, despite issues frequently taking many years to arise (particularly in life insurance cases); and
    - do not apply to advisers who have left or changed schemes.

    Civil liability allows an alternative means of recourse when Dispute Resolution Schemes fail due to these limitations.

    For example, a policy holder might be advised to change policy of $500,000 life insurance. The new policy removes cover at work, without the consumer knowing this The policy holder then subsequently dies at work. In this situation, the estate should be able to pursue the financial adviser for the full amount.

    For completeness, we note that financial advisers should also be civilly liable to other parties such as providers and manufacturers in the event they breach their obligations. The following are two situations where the insurer should have recourse against the financial adviser:

    - Situations of 'tombstoning': This is when a financial adviser submits insurance policies to an insurer for clients who do not exist, in order to receive upfront commission (which is greater than the premium). The insurer should have recourse against the financial adviser.

    - Situations where false advice is knowingly submitted to an insurer: In the life insurance space, these situations arise when a retail client tells his or her financial adviser about a health condition, and is advised not to include it on an insurance application.

    In these situations, the contract between the financial adviser and the other party (such as the insurer) may or may not offer recourse. Therefore, it is imperative that parties such as insurers have the option to make a civil claim against the adviser. (Noting that under the Insurance Law Reform Act 1977, in the context of adviser mis-statements in life insurance policies, the insurer

is deemed to know the knowledge of their agents).

12. Should the regime allow financial advice providers to run a defence that they met their obligations to have in place processes, and provide resources to enable their advisers to comply with their duties?

In our view:

- If advice is given by a financial advice representative, then the financial advice provider is liable and should be unable to run this defence.
- If advice is given by a financial adviser, then the financial advice provider should be able to run this defence.

We submit that recourse for a retail client to an appropriate remedy must be a priority in the legislation. This is consistent with Goal 3 of the FAA review Issues Paper which was to promote public confidence in the professionalism of financial advisers.

Financial advice representatives

Financial advice providers are accountable for the advice of their financial advice representatives, so the financial advice provider should also be liable for the actions of financial advice representatives, notwithstanding whether the provider has met their obligations. A strict approach should be taken, given the importance of retail client confidence in the financial advice framework.

Financial Advisers

If a financial advice provider has met its obligations, it seems unjust that they should be liable for actions of a financial adviser who acts outside their mandate or has failed to meet the necessary standards set by the financial advice provider. We submit two options for this situation:

- the retail client has recourse against the financial adviser and not against the financial advice provider; or

- the retail client has recourse against the financial adviser and the financial advice provider, and adjudicators should consider the actions of the financial advice provider as a mitigating factor when determining the quantum of liability in these cases.

13. Is the designation power for what constitutes financial advice appropriate? Are there any additional/different procedural requirements you would suggest for the exercise of this power?
No comment.

14. Do you have any feedback on applying the concept of a 'retail service' to financial advice services? Is it workable in practice?

The proposed approach will have negative consequences for clients and the industry.

We submit that retail clients should be treated as retail clients, and wholesale clients should be treated as wholesale clients, regardless of whether a financial advice provider has a mix of retail and wholesale clients.

Our understanding is that the proposal dictates that if a firm has just one retail client, all clients must be treated as retail clients in certain respects. This creates an uneven playing field for wholesale clients across financial advice providers, as each are treated based on the status of

their provider, as opposed to their own composition. We see this resulting in the following possible consequences:

1. Some financial advice providers may choose not to service retail clients. Providers may decide that the compliance costs and potential liability of servicing all clients as retail clients is too high. This is antithetical to the goal of the reform to make financial advice accessible to the consumer.

2. Some wholesale clients may choose a financial advice provider who does not have any retail clients, to avoid being treated as a retail client. This would have negatively impact financial advice providers, and may lead to the consequence discussed above at 1.

Moreover, firms would still be able to treat clients in a way that the firm sees fit (as long as the more onerous requirements are chosen). For example, a firm would still be able to implement a disclosure document for both retail and wholesale clients.

While some have suggested that businesses should simply have separate business units for retail and wholesale clients, this is:

- not feasible for a small business; and
- an over-complicated solution. It is easier to treat clients on a case-by-case basis – retail treatment for retail clients, and wholesale treatment for wholesale clients.

The uneven playing field this proposal would create will reflect the existing issues that arise from AFAs having higher disclosure obligations than RFAs. Those are:

- some AFAs who do not offer category 1 products dropped to RFA status, so they do not have higher disclosure requirements. This has resulted in a decreased accountability for many advisers in the industry; and

- some RFAs have chosen not to upskill and qualify as AFAs because of the greater obligations and higher disclosure requirements. This has resulted in a number of less educated financial advisers in the industry.

15. Do you have any other feedback on the drafting of Part 5 of the Bill?
    No.

Part 6 of the Bill amends the FSP Act

16. Does the proposed territorial application of the Act set out above help address misuse of the FSPR? Are there any unintended consequences? How soon after the passing of the Bill should the new territorial application take effect?
    No comment.

17. Do you support requiring further information (such as a provider's AML/CFT supervisor) to be contained on the FSPR to help address misuse?
    No comment.

18. Do you consider that other measures are required to promote access to redress against registered providers?

    Yes. We submit two other measures are required to promote access to redress against registered providers. Those are:

    1. changing timing requirements for Dispute Resolution Schemes; and

2. increasing compensation limits for Dispute Resolution Schemes.

Changing timing requirements for Dispute Resolution Schemes

We propose that clients should have mandatory redress against a financial adviser via a Dispute Resolution Scheme if the financial adviser was a member of the scheme at the time of the action, regardless of whether the financial adviser is a member of the scheme at the time of the complaint.

In this respect, Dispute Resolution Scheme membership fees should cover actions that occur during membership, rather than claims during membership. In comparison, at present (subject to the rules of the scheme), a consumer can only make a claim to a Disputes Resolution Scheme if the financial adviser (or other financial services provider) is still a member of the scheme that they were part of at the time of the complaint. Given the transient nature of advisers within the financial service industry (see below), this unfairly limits the situations in which a client can seek recourse.

Financial adviser data on the FSPR from 1 March 2017 shows that:

- there are 16,021 financial advisers;
- 7,698 have deregistered (of whom 134 have reregistered);
- 2,356 were registered for less than 1 year; and
- 5,263 were registered for less than 2 years.

There are also many advisers on the register with more than one FSP number. For example, there are 846 instances of two FSP numbers with identical full names.

Due to the limitations of Dispute Resolution Schemes, in many situations clients can only seek redress through the courts. However, retail clients often do not have the resources required to pursue litigation, which is an expensive process. In cases of life and health insurance, litigation is even more undesirable as the client is often suffering a significant health event. Dispute Resolution Schemes should therefore be expanded to cover more situations where clients need recourse.

Example:

- In 2014, Adviser A advises Client C to replace her insurance product. Client C replaces the product as advised.
- In 2015, Adviser A decides to leave the advice industry, deregisters from the FSPR, cancels membership of her DRS, and becomes a plumber.
- In 2017, Client C discovers that she cannot claim on her new insurance product. She discovers that Adviser A gave poor advice, and she would have been able to claim on her former insurance product (which is now cancelled).

The Dispute Resolution Scheme with whom Adviser A was a member at the time of the advice in 2014 cannot adjudicate Client C’s complaint in 2017. While the harm occurred in 2014 when Adviser A was a member, the complaint occurred in 2017 when Adviser A is no longer a member.

In our view, the Dispute Resolution Scheme should have jurisdiction for actions that took place while Adviser A was still part of that scheme.

Increasing compensation limits for Dispute Resolution Schemes

The compensation limits applicable to Dispute Resolution Schemes are too low. Currently, limits often are up to $200,000, or $1,500 per week.

Often life insurance disputes are for sums far greater than these limits.

In our view, monetary thresholds for claims should be set to the industry average value for that product and channel. For example, the monetary threshold for life insurance should reflect the average cost of life insurance policies sold by advisers. These thresholds could be specified in regulations and reviewed from time to time.

We further submit that if the amount of compensation adjudicated by the Dispute Resolution Scheme is above this specified threshold, then the financial service provider should have appeal rights to the Courts. If the amount adjudicated is below the monetary threshold, then only the consumer should have appeal rights to the Courts.

19. Do you have any comments on the proposed categories of financial services? If you're a financial service provider, is it clear to you which categories you should register in under the proposed list?

    Under the proposed changes, it is unclear where companies who offer sales without advice register.

    This does not take into account that some financial services providers structure their business so that they sell financial products without offering advice (for example, LifeDirect). In our view these businesses should continue to be registered on the FSPR. This is consistent with the FMA's concern with 'perimeter issues'. That is, activities they do not regulate, but pose a risk to financial services clients (Strategic Risk Outlook 2017, p9).

    The proposed service that is closest to these entities is 26: "other financial services of the types described in group A, but where the provider is exempt from licensing requirements". However, it is not sufficiently clear whether this is intended to capture the above scenario as an entity could argue that it is not a type of financial advice provider (4 on the list) because it does not offer advice.

20. Do you support clarifying that schemes must provide information to the FMA if they believe that a provider may be involved in conduct that constitutes breach of relevant financial markets legislation?
    No comment.

21. Do you have any other feedback on the drafting of Part 6 of the Bill?
    No.

Schedule 1 of the Bill sets out transitional provisions relating to DIMS and the code of conduct

22. When should an FMC Act DIMS licence granted to AFAs who provide personalised DIMS expire? For example, should it expire on the date on which the AFA's current authorisation to provide DIMS expires?
    No comment.

23. Do you have any other feedback on the drafting of Schedule 1 of the Bill?
    No.

Schedule 2 of the Bill creates a new schedule to the FMC Act with detail about the regulation of financial advice

24. Should the FMC Act definition of 'wholesale' be adopted as the definition of wholesale client for the purposes of financial advice? Why or why not?

    Yes. Having the same term with different meanings across the same regulatory regime (in this case financial services legislation) is likely to create confusion for those applying the law.

    However, entities with a large amount of wealth (through turnover or net assets) should not be considered wholesale clients by default. As such, we submit that schedule 2, clause 3(1)(c) should be removed. The concern with the wording as drafted, is that it could capture those who are not particularly sophisticated or knowledgeable about financial services by virtue of having a high turnover or net assets. By way of example, a family trust might inherit a house, but the trustees of family trusts are often the settlors and a friend of the family, who do not have experience with financial services and products. Further, this clause does not have an equivalent in the FMC Act definition.

    Alternatively, we submit that clients with a large amount of wealth should be able to opt-out of retail client status, rather than opting-out of wholesale client status. This would mean that those without financial services knowledge would not be assumed to have it.

    Such clients would therefore be treated conservatively unless they opt out. We submit this approach is preferable to that of clients being treated as sophisticated, when a client does not have the necessary capability to make decisions regarding financial products without appropriate safeguards. In addition, unsophisticated but wealthy clients may not know that they can opt-out of treatment as wholesale clients.

25. We understand that some lenders consider that they may be subject to the financial adviser regime because their interactions with customers during execution-only transactions could be seen to include financial advice. Does the proposed clarification in relation to execution-only services help to address this issue?
    No comment.

26. Are there any unintended consequences resulting from the minor amendments to the exclusions from regulated financial advice, as detailed above?
    No comment.

27. Do any of the membership criteria or proceedings for the code committee require further clarification? If so, what?

    We submit that the following points require clarification:

    1. the skills and experience of members of the Code Committee should represent all regulated financial advice;
    2. members of the Code Committee should have knowledge, skills and experience related to financial advice; and
    3. members of the Code Committee should be required to consult product manufacturers and other parties who distribute financial products through financial advisers.

    Note: in this answer, references to the Code Committee include the Code Working Group.

    1. Skills and experience in the Code Committee should represent all regulated financial advice

Given the broad group that the Code will apply to, members of the Code Committee must have the necessary experience to relate to all those potentially affected by the regime.

Schedule 2 clause 23 of the Bill requires the Minister to appoint (a) two consumer representatives and (b) five to nine people with a background in providing financial services or other relevant backgrounds ("knowledge, skills and experience").

Section 83(4)(b) of the Financial Advisers Act is similar to subclause (b), except that it requires backgrounds ("knowledge… experience and competency") in "the financial adviser industry".

The existing Code Committee established a Code of Conduct for Authorised Financial Advisers, who were the only financial advisers on the FSPR allowed to sell category 1 products.

The new Code of Conduct will relate to all regulated financial advice (for all financial products), whether provided by financial advice providers, financial advisers, or financial advice representatives.

We submit that the proposed clause 23(b) does not reflect this difference. The members of the Code Committee should together have the knowledge, skills and experience that cover all regulated financial advice, all major distribution models, and all relevant financial products (including fire and general insurance, life and health insurance, investment advice, and mortgage advice).

2. The Code Committee should have knowledge, skills and experience related to financial advice

In addition to point 1 above, clause 23(b)(i) should refer to "financial advice", rather than "financial services".

3. The Code Committee should be required to consult product manufacturers and other parties who distribute financial products through financial advisers.

Schedule 2 clause 29(2)(d) requires that the Code Committee consult with "any persons that it reasonably considers to be representative of the financial advice industry".

We submit that the Code Committee must consult product manufacturers and other parties who distribute financial products through financial advisers.

As a product manufacturer who distributes primarily through non-aligned financial advisers, we have a vested interest in ensuring that the Code of Conduct meets the needs of our policyholders. We seek to ensure that we are consulted when the Code of Conduct is developed.

28. Does the drafting of the impact analysis requirement provide enough direction to the code committee without being overly prescriptive?
    No comment.

29. Does the wording of the required minimum standards of competence knowledge and skill which 'apply in respect of different types of advice, financial advice products or other circumstances' adequately capture the circumstances in which additional and different standards may be required?
    No comment.

30. Should the Financial Advisers Disciplinary Committee consider complaints against financial advice providers as well as complaints against financial advisers? Why or why

not?

The FMA, not the Financial Advisors Disciplinary Committee ("FADC"), should consider complaints against financial advice providers.

The FADC is only structured to handle complaints against individual advisers. The maximum fine it can impose is $10,000, and other sanctions it can impose are appropriate in relation to individuals only (Schedule 2 clause 43(3), similar to the Financial Advisers Act s101(3)).

The FADC also lacks sufficient powers and resources to investigate complaints against financial advice providers.

The FMA has better suited powers and resources for investigating and enforcing compliance against financial advice providers, such as powers under the FMC Act.

31. If the jurisdiction of the Financial Advisers Disciplinary Committee is extended to cover financial advice providers, what should be the maximum fine it can impose on financial advice providers?
    No comment.

32. Do you have any other feedback on the drafting of Schedule 2 of the Bill?
    No.

About transitional arrangements

33. Are there any other objectives we should be seeking to achieve in the design of transitional arrangements?

Yes. To achieve the goals expressed in the Issues Paper, we submit two additional objectives for designing the transitional arrangements:

1. Optimise the number of financial advisers who transition to the new regime; and
2. Maximise consumer access to quality financial advice.

1. Optimise the number of financial advisers who transition to the new regime.

Goal 2 of the FAA review Issues Paper emphasised the desire for accessibility of financial advice. Accessibility is best catered for when there are many advisers in the market. Therefore, the transitional arrangements should be designed to maximise the number of advisers who transition to the new regime.

There are approximately 8,200 RFAs and AFAs, and 26,000 QFE advisers, in New Zealand (FMA report Replacing life insurance 160322, p8).

Tightening the regime will inevitably result in some financial advisers retiring or leaving the industry. An objective of the transitional arrangements must be to reduce those exiting the market as a result of the new regime.

2. Maximise consumer access to quality financial advice.

Quality financial advice is a recurring theme in the FAA review Issues Paper. This goal should be made more explicit in the transitional objectives. Ensuring that as many financial advisers as possible who are willing to comply with the new regime transition, will maximise consumer access to quality financial advice.

Proposed transitional arrangements

34. Do you support the idea of a staged transition? Why or why not?

Yes. Transitional licences will:

1. Allow the FMA to estimate the size of the population to be licensed.
2. Allow financial service providers to prepare for the regime, while implementing elements of the regime as early as possible.

1. Allow the FMA to estimate the size of the population to be licensed.

Licensing financial advisers will be an onerous undertaking for the FMA. Transitional licensing will give the FMA an opportunity to size and plan its workload under the new regime. This is necessary given:

- Licensing to date by the FMA has already been a challenging undertaking (the FMA has issued approximately 190 licences that are different types and had different deadlines);
- FSPR data is not complete or clean enough to accurately estimate how many adviser businesses exist in the market;
- The FMA cannot predict how many advisers will transition into the new system (although the FMA knows the ages of advisers, which may help them estimate how many financial advisers may retire rather than transition, without further information they will be unable to predict how many financial advice provider licences will be sought.)
  - Even if half of the financial advisers retire from the industry, and the remainder average four advisers per financial advice provider, that is approximately 1,000 financial advice provider licences. This is over five times the number of licences that the FMA has issued so far; and
  - Alternatively, if one quarter leave the industry, and the remainder average 10 to a financial advice provider, that is approximately 600 licences – more than three times licences issued to date.

2. Allow financial service providers to prepare for the regime, while implementing elements of the regime as early as possible.

The proposed transitional arrangements in respect of the Code give industry participants sufficient time to adapt to its requirements (ten months to develop the Code and six months after Code approval).

The proposed transitional arrangements in respect of the Draft Bill also allow sufficient time for the industry to adapt to new duties (six months after the Code is approved).

As the educational requirements in the Code will take longer to implement, we support the two year transitional licence to ensure that advisers have sufficient time to complete the necessary study to meet the requirements of the new regime.

The absence of a staged transition might instead result in a regime that could only be implemented after this two-year period to allow advisers to meet educational requirements. We therefore support the staged transition that allows each element of the new regime to

come into effect as soon as is practicable.

35. Is six months from the approval of the Code of Conduct sufficient time to enable existing industry participants to shift to a transitional licence?

    Yes, if the transitional licensing process is minimal.

    We understand that the purpose of the transitional licensing process it to allow existing financial advisers and businesses to enter the new regime quickly. This will allow the FMA to understand the magnitude of the licensing task, and establish a starting point for licensing.

    We understand that the process to obtain a transitional licence will involve little more than submitting company details and fit and proper tests of directors and senior managers.

    On this basis, six months will be enough time for businesses to obtain a transitional licence.

    Further to our answer to Q34 above, we believe that financial advisers and businesses will have sufficient time to adjust to the duties and Code of Conduct (excluding educational requirements), as they will be consulted during the development process. In reality, financial advice providers and advisers will begin to design and plan processes before the duties and the Code of Conduct are implemented.

    Moreover, financial advice providers and advisers will have up to two years before they have to evidence these processes to obtain a full financial advice provider licence.

36. Do you perceive any issues or risks with the safe harbour proposal?

    While there are risks associated with the safe harbour proposal, we perceive that the proposal offers the best solution, as there is even greater risk without the safe harbour proposal.

    Risks of the safe harbour proposal include:

    - Consumer uncertainty regarding the competence of financial advisers and financial advice representatives – both during transition and after transition.

    - Some financial advisers may seek a transitional licence with no intent to seek a full licence, as a means to continue in the industry for an additional two years before retirement.

    - Strong financial service providers and weak financial advisers will have the same licensed status during the transitional period.

    Risks without a safe harbour proposal include:

    - A delay in implementation of the entire regime, as competence requirements could not be met within six months (eg study for a Level 5 certificate or equivalent);

    - A compromise in the competency standard, to something that can be obtained in six months. A competency requirement that can be obtained in this timeframe is unlikely to be of a requisite standard that will establish consumer trust in the regime; and

    - Pushing advisers out of the industry in the instance that the implementation period is short, but the competency standard is high.

37. Do you think there are any elements of the new regime that should or shouldn't take effect with transitional licences? What are these and why?

We agree with the proposed transitional arrangements. They balance the need to implement the regime quickly with the need to give participants a realistic transition time. These are discussed in detail elsewhere in this section.

38. Is two and a half years from approval of the Code of Conduct sufficient time to enable industry participants to become fully licensed and to meet any new competency standards?

Yes, subject to the content of the competency standards.

- Education providers will need sufficient time to develop programmes. If these are similar to existing programmes, it will take considerably less time than if the educational requirements differ from those currently available.

- If the educational standard is set to a university degree standard, which usually takes three years to obtain, then two and a half years is insufficient.

- If the educational standard is similar to the current Level 5 Certificate, which usually takes about one year to obtain, then two and a half years for up to 8,200 financial advisers, plus up to 26,000 financial advice representatives (existing QFE advisers), seems reasonable.

Possible complementary options

39. Do you support the option of AFAs being exempt from complying with the competence, knowledge and skill standards for a limited period of time? Why or why not?

No, we do not support this exemption for the following reasons:

1. AFAs will have a smaller educational gap than RFAs, and will need less time to adapt.
2. An exemption may increase confusion for consumers.
3. An exemption delays full implementation of the regime

1. AFAs will need less time to adapt than RFAs

Giving AFAs up to five years longer than RFAs is unnecessary and inconsistent.

Currently, AFAs are required to have a Level 5 Certificate or equivalent, whereas RFAs do not have an educational requirement. It therefore likely that AFAs will have a smaller educational gap to fill than RFAs. Seven years to complete the requirements is not only an excessive timeframe, but will also create an unfair outcome in respect of RFAs.

2. An exemption may increase confusion for consumers.

If AFAs are given this exemption, financial advisers will operate at differing levels of competence until February 2026. This will confuse consumers.

An exemption will create three differing periods of competence in the market:

- Existing competence levels for transitional licence holders until February 2019.
- RFAs and QFE advisers meet new competency requirements by February 2021.
- AFAs meet new competency requirements by February 2026.

Moreover, the competency levels of individual financial advice providers, financial advisers and financial advice representatives will vary within these time periods, as different entities obtain licences and advisers meet competency requirements at different times before these deadlines.

An extended period will create complexity, uncertainty, and is likely to exacerbate consumer confusion.

3. An exemption delays full implementation of the regime

As shown in the timeline above, this exemption delays full implementation of the regime by an extra five years, until February 2026.

While there is a small advantage in reducing the amount of advisers in the market needing further education, 1,800 AFAs is a small portion of the overall number (8,200 of financial advisers, or 34,000 total including QFE advisers) and will have minimal impact on industry capacity.

Therefore, there are significant disadvantages to the five-year extension for AFAs, that greatly outweigh the minor advantages. The extension for AFAs is unnecessary, and potentially harmful to implementing the new regime.

40. Would it be appropriate for the exemption to expire after five years? If not, what timeframe do you suggest and why?

    As above at 39, we disagree with the exemption.

41. Is there a risk that this exemption could create confusion amongst industry and for consumers about what standards of competence, knowledge and skill are required?

    Yes. See answer above at 39. If AFAs are given this exemption, financial advisers will operate at differing levels of competence until February 2026. This will confuse consumers and cause confusion within the industry.

42. If you support this option do you think it should be set in legislation or something for the Code Working Group to consider as an option as it prepares the Code of Conduct?
    We do not support this option.

43. Do you support the option of a competency assessment process for existing AFAs and RFAs? Why or why not?

    Yes. Providing a competency process for existing AFAs and RFAs will result in more financial advisers transitioning to the new regime. This will make quality financial advice more accessible to consumers. More financial advisers will transition to the new regime because:

    - The adviser population is an ageing demographic (this is an anecdotal observation as data is not publicly available on this issue). We know from our own business relationships, that financial advisers often work beyond the national retirement age. However, many older advisers are put off the new regime due to the effort of transitioning. Many experienced financial advisers have expressed that if it is too difficult, they will retire.

    - Most financial advisers, particularly those who have been in the industry for a number of years, have not studied in a long time, and will be deterred from having to do so now.

    - Many financial advisers have cited to us that if they must complete a tertiary

qualification, it will be too difficult to transition.

Therefore, those who can prove that they are already competent and meet the required standard should have the opportunity to prove that they meet this standard. If they are successful, they should be exempt from completing the formal qualification. Moreover, if financial advisers prove that they are competent in some of the requirements, they should be exempt from completing those parts of the formal qualification in which they can prove competence. This will maximise the number of quality financial advisers who transition to the new regime at the required standard.

44. Is it appropriate for the competency assessment process to be limited to existing AFAs and RFAs with 10 or more years' experience? If not, what do you suggest?

No, there should not be a time requirement. Time in the industry does not necessarily determine adviser competence. The competency assessment should be available to all financial advisers.

In our experience, there are many factors that determine adviser confidence, such as:

- formal education;
- regularly attending product updates and training courses;
- knowledge of the industry (often gained during previous employment with a product manufacturer);
- diligence in record-keeping, and strong administrative processes;
- experience in the industry;
- skills in key areas of lead generation and sales; and
- motivation to help clients.

Many of these factors are not related to time in the industry. We work with many very competent advisers who have been in the industry less than 10 years.

For example, we offer a free two-week in-house New Adviser Training course to a significant portion of life insurance advisers. Almost all of those who attend this course have been in the industry less than three years yet, despite this, reached necessary competence standards.

Additionally, the FMA found that a third of financial advisers who represented more than 100 life insurance policies are AFAs, who have greater educational and competency requirements than RFAs (FMA report 160629 Replacing life insurance who benefits, p5). There is no evidence to suggest that AFAs have been in the industry longer than RFAs.

45. If you support this option do you think it should be set in legislation or something for the Code Working Group to consider as an option as it prepares the Code of Conduct?

The competency assessment process should be defined by the Code Working Group / Code Committee, rather than defined in law. This would allow:

- flexibility of the assessment process as it will not need to go through the Parliamentary process for amendment; and

- compatibility with the Code of Conduct, as the Code Working Group / Committee will be responsible for both setting competency standards in the Code, and the associated assessment process that will align with these standards.

Phased approach to licensing

46. What would be the costs and benefits of a phased approach to licensing?

    We submit that the disadvantages of a phased approach to licensing are greater than the benefits of a phased approach. The strain it may place on those groups scheduled early in the timeframe would reduce their ability to provide quality financial advice, and is unfair across all applicants.

    In our view, the disadvantages to a phased approach to licensing are:

    - It would reduce the time available for early licensees to complete the licensing process, without giving those licensees the choice of when to apply. This may result in those licensees prioritising the license application over business operations, reducing the quality of service to clients, reducing income generation, and pressuring cash flows.

    - It would reduce fairness to applicants. Applicants scheduled to apply early have significantly more pressure than those who are scheduled to apply later. This is contrary to the FMA's main objective "to promote and facilitate the development of fair, efficient, and transparent financial markets" (Financial Markets Authority Act 2011, s 8).

    While the benefits of a phased approach to licensing are:

    - It would enable the FMA to smooth the demands on their licensing resources. If there is a significant spike in applications at one point in the two-year period, there is a risk the FMA may:
        - employ additional resources which will increase licensing costs (this might be borne by the taxpayer or licensees);
        - be unable to process all applications by the deadline, causing problems for late applicants; and
        - reduce scrutiny in the licensing process, so there is a risk that some entities who do not meet licensing requirements may obtain licences.

47. Do you have any suggestions for alternative options to incentivise market participants to get their full licences early in the transitional period?

    Yes, we have six complementary suggestions for alternative options:

    1. Applicants choose the commencement date of their licence (within the licensing period).
    2. The licence expiry date is randomly determined, within a specified period.
    3. FMA assistance for early applicants.
    4. Licensing discounts for early applications.
    5. The FMA works with industry groups to make it easier for financial advisers to meet the new requirements and obtain licences.
    6. Those implementing robo-advice, or a financial advice provider extending its services are incentivised to license early as they will need a licence to offer the new services.

    1. Applicants choose the commencement date of their licence (within the licensing period).

    Licensed entities have greater obligations than transitionally licensed entities. Therefore, there is an incentive to apply for a licence at the end of the licence period.

To eliminate this incentive, applicants could choose the commencement date of their licence (within the licensing period), as distinct from an application date.

The default licence start date should be the last day of the licensing period.

This default start date would need to be widely publicised among potential applicants. If the date is not known by applicants, they may only apply at the end of the period due to the perceived incentive to do so.

However, if the licence is for a limited period, the FMA will need to ensure that licence expiry dates are staggered, so the FMA does not face capacity problems in the future when the licences expire.

2. The licence expiry date is randomly determined, within a specified period.

If there is a standard licence term that commences from the application date, there is an incentive to apply at the end of the period, as a later application date will delay the date the licence lapses.

The FMA prefer licence expiry dates to be staggered, so it has the capacity to process reapplications. One option, therefore, is that as the FMA risk assesses applicants during the licensing process, the approximate licence term could be determined by risk (for example, 3, 4 or 5 years). Following the risk determination, the month of licence expiry could be randomly determined, and not determined by application date. This would smooth reapplication volumes, while also removing the incentive to apply late in the licensing period.

3. FMA assistance for early applicants

Early applicants do not have the benefit of institutional or industry learning. For example:

- The FMA will become more efficient at processing each type of application as they become more experienced at processing applications. This is because there will be commonalities among business models and business processes (including strengths and weaknesses) that will become apparent across applications.

- Industry consultants who work to assist applicants will also become more effective as they help more applicants through the process, because their understanding of licensing requirements and common processes will increase. (Industry consultants such as IDS, http://idslimited.co.nz/, and Strategi, https://www.strategi.co.nz/, are likely to provide consulting services to applicants.)

If the FMA publicise that they will provide assistance to early applicants through the licensing process, applicants will be encouraged to apply early.

4. Licensing discounts for early applications

If application pricing increases as the licensing period progresses, cost conscious applicants are more likely to apply as early as possible.

In our view, discounts are a more appropriate course of action than penalties.

Discounts could reduce quarterly or biannually in a stepped manner, until applicants at the end of the licensing period receive no discount.

5. The FMA works with industry groups to make it easier for financial advisers to meet the new requirements and obtain licences.

This proposal would make it easier for small financial advice businesses to obtain a licence, increasing the number of advisers who transition.

This proposal also has the potential to reduce the costs for the FMA to issue licences, by making the process more efficient and effective. This could also reduce unnecessary compliance cost for the applicants, a goal of the transition arrangements (MBIE Consultation Paper – New Financial Advice Regime, p40).

Many industry groups and participants have a vested interest in advisers transitioning to the new regime. Those groups include adviser associations such as Financial Advice New Zealand, dealer groups such as Kepa and Newpark, the Financial Services Council, and financial services providers who distribute products through financial advisers.

We envision that these groups could work alongside the FMA to develop and document an adviser business model that meets licensing requirements, and train small financial advisers to use or adapt the model.

Financial adviser businesses who use this model would be faster and easier to licence. The FMA would already know that the model meets licensing requirements. The financial adviser business would therefore only need to prove to the FMA that they follow the model. This will also improve the quality of applications and reduce the administrative burden on the FMA.

We also anticipate that this approach will increase the number of financial advisers who transition to the new regime, due to the added support.

6. Robo-advice, or a financial advice provider extending its services, will incentivise some to license early, because they will need a licence to offer the new services.

While not a suggested amendment, we note that there is already an incentive for providers seeking to extend their services to apply early in the licensing process. Transitional licences allow financial advice providers, financial advisers and financial advice representatives to continue offering the services they offered before obtaining their transitional licenses.

However, some market participants intend to offer new services during the licensing period. To offer new services, financial advice providers will need a full financial advice provider licence.

This requirement incentivises those entities to apply for a full licence earlier in the licensing period.

For example, we understand that many entities are investigating robo-advice opportunities. These entities will require a full financial advice provider licence before they can offer robo-advice.

We note that the FMA is seeking ways to allow robo-advice as early as possible, perhaps before the licensing period begins. There may be class or individual exemptions to enable these services, which could remove the incentive to obtain a full licence early.

The FMA could limit the period of exclusions to expire early in the licence period, or include a condition in the exemption that requires a robo-advice provider to obtain a full licence early in the licensing period.

48. Do you have any other comments or suggestions regarding the proposed transitional arrangements?
    No.

Demographics

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