Issues Paper

Review of the Financial Advisers Act 2008 and the Financial Service Providers (Registration and Dispute Resolution) Act 2008

newzealand.govt.nz

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 22 July 2015.

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

Please use the submission template provided at ***www.mbie.govt.nz/what-we-do/faareview*** as this will help us to collate submissions and ensure that your views are fully considered. Please also 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:

  Corporate Law
  Labour and Commercial Environment Group
  Ministry of Business, Innovation & Employment
  PO Box 3705
  Wellington
  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 MBIE's policy development process, and will inform advice to Ministers on the operation of the Financial Advisers Act 2008 and the Financial Service Providers (Registration and Dispute Resolution) Act 2008.

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

Except for material that may be defamatory, MBIE intends to upload PDF copies of submissions received to MBIE's website at ***www.mbie.govt.nz***. MBIE will consider you to have consented to uploading by making a submission, unless you clearly specify otherwise in your submission.

Release of information

Submissions are also subject to the Official Information Act 1982. Please set out clearly with your submission if you have any objection to the release of any information in the submission, and in particular, which part(s) you consider should be withheld, together with the reason(s) for withholding the information. MBIE will take such objections into account and will consult with submitters when responding to requests under the Official Information Act 1982.

If your submission contains any confidential information, please indicate this on the front of the submission. Any confidential information should be clearly marked within the text. If you wish to provide a submission containing confidential information, please provide a separate version excluding the relevant information for publication on our website.

Private information

The Privacy Act 1993 establishes certain principles with respect to the collection, use and disclosure of information about individuals by various agencies, including MBIE. Any personal information you supply to MBIE in the course of making a submission will only be used for the purpose of assisting in the development of policy advice in relation to this review. Please clearly indicate in your submission if you do not wish your name to be included in any summary of submissions that MBIE may publish.

Permission to reproduce

The copyright owner authorises reproduction of this work, in whole or in part, as long as no charge is being made for the supply of copies, and the integrity and attribution of the work as a publication of MBIE is not interfered with in any way.

ISBN 978-0-908335-13-8

Contents

Foreword 3
Part 1 – Introduction 4
Chapter 1 – Purpose and context of the review 4
Chapter 2 – Overview of key questions 7
Part 2 – Financial Advisers Act 10
Chapter 3 – Development of the FA Act 10
Chapter 4 – Role and regulation of financial advice 18
Chapter 5 – How the FA Act works..22
Chapter 6 – Key FA Act questions for the review..32
Part 3 – The Financial Service Providers (Registration and Dispute Resolution) Act 2008 49
Chapter 7 – Development of the FSP Act..49
Chapter 8 – Role of financial service provider registration and dispute resolution 52
Chapter 9 – How the FSP Act works..56
Chapter 10 – Key FSP Act questions for the review 60

List of Acronyms

ABS	Adviser Business Statement
AFA	Authorised Financial Adviser
AML-CFT Act	Anti-Money Laundering and Countering Financing of Terrorism Act
BOS	Banking Ombudsman Scheme
CPD	Continued Professional Development
DIMS	Discretionary Investment Management Services
FA Act	Financial Advisers Act 2008
FADC	Financial Advisers Disciplinary Council
FATF	Financial Action Task Force
FDRS	Financial Dispute Resolution Scheme
FMA	Financial Markets Authority
FMC Act	Financial Markets Conduct Act 2013
FSCL	Financial Services Complaints Limited
FSP Act	Financial Service Providers (Registration and Dispute Resolution) Act 2008
IPS	Investment Planning Service
ISO	Insurance and Savings Ombudsman
MBIE	Ministry of Business, Innovation and Employment
QFE	Qualifying Financial Entity
RFA	Registered Financial Adviser
RFPP	Review of Financial Products and Providers 2006

Foreword

Hon Paul Goldsmith

Minister of Commerce and Consumer Affairs

The Government is working to grow the economy to deliver greater opportunities for all New Zealanders. Strong capital markets are integral to any productive and competitive economy, as businesses need access to capital to grow. When these markets operate well they help drive business growth, create jobs and increase incomes.

Sound financial advice gives consumers the confidence to make the most of the investment opportunities capital markets present. To achieve this, New Zealanders need unbiased, quality financial advice that is appropriately tailored to the needs of individuals, families and businesses. Advice should be available to consumers when they need it, and should be flexible enough to respond to the growth of new technologies and to the changing needs of New Zealanders.

Both the Financial Advisers Act 2008 and the Financial Service Providers (Registration and Dispute Resolution) Act 2008 were designed to help consumers make informed decisions and to ensure our capital markets function well.

The Government introduced these Acts to increase the professional standards of financial advisers, to ensure New Zealand meets international best practice standards and to promote greater participation in capital markets. Subsequent regulation has brought about higher levels of professionalism within the industry and better consumer protection.

Global practice has shifted since 2008. A number of countries have moved beyond insisting on transparency over commissions to an outright ban on commissions for financial advisers, and clearer boundaries have been drawn between sales and advice. In the meantime, there have been concerns raised about the level of compliance cost imposed by the regime.

It is now time to take stock and identify areas where New Zealand can do better. This review is an opportunity to identify if there are ways to limit unnecessary complexity, ensure the costs of regulation do not outweigh its benefits, guarantee that conflicts of interest are effectively dealt with, and make sure that there are protections in place to give consumers confidence to invest. This Issues Paper is the first step in this review process.

Some of the key questions for the review include whether consumers understand how advisers are regulated and whether regulatory requirements and compliance costs have unduly reduced access to financial advice.

This review is also an opportunity to consider the long-term future of New Zealand's financial advice market. With this in mind, it is important that the Government understands the industry's perspective along with the needs and expectations of consumers who seek financial advice.

I look forward to your contribution.

Part 1 – Introduction

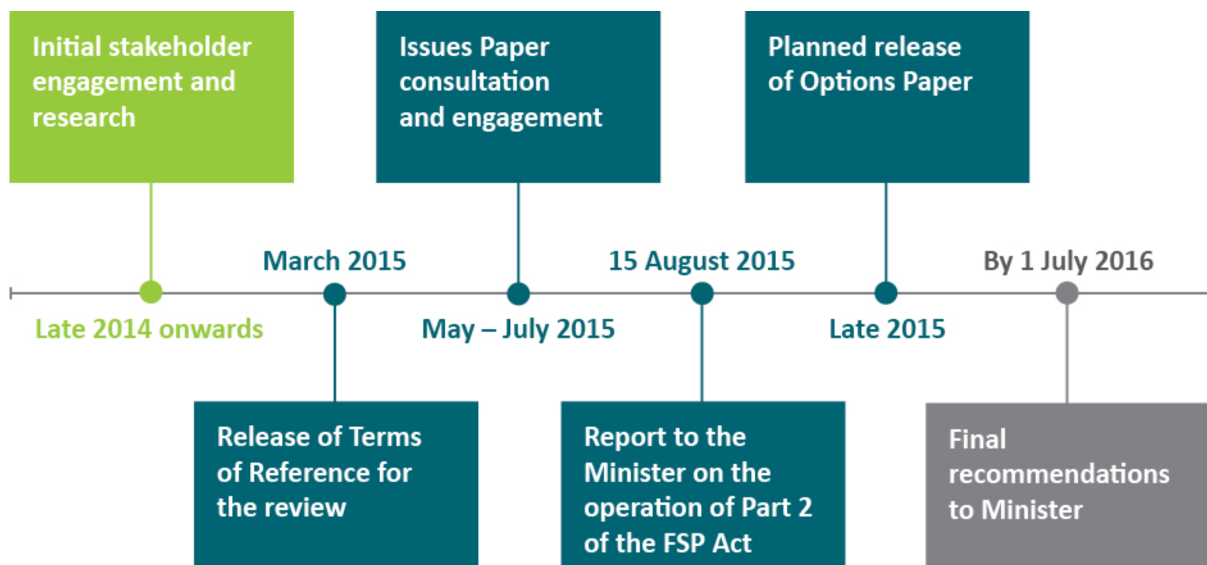
Chapter 1 – Purpose and context of the review

1. The Ministry of Business, Innovation and Employment (MBIE) with input from the Financial Markets Authority (the FMA), the Commission for Financial Capability and the Treasury is reviewing the Financial Advisers Act (FA Act) and the Financial Service Providers (Registration and Dispute Resolution Act 2008 (FSP Act). The terms of reference for the review are available at ***www.mbie.govt.nz/what-we-do/faareview***.
2. The objectives of this review are to:

- Analyse the role of financial advice and financial service provider registration and dispute resolution in improving financial outcomes for New Zealanders, and to assess and update the objectives of, and rationale for, regulatory intervention in this area.
- Assess the performance of the FA Act and the FSP Act against the updated objectives of, and rationale for, regulatory intervention in this area.
- Meet the statutory review requirements in section 161 of the FA Act by:
    - reviewing the operation of the FA Act and preparing a report for the Minister of Commerce and Consumer Affairs by 1 July 2016, including recommendations on whether any amendments to the FA Act are necessary or desirable.
- Meet the statutory review requirements in section 45 of the FSP Act by:
    - reviewing the operation of Part 2 of the FSP Act and preparing a report for the Minister by 14 August 2015.

3. We are reviewing the FA Act and FSP Act together due to the significant cross-over between these two pieces of legislation.

Timeline for the review



Treasury’s Principles for Best Practice Regulation

4. The review will be informed by the New Zealand Treasury’s principles for best practice regulation:

- **Growth Compatible**: Economic objectives are given an appropriate weighting relative to other specified objectives, including other factors contributing to higher living standards.
- **Proportionality**: The burden of rules and their enforcement should be proportional to the benefits that are expected to result.
- **Flexible, durable**: Regulated entities have scope to adopt least cost and innovative approaches to meeting legal obligations. The regulatory system has the capacity to evolve in response to changing circumstances.
- **Certain, predictable**: Regulated entities have certainty as to their legal obligations, and the regulatory regime provides predictability over time.
- **Transparent, accountable**: Rules development, implementation and enforcement should be transparent.
- **Capable regulators**: The regulator has the people and systems necessary to operate an efficient and effective regulatory regime.

What is this document for?

5. This Issues Paper outlines MBIE’s analysis of the role of financial advice, registration and dispute resolution as well as the aims and role of government regulation in this area. It contains a number of key questions, informed by initial discussions with government agencies, industry groups, financial advisers and consumers.
6. We seek your responses to these questions and other relevant feedback to improve our understanding of the financial advice and financial service providers sectors and key issues and opportunities for change. While this document does not propose any solutions or legislative changes, submissions will inform the development of policy options for a second consultation document to be released toward the end of 2015.

How to use this document

7. This document is structured in three parts as outlined below. We have included suggested questions throughout the document but we welcome any other relevant information that you wish to provide. All paragraphs are numbered for ease of reference.

Part	Content
Part 1: Introduction (Chapters 1-2)	Purpose, context and objectives of the review (Chapter 1). Summary of goals and key related questions (Chapter 2).
Part 2: FA Act (Chapters 3-6)	Outline of the development of the FA Act and the role and regulation of financial advice, including goals for regulation (Chapters 3-4). How the FA Act works (Chapter 5) Key FA Act questions for the review (Chapters 6).
Part 3: FSP Act (Chapters 7-10)	Outline of the development and operation of the FSP Act, including the role and goals of registration and dispute resolution (Chapter 7-9). Key FSP Act questions for the review (Chapter 10).

Chapter 2 – Summary of goals and key questions

Regulation of Financial Advice

Proposed goals	Key questions for feedback
Goal 1: Consumers have the information they need to find and choose a financial adviser.	Do consumers understand the regulatory framework? Should there be a clearer distinction between advice and sales? How should we regulate commissions and other conflicts of interest?
Goal 2: Financial advice is accessible for consumers.	Does the FA Act unduly restrict access to financial advice? How can compliance costs be reduced under the current regime without limiting access to quality financial advice? How can we facilitate access to advice in the future?
Goal 3: Public confidence in the professionalism of financial advisers is promoted.	Should we lift the professional, ethical and education standards for financial advisers? Should the individual adviser or the business hold obligations?

Goal 1: Consumers have the information they need to find and choose a financial adviser

8. Key questions include:

- ***Do consumers understand the complexities of the regulatory framework?*** We have heard that the regulatory framework is too complex for consumers. Consumers have noted that it is difficult to understand differences between classes of advisers, their different obligations, and their ability to advise on different products and give different types of advice. This may be undermining consumers' ability to make informed decisions about which type of adviser to use and how to interpret their advice, and may discourage some from seeking advice altogether. We seek feedback on any clarifications that could be made to the current regulatory regime to make it easier to understand.
- ***Should there be a clearer distinction between advice and sales?*** The FA Act's definition of financial advice includes many activities that could arguably be more accurately described as "sales". We are interested in feedback on whether drawing a clearer distinction between these activities, with appropriate standards for each, would benefit consumers. Should all these activities be covered in the definition of financial advice, or should a clearer distinction be drawn between sales, information provision and advice?
- ***How should we regulate commissions and other conflicts of interest?*** A number of financial advisers are either partly or wholly paid by commissions that are paid by product providers. These commissions can create a conflict of interest for the adviser; incentivising them to advise that their client buys a particular product. Though some types of adviser must inform their clients of any commissions, there are concerns about the ability of consumers to interpret this information. Internationally, a number of jurisdictions changed regulatory requirements following the global financial crisis to either ban or restrict the use of commissions. We seek feedback on whether the current disclosure requirements for

commissions and conflicts of interest are adequate and how they should be changed or improved. We also note that current requirements apply only to authorised financial advisers, and seek feedback on whether they should be applied to all financial advisors, and if so, at what level.

- You may also wish to provide feedback on how easy it is for consumers to use the Financial Service Providers Register to search for, compare and learn about financial service providers, including financial advisers, this is discussed further below.

Goal 2: Financial advice is accessible for consumers

9. Key questions include:

- ***Does the FA Act unduly restrict access to financial advice?*** We are interested in understanding the overall impact that the FA Act has had on consumer access to financial advice. We seek feedback on the level of competition in the financial adviser market and whether regulatory constraints and boundary issues are adversely impacting on the type of advice available.
- ***How can compliance costs be reduced under the current regime without limiting access to quality financial advice?*** We seek feedback on the extent to which compliance costs are restricting access to financial advice. We are particularly interested in information on any specific compliance requirements that are unduly burdensome or are limiting consumers' access to good quality financial advice.
- ***How can we facilitate access to advice in the future?*** We seek feedback on how the FA Act can deal adequately with a number of potential developments that might affect both the demand for and supply of financial advice. Potential developments include increasing demand for advice as New Zealanders' KiwiSaver balances increase and Financial Markets Conduct reforms come into effect in relation to new investment products such as peer-to-peer lending, and the increasing supply of advice through online platforms. There is a question of whether the FA Act could limit access to advice on these types of new investment products. We seek feedback on whether any changes to regulation of advice should be considered in response to the Financial Markets Conduct Act changes and the changing investment and advice environment.

Goal 3: Public confidence in the professionalism of financial advisers is promoted

10. Key questions include:

- ***Should we lift the professional, ethical and education standards for financial advisers?*** We seek feedback on the adequacy of the ethical and education standards that apply to different types of financial advisers, which currently differ significantly. There is debate as to whether these standards should be aligned and/or increased. We also seek feedback on what role the various professional bodies could play in lifting these standards.
- ***Should the individual adviser or the business hold obligations?*** An important decision when regulating financial advisers is whether to apply obligations to the individual adviser or to the business they represent. The FA Act takes a mixture of these two approaches. We are interested in stakeholder views as to how this is working and whether changes to this approach should be considered.

Financial service provider registration and dispute resolution

Proposed goals	Key questions for feedback
Goals for the Financial Service Providers Register: The register information is useful, accurate and accessible.	Could the Register provide better information to the public? How can we avoid misuse of the register by overseas financial service providers?
Goals for dispute resolution: Consumers are aware of, can access and are confident in using dispute resolution schemes.	What is the impact of having multiple dispute resolution schemes?

11. Key questions include:

- ***Could the Register provide better information to the public?*** One of the aims of the Financial Service Providers Register is to provide information to the public about financial service providers. We are interested in your views on whether the Register could be improved to help consumers search for, compare and learn about financial service providers, including financial advisers.
- ***How can we avoid misuse of the Register by overseas financial service providers?*** A large number of offshore financial service providers have attempted to register in New Zealand in order to give the misleading impression that they are regulated here. While changes have been made to the legislation to address this problem, it appears to be an ongoing issue. We are seeking stakeholder views on the significance of the problem and whether further changes are needed to address it.
- ***What is the impact of having multiple dispute resolution schemes?*** There are currently four approved dispute resolution schemes, three of which accept any type of financial service provider as members. We are seeking stakeholder feedback on the impact of having multiple schemes, including on the competitive dynamic between the schemes and potential inconsistencies between the schemes' rules and approaches.

Part 2 – Financial Advisers Act

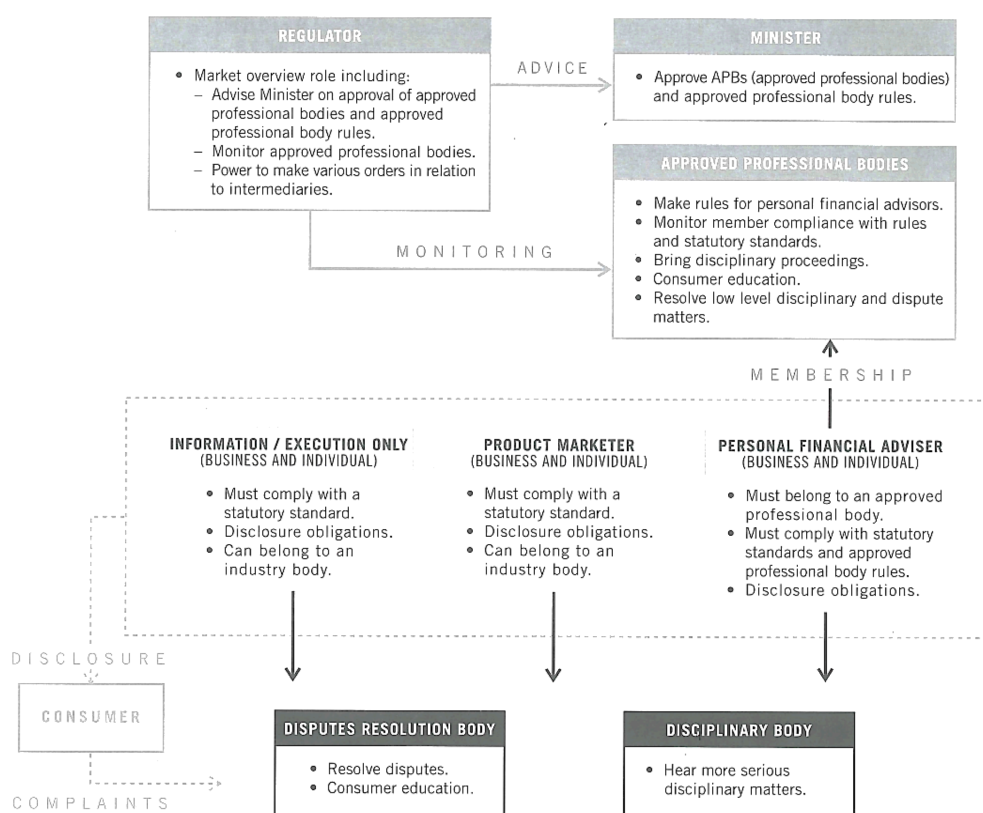
Chapter 3 – Development of the FA Act

13. The FA Act had a lengthy development process, in which significant changes were made to the regulatory model and the scope of regulation. In addition, there have been substantial changes to the market and to the rest of the regulatory environment since it was passed in 2008. The difference between the current FA Act and the original framework is a key reason why this review seeks to re-evaluate the role of advice and principles behind regulatory intervention.

Financial Intermediaries Taskforce

14. The FA Act reform process started from the recommendations of the Financial Intermediaries Taskforce, appointed in 2004, following repeated calls to increase the professional standards of financial advisers. The International Monetary Fund had also assessed New Zealand as only being partially compliant with the objectives and principles of the International Organization of Securities Commissions.
15. Although the Taskforce emphasised that it did not consider the financial advice sector to be in crisis, it recommended to the Government the following system of co-regulation between the then Securities Commission (now the FMA) and professional bodies.

Figure 1: Financial Intermediaries Taskforce regulatory model



16. This system aimed to promote confidence in advisers while maximising flexibility and minimising costs, by allowing different parts of the advice sector to set their own minimum standards subject to the Securities Commission oversight. It also differentiated between

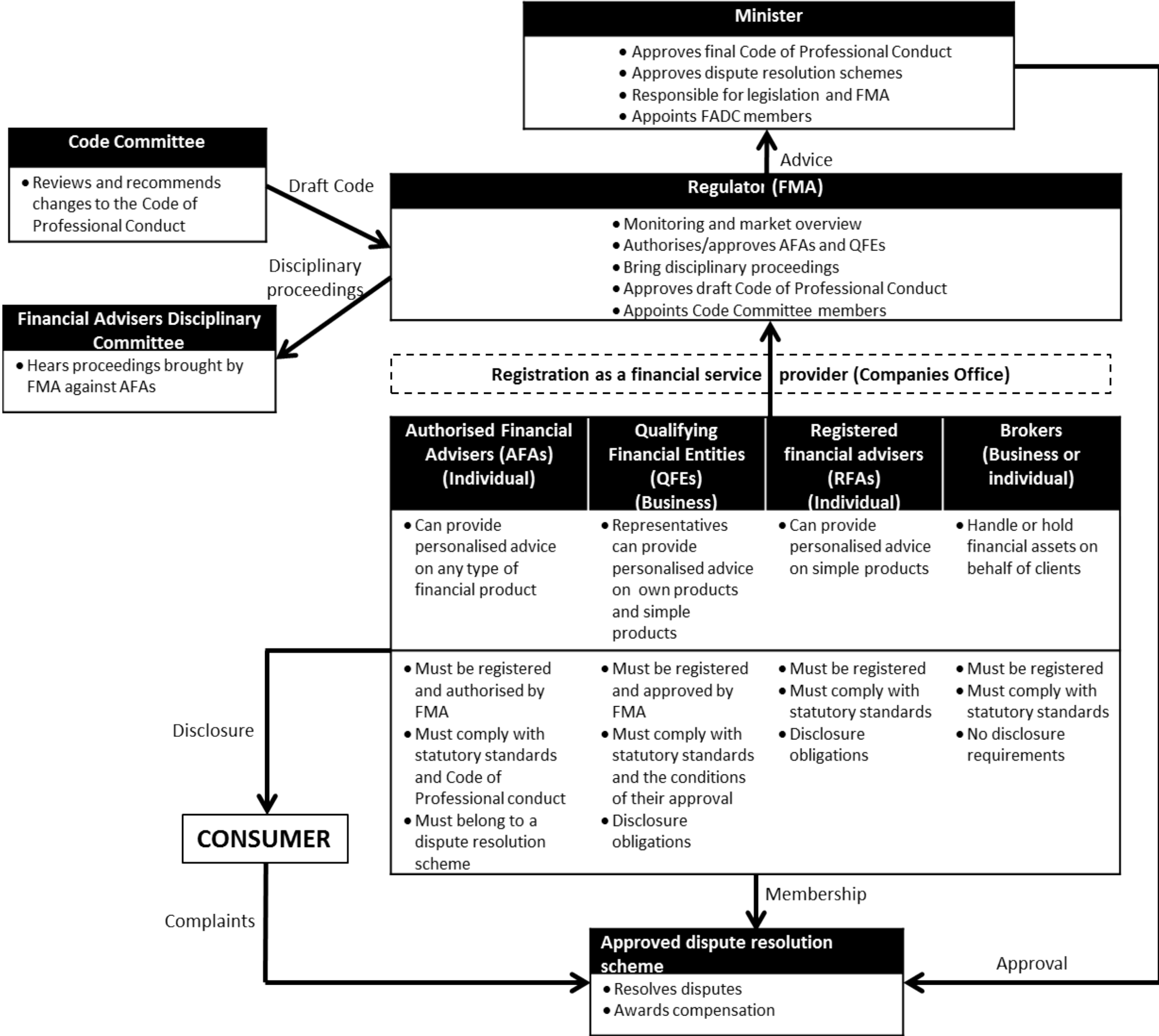
product executors (execution only), information providers (information only), product marketers (general advice only) and personal financial advisers (personalised financial advice).

Development of the FA Act

17. While the Government accepted the Taskforce's recommendations in principle, the regulatory model changed significantly throughout the policy development and legislative stages. The FA Act was passed in 2008, but did not commence until mid-2011 after two sets of amendments were made to the legislation.
18. The intervening period was a tumultuous time for financial markets and for New Zealand investors. The failure of the bulk of the New Zealand finance company market cost investors over $3 billion in savings and the global financial crisis triggered a worldwide recession.[1] These events were the catalyst both for some of the changes to the FA Act and for broader changes to financial markets regulation.
19. The final FA Act introduced a tiered set of regulatory requirements for financial advisers, which depended on the type of advice being provided, the type of product being advised on, and the type of client being advised. It abandoned the concept of co-regulation through approved professional bodies in favour of direct regulation by the FMA. The FA Act also excluded information-only services and incorporated the product marketer function as a type of financial advice. The following diagram outlines the final regime.

[1] http://www.parliament.nz/resource/en-nz/49DBSCH_SCR5335_1/0d9cfef1280ab5ba97f9569c8f965bfd7374305f

Figure 2: Overview of current regulatory regime



Baseline review of Financial Advisers

20. In 2012 MBIE issued the Baseline Review of Financial Advisers in New Zealand. The Baseline Review described the financial advice industry at the time the FA Act was being implemented, provided some of the rationale for government regulation of the sector, and made suggestions for the future evaluation of the regulatory regime. It identified the following desired outcomes for the financial advice industry, which closely align with some of the goals for regulation of financial advice outlined in Chapter 2:

- That consumers can make informed investment decisions.
- That consumers can judge the quality of financial advisers.
- That consumers can determine the interests and incentives of financial advisers.
- That consumers have trust and confidence in financial advisers.

21. This review will draw on the findings in the Baseline Review report, and will compare current features of the now-regulated financial advice market with what was in place immediately prior to regulation.

Post-implementation changes

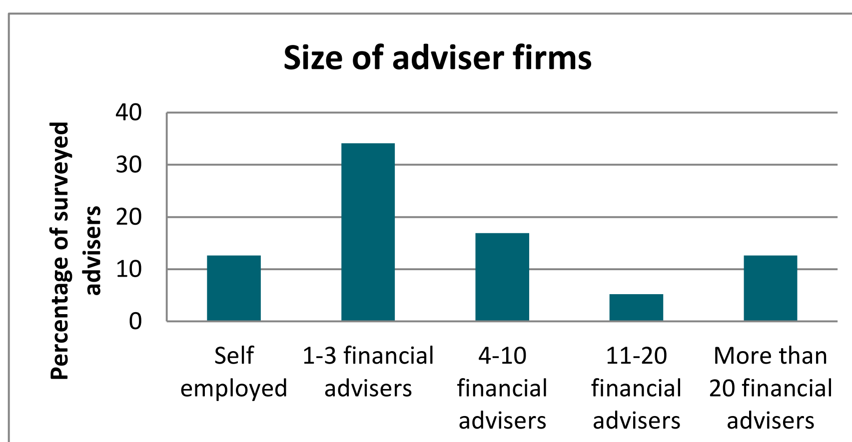
22. The Financial Markets Conduct Act 2013 (FMC Act) reforms made significant changes to the FA Act and to the broader regulatory landscape for financial markets. The FMC Act replaced much of the previous law governing financial markets and introduced new disclosure and governance regimes for financial products and some financial services.
23. A number of consequential changes to the FA Act were made, including to the definitions of financial products and wholesale clients, and to the regulation of discretionary investment management services (DIMS).

The current state of the financial adviser market

24. As at February 2015, 8,000 individuals and 906 entities were registered to provide financial adviser services. In comparison, by the end of May 2011, just prior to the implementation of the FA Act, more than 5,000 financial service providers were registered as a financial service provider. More than 3,700 of this number registered as individual financial advisers. By the end of December 2011, more than 9,900 financial service providers (of which 8,675 were individual financial advisers) were registered.
25. In March 2015, MBIE received nearly 600 responses from financial advisers to a survey about the services they offer, their qualifications and experience, and their views regarding the impacts of changes to legislation. Results from this survey indicated that respondents were typically:

- male (73.8 per cent);
- aged over 55 (46.9 per cent); and
- New Zealand European/Pākehā (91.1 per cent)

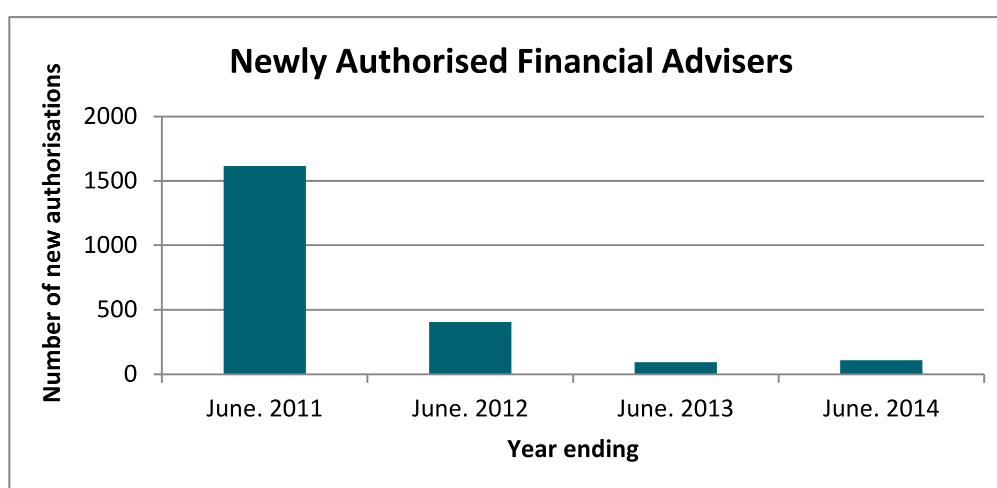
26. The survey also revealed that respondents had generally been working as a financial adviser for a substantial period of time, with 51.4 per cent stating they had been providing advice for over 20 years and 40.9 per cent estimating they planned to continue to work as a financial adviser for another 4-10 years.
27. A survey conducted in 2011 as part of the Baseline Review revealed that of the 325 advisers surveyed, almost half were sole traders or employed in companies with five or fewer employees. In comparison, respondents to MBIE's most recent survey found that advisers typically provide financial adviser services to a large number of clients, with 54.1 per cent seeing over 100 clients on an annual basis. Respondents also tend to primarily work in smaller firms, as they did immediately prior to the implementation of the Acts:



28. The most common work typically carried out by survey respondents was insurance advice (73.0 per cent), followed by KiwiSaver (30.2 per cent) and investment advice (27.8 per cent).

Current Authorised Financial Adviser market

29. As at June 2014, there were approximately 1,900 Authorised Financial Advisers (AFAs). The FMA's 2014 AFA information return revealed that about 200 AFAs have chosen to retain their authorisation, but do not currently provide financial adviser services to clients. Reasons for this are varied, and include those taking leave from the industry, and those who have moved into compliance roles.
30. The number of newly authorised financial advisers dropped significantly after the initial registration period following the implementation of the Acts, with 108 gaining authorisation by the year ending June 2014. From 1 July 2014 to 31 March 2015, 52 new AFA registrations were processed by the FMA:



Experience

31. The FMA's 2014 AFA return showed 15 per cent of AFAs reporting three years or less experience in providing financial adviser services in New Zealand on investment products. 54 per cent reported having more than three years of experience but less than 20 years; and 31 per cent had more than 20 years of experience.

Number of clients

32. According to FMA's 2014 AFA information return, the average number of clients of an individual AFA is around 250. This figure is based on AFAs that report managing their own set client base.

Range of services provided

33. AFAs reported providing the following financial adviser services in the 12 months to 30 June 2014:

- 41 per cent provided financial adviser services in relation to insurance
- 67 per cent provided advice in relation to KiwiSaver

- 81 per cent provided advice in relation to other types of investment products
- 14 per cent provided advice in relation to mortgages.

Payment for services

34. Remuneration methods are varied across the industry:

- 45 per cent of AFAs report that their clients pay commissions for their services
- 36 per cent report that their clients pay a fixed fee or an hourly rate
- 20 per cent report receiving bonuses based on volume as set targets
- 40 per cent report they receive bonuses based on a mix of measures, including compliance and quality.[2]

Current Registered Financial Adviser market

35. Currently around 6,200 individuals are registered to provide a financial adviser service, but are not authorised by the FMA.
36. Registration on its own only permits an adviser to provide limited types of financial advice, including personalised advice on category 2 (lower risk or less complex – see Chapter 5) products as well as class advice on any financial product. As a result, Registered Financial Advisers (RFAs) predominantly work in the following areas:
    a) Life insurance advisers work with their clients to assess risk, help their clients understand policy exclusions and to ensure they possess the correct information relevant to their policy. Such policies exist to cover debts, funeral expenses, full mortgage repayment, and any living costs incurred by a client's family after death. Life insurance can also include income replacement insurance.
    b) Fire and general insurance advisers provide personalised advice on fire and general insurance. Such insurance encompasses a wide range of products and includes home, contents, vehicle, commercial and rural cover. A large proportion of this market appears to be aimed at providing advice to small to medium sized entities.
    c) Mortgage brokers are intermediaries who facilitate mortgage loans on behalf of their clients. An individual or business is able to utilise a mortgage broker to match with a bank or lender to secure a loan.
37. RFAs surveyed by MBIE's survey of financial advisers found that over half had been working as a financial adviser for over 20 years, with a further 25 per cent working in the role for 11-20 years. A majority of 62 per cent provided financial adviser services to over 100 clients per annum.
38. There are a number of reasons why many RFAs do not seek AFA status. The most common reasons cited by respondents to MBIE's survey of financial advisers were that authorisation is not required to offer advice on the products that they deal with and a view that the qualifications required are not relevant to their current role. In addition, some noted their clients do not see sufficient value in AFA status.

[2] Respondents to the AFA return were able to select multiple options when asked how they were paid for their services.

Current Qualifying Financial Entity market

39. As of February 2014, 56 entity groups had Qualifying Financial Entity (QFE) status, consisting of:

- 31 per cent insurers
- 18 per cent banks
- 18 per cent non-bank deposit takers (e.g. credit unions)
- 15 per cent lenders
- 13 per cent fund managers
- 5 per cent other.

40. The 2014 AFA return showed that about 35 per cent of AFAs work within a QFE group. Non-AFAs working within a QFE are estimated to number around 23,000.

What do consumers think?

41. A number of consumer surveys have found low levels of use of financial advisers. For instance, the 2013 *Financial Knowledge and Behaviour Survey* found that on average 15 per cent of people had talked to a financial adviser in the past 12 months. [3] Usage varied considerably, with the following groups more likely than average to have used a professional adviser:

- 45-54 year olds (24 per cent)
- People with a tertiary or graduate education (20 per cent)
- Home owners (20 per cent) or people with a home in a trust (31 per cent)
- Those with higher household incomes (35 per cent of households with income over $100,000 used an adviser).

42. Those less likely to have received financial advice included young people (only 3 per cent of 18-24 year olds and 8 per cent of 25-34 year olds had used an adviser) and those on a low personal income (6 per cent of those earning between $10,001 and $20,000).
43. The survey also identified that people with self-perceived low levels of financial knowledge were much less likely to seek financial advice than average (6 per cent), while those with high self-perceived knowledge were much more likely to have done so (22 per cent).

Perceptions of financial advisers are often negative

44. A 2011 survey by RaboDirect asked about consumers' perception and experiences of financial advisers. It indicated that 24 per cent of people had confidence in financial advisers, 19 per cent believed the fees were reasonable, 27 per cent believed they act fairly and with integrity, and 31 per cent believed they provide good products and services.
45. As might be expected, results differed markedly between those who used financial advisers and those who did not. Current users of financial advisers had much better perceptions of financial advisers, with 60 per cent having confidence in them, 49 per cent believing fees are reasonable, 57 per cent believing they act with integrity, and 68 per cent believing they provide good products and services.

[3] Commissioned by the Commission for Financial Literacy and Retirement Income, supported by ANZ and conducted by market research company Colmar Brunton.

46. A similar survey by the New Zealand Financial Advisers Association in 2013 found that 25 per cent of those surveyed considered investment advisers to be untrustworthy, compared to 19 per cent who considered them trustworthy. Insurance advisers fared somewhat better, with 20 per cent considering them untrustworthy and 24 per cent trustworthy.

Further consumer research for the review

47. Earlier in 2015 MBIE commissioned Colmar Brunton to run a number of consumer focus groups, consisting of investment advice clients, insurance advice clients and people who do not currently receive financial advice. MBIE also ran focus groups of members of the New Zealand Shareholders Association. Quotes from these focus groups are used throughout this paper to illustrate consumer views.
48. MBIE will be undertaking further consumer surveying over the coming months to get a more up to date picture of consumer perceptions of financial advisers.

Chapter 4 – Role and regulation of financial advice

49. To effectively review the FA Act we need a clear understanding of the role of financial advice and the goals for financial adviser regulation.

What is financial advice and why is it important?

50. People make financial decisions every day throughout the course of their lives, ranging from relatively simple decisions, such as opening a bank account, through to decisions on how to save and invest for retirement.
51. At its broadest level, financial advice can be defined as advice given from anyone recommending a particular course of action in relation to spending, saving, borrowing, investing, choice of financial products, and similar activities. People get advice from family, friends, workmates, publications and the internet as well as from professional financial advisers.
52. The FA Act defines financial advice as giving an opinion or making a recommendation on whether to buy or sell a financial product. This is much broader than just financial planning services – it includes advice on individual investments, on purchasing insurance or taking out a loan, as well as advice on what type of savings account to use. The FA Act therefore has a broad impact across the economy.
53. Financial advice can help people make good saving, investment, and financial planning strategies that help them reach their financial goals. However, we know from a number of incidents both in New Zealand and overseas that bad or negligent advice can leave affected people worse off than if they had received no advice at all.
54. Financial advice has wider economic benefits and risks for New Zealand. Appropriate financial advice that assists people to participate in financial markets effectively can support economic growth and enhance financial stability. Conversely, poor investment decisions can increase systemic risks in the economy.

What role do financial advisers play?

55. Literature indicates that people seek financial advice for three main reasons:

Financial advice can reduce "search costs" and asymmetric information

56. To make good financial decisions, people need to acquire and analyse a wide range of information, which can be time consuming, costly, and difficult. Using a professional financial adviser can help people to get the information they need at a much lower cost. Feedback from consumer focus groups supported this rationale for seeking advice:

"You're basically buying their expertise. Some things change in the marketplace or where the products come along or when law changes in relation to certain things then they will tell you." – Insurance advice client.

"It was originally time [when I chose to use an adviser], I didn't have time to track all what's happening in the stock market." – Investment advice client.

Financial advice can help correct biases and poor judgements

57. Results from behavioural economics suggest that people are subject to significant biases and cognitive errors that can lead to sub-optimal saving and investment decisions. Using an advisor to provide objective advice can improve decision making for consumers and investors.

Financial advice can promote confidence and participation

58. By providing coaching, mentoring and other similar benefits, financial advisers may reassure consumers about participating in financial markets, increasing consumer confidence and participation.

Studies show mixed impacts from financial investment advice

59. A number of international studies have sought to quantify the value professional financial advice. However the impact of financial advice has proved difficult to measure and results of such studies have not clearly shown whether or not financial advice has led to better portfolio performance or diversity. These international findings are reflected in (limited) New Zealand work in this area, which does not show any effect on returns and portfolio composition from financial advice. New Zealand studies suggest that the investment decisions of peers play a significant role in financial decision making, as peers are people consumers know and trust.

Why regulate financial advisers?

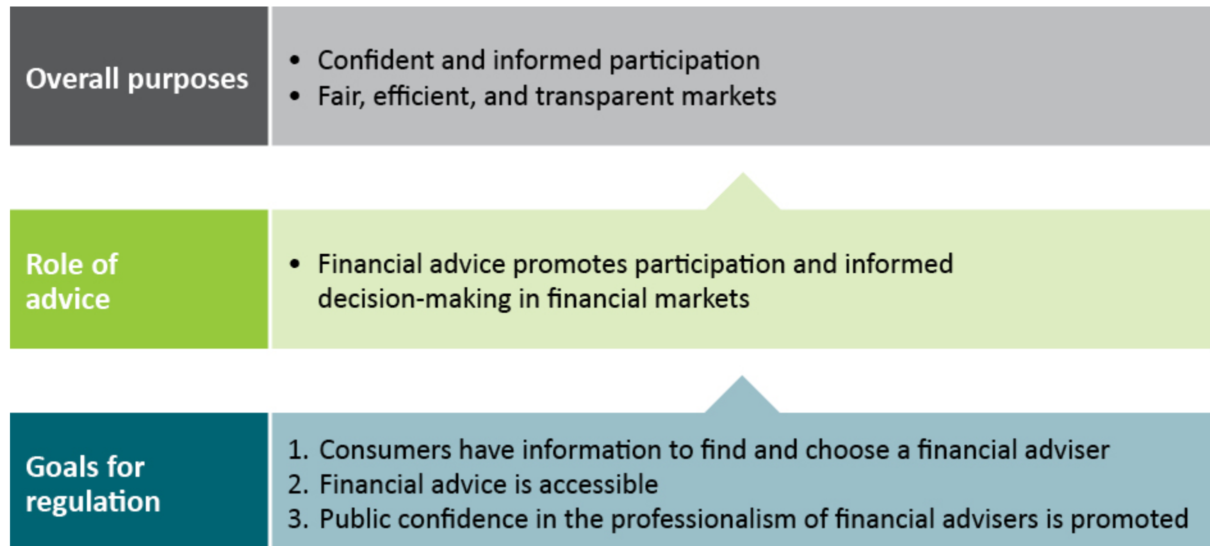
60. In the financial advice market there is potential for market failure and poor consumer outcomes if consumers do not have the knowledge to be able to select the right financial adviser to meet their needs. Given the variety of providers and consumer needs, and difficulties in judging quality of advice over time, consumers may find it difficult to assess the quality and suitability of advisers. This information asymmetry could lead to an adviser market of variable quality, with some consumers ending up with 'bad' advisers with corresponding financial outcomes.
61. Another key trigger for occupational regulation is whether there is a possibility that incompetent, negligent, or fraudulent service by members of the profession could result in harm to consumers or a third party. In the case of financial advice, this potential was highlighted following finance company collapses in New Zealand from 2008. Serious problems internationally following the global financial crisis demonstrated that this was not a New Zealand-specific problem and that regulatory interventions in other countries have not always successfully prevented such problems.
62. Reputation is frequently cited as a possible solution to this problem, on the basis that the experiences of other consumers can guide would-be clients of advisers to choose an appropriate adviser. However, as the recent global financial crisis has shown, the effects of poor investment advice can take a long time to become apparent. In well performing financial markets even poor investment decisions can be associated with strong performance in the short to medium term, with poor advice only being detectable following a significant market correction.

Goals for financial adviser regulation

63. The main purposes of New Zealand's financial markets legislation, set out in the FMC Act and referred to in the FA Act, are to:

a) Promote the confident and informed participation of businesses, investors and consumers in financial markets
b) Promote and facilitate the development of fair, efficient and transparent financial markets.

64. We have developed the following framework for thinking about how regulating financial advice and financial advisers can contribute to these purposes:



65. This framework is deliberately consumer focussed and sets out the three primary goals for a successful financial advice regulatory regime:

1: Consumers have the information they need to find and choose a financial adviser

66. If people are able to identify competent and ethical financial advice professionals to provide them with financial advice, they will be well placed to use advice to make sound saving, investment and insurance decisions.

2: Financial advice is accessible for consumers

67. The availability of good financial advice will only assist consumers if they are able to access it on reasonable terms. In particular, the cost of financial advice must be reasonable and proportionate to the quality and value of advice received, and not overly burdened by compliance costs.

3: Public confidence in the professionalism of financial advisers is promoted

68. A key goal for regulation is to make sure that consumers are confident about the conduct and competence of financial advisers, therefore increasing the use of financial advisers to improve decision making and increase participation in financial markets. Regulation seeks to achieve this goal by lifting levels of professionalism in the adviser industry and by ensuring that adequate ethical and educational standards are in place for advisers.

69. This goal is clearly reflected in the statutory purpose of the FA Act: "*to promote the sound and efficient delivery of financial adviser and broking services, and to encourage public confidence in the professionalism and integrity of financial advisers and brokers*".

1	Do you agree that financial adviser regulation should seek to achieve the identified goals? If not, why not?
2	What goals do you consider should be more or less important in deciding how to regulate financial advisers?

Chapter 5 – How the FA Act works

How is financial advice defined?

70. Section 10 of the FA Act defines **financial advice** as when a person *makes a recommendation or gives an opinion in relation to acquiring or disposing of a financial product*. There are a number of exclusions from this definition, including providing information about a financial product, giving advice about a class of financial products or a process for acquiring or disposing of a financial product, transmitting the advice of another person, and recommending a person consult a financial adviser.
71. Financial advice does not typically capture advice about purchasing physical property, such as land, as this is outside of the definition of a financial product. Property investment schemes that are captured by the FMC Act as managed investment schemes are included as financial products.

3	Does this definition adequately capture what financial advice is? If not, what changes should be considered?

What are the different types of financial advice?

72. Who can provide financial advice depends on:

1: Who the client is

The majority of requirements in the FA Act only apply to financial adviser services provided to **retail clients**: defined as clients who are not **wholesale clients** (***section 5C*** of the FA Act). Wholesale clients are persons who, due to their assets, size or sophistication, are assumed to be able to effectively choose a financial adviser without much regulatory assistance. The wholesale client definition was recently amended to bring it closer to that in the FMC Act.

2: Whether the advice is personalised

The FA Act applies tighter restrictions on who can provide a personalised financial service i.e. personalised advice that takes into account a client's particular financial situation or goals. A class service is defined as advice that does not come under the definition of a personalised financial service. For the ease of the reader, this paper refers to these types of advice as 'personalised advice' and 'class advice' respectively.

The rationale behind placing higher restrictions on personalised advice is that someone receiving personalised advice has a reasonable expectation that their circumstances have been properly taken into account and that it usually takes a higher level of skill and competence to make this assessment.

3: The product being advised on

The FA Act divides financial products into **category 1** and **category 2** products. Category 1 products have been assessed as being higher risk or more complex and therefore advice on these products is subject to higher regulatory requirements. Category 1 includes investment products such as equity securities and KiwiSaver funds.

Category 2 includes products that have been assessed as being lower risk or less complex (such as most insurance products, credit contracts and many savings products) and are therefore subject to lower regulatory requirements.

4	Is the distinction in the FA Act between wholesale and retail clients appropriate and effective? If not, what changes should be considered?
5	Is the distinction in the Act between a personalised financial service and a class service appropriate and effective? If not, what changes should be considered?
6	Is it appropriate to have different requirements on advisers depending on the risk and complexity of the products they advise upon?
7	Does the current categorisation system accurately reflect the level of complexity and risk associated with financial products? If not, how could it be improved?

Who can provide different types of financial advice?

	Authorised Financial Advisers (AFA) Individuals who are registered and authorised by the FMA	**Qualifying Financial Entity (QFE) advisers** Representatives of entities approved by the FMA as Qualifying Financial Entities	**Registered Financial Advisers (RFA)** Individuals registered to provide financial advice	**Registered financial adviser entities** Entities registered to provide financial advice
Wholesale adviser services	✓	✓	✓	✓
Class advice	✓	✓	✓	✓
Personalised advice on category 2 products	✓	✓	✓	×
Personalised advice on category 1 products	✓	✓ in respect of category 1 products issued by the QFE	×	×
Investment planning services	✓	×	×	×
Personalised Discretionary Investment Management Services	✓	×	×	×

Examples of the different types of advice

1: Deborah goes into her bank to open a new savings account. The bank teller tells her about the different interest rates and fees, but is clear that he or she cannot give a view on which specific account is right for Deborah.

This is **not financial advice**, as no opinion or recommendation has been given on whether Deborah should open a particular savings account. The FA Act does not apply.

2: Daniel is shopping for a television, but does not have money saved to buy the model he wants outright. The salesperson recommends that Daniel purchase the television on a hire purchase.

This is **not financial advice** for the purpose of the FA Act, which exempts financial advice provided as an incidental part of a non-financial services business (***see section 13***).

3: Andrea reads a brochure produced by her insurance company recommending that people with dependent children should buy income protection insurance policy.

This is **class advice**, as Andrea's particular circumstances have not been taken into account. The insurance company must be registered on the Financial Service Providers Register.

4: Wiremu visits his KiwiSaver provider to discuss whether he is invested in the right type of KiwiSaver fund. He outlines his circumstances, including his goals and risk tolerance, to a financial adviser. The adviser recommends that people in similar circumstances to Wiremu invest in a balanced KiwiSaver fund.

This is likely to be **personalised advice**, regardless of whether the adviser explicitly takes Wiremu's circumstances into account, because Wiremu would reasonably expect that they had been considered. As KiwiSaver is a category 1 product, the financial adviser must either be an AFA or a QFE advisor.

Registered Financial Advisers (RFAs)

73. The FA Act and FSP Act require anyone in the business of providing a financial adviser service to be registered on the Financial Service Providers Register.

Becoming an RFA

74. Individuals who have registered on the Financial Service Providers Register to provide a financial adviser service but have not been authorised by the FMA are restricted to providing more limited types of advice. While the term is not used in the FA Act, these advisers are often referred to as Registered Financial Advisers (RFAs).

8	Do you think that the term Registered Financial Adviser gives consumers an accurate understanding of what these advisers are permitted to provide advice on and the requirements that apply to them? If not, should an alternative term be considered?

RFA conduct requirements

75. The FA Act sets out general conduct requirements that apply to all types of advisers, including RFAs providing a financial adviser service. These include:
    a) To exercise the care, diligence and skill that a reasonable financial adviser would exercise in the same circumstances
    b) To not engage in misleading or deceptive conduct or advertise in a way that is misleading, deceptive, or confusing.
76. The requirement to exercise care, diligence and skill has provided the FMA, dispute resolution schemes and, to an extent, professional bodies with a tool by which to encourage advisers to improve their standards.

Based on the responses from MBIE's survey of financial advisers, advisers tend to find their conduct and disclosure obligations clear under the FA Act.

The most commonly reported benefits for advisers regulated under the FA Act include development of better advice processes and record keeping (46.2 per cent), greater transparency (43.0 per cent) and better reputation of their business (32.5 per cent).

77. The FMA's main tool when it detects poor practice by RFAs (the RFA is in breach of its conduct or disclosure obligations) is to issue a written direction under section 49 of the FA Act. Failure to comply with a direction constitutes an offence under the Act.

9	Are the general conduct requirements applying to all financial advisers, including RFAs, appropriate and adequate? If not, what changes should be considered?

RFA disclosure

78. RFAs are required to provide retail clients with a prescribed disclosure statement before providing personalised advice. This disclosure statement sets out:

- The adviser's name and contact details
- The types of services the adviser provides
- The adviser's dispute resolution processes and scheme membership

79. RFAs are not obliged to actively disclose how they are remunerated, including whether they receive commissions or other incentives from financial product providers. This issue is discussed further in Chapter 6.

10	Do you think that disclosing this information is adequate for consumers? Should RFAs be required to disclose any additional information?

RFA Entities

80. Businesses, rather than individuals, that register to provide financial adviser services are only permitted to provide class advice. This allows entities to take sole liability for published class advice (on a website, for example) and allows the entity's employees to provide class advice directly to clients. At present around 900 entities are registered to provide financial advice.

11	Are there any particular issues with the regulation of RFA entities that we should consider?

Authorised Financial Advisers (AFAs)

81. The FA Act permits AFAs to provide the widest range of financial adviser services and, in turn, applies a higher level of regulatory requirements to them.

Authorisation

82. To become an AFA a person needs to be authorised by the FMA. In order to be eligible to be authorised in respect of financial advice and investment planning services, a financial adviser must:

- Be registered on the Financial Service Providers Register or not be a disqualified person
- Meet a good character test
- Meet the level of competency, knowledge and skills specified in the Code of Professional Conduct for AFAs (currently the Level 5 Certificate in Financial Services (Financial Advice))
- Not have a criminal conviction for an offence punishable by imprisonment for a term of six months or more, unless the FMA is satisfied that the conviction does not reflect adversely on their fitness to act as an AFA
- Comply with any terms and conditions the FMA sets in granting their authorisation.

83. All AFAs must have and keep up to date an adviser business statement (ABS). These statements are written documents that set out what type of adviser business they provide, and what compliance arrangements they have in place. They also explain the systems and procedures the adviser has in place to ensure he or she conducts business professionally.

12	Are the costs of maintaining an adviser business statement justified by its benefits? If not, what changes should be considered?

84. In addition to financial advice, AFAs can be authorised to provide two other types of financial adviser services: investment planning services and discretionary investment management services.

Investment planning services

85. An **investment planning service** (IPS) is defined as the design of a plan for an individual based on an analysis of their current and future overall financial situation, and identification of their investment goals, including a recommendation or opinion on how to realise them. Only AFAs can provide IPS to retail clients, regardless of whether it relates to category 1 or category 2 products. While IPS is a separate authorisation, there are no additional authorisation requirements for this service. As at April 2015, 1,490 advisers had IPS as part of their authorisation scope, but not all are believed to actually provide this service. In June 2014, the AFA return facilitated by FMA revealed that of the 1,490 AFAs who were authorised to provide an IPS, only 835 indicated they were offering this service.

13	Is the distinction between an investment planning service and financial advice well understood by advisers and their clients? Are any changes needed to the way that an investment planning service is regulated?

Discretionary investment management services

86. A **discretionary investment management service** (DIMS) is defined as any service in which the provider decides which financial products to acquire or dispose of on behalf of and

authorised by their client. As at April 2015, 902 AFAs have DIMS as part of their authorisation scope. Financial advice does not necessarily have to be provided in providing DIMS.

87. Since changes to the FA Act which came into force on 1 December 2014, AFAs are only permitted to provide DIMS to retail clients if the investment strategy is personalised to their circumstances (personalised DIMS). Any other type of DIMS (class DIMS) requires a licence under the FMC Act, on the basis that it could be similar in practice to a managed fund (with the only significant difference being that clients hold a beneficial interest in the actual financial products rather than owning units in a fund which owned the products).

88. In response to feedback that a number of AFAs would need to obtain a DIMS licence in order to continue to offer their existing services, the Government adjusted the FMC DIMS licensing regime to make it more accommodating for small financial adviser businesses.[4] A key change was to provide an exemption from the FMC Act for AFAs exercising incidental discretion in some situations. Although the DIMS regulatory regime is still new, we are interested in feedback on whether the regime is working for advisers and whether any further changes should be considered in this area.

14	To what extent do advisers need to exercise some degree of discretion in relation to their clients' investments as part of their normal role?
15	Should any changes be considered to reduce the costs on advisers who exercise some discretion, but are not offering a funds management-type service?

AFA disclosure

89. AFAs are required to provide two disclosure statements to their clients before providing them with personalised advice, investment planning services or personalised DIMS. The first, known as the primary disclosure statement, is intended to be a relatively short description of the adviser's business which allows prospective clients to compare advisers. It is a largely prescribed document that outlines:

    a) The adviser's contact details
    b) The services they offer
    c) A general description of how they are paid
    d) Their disciplinary history (if any)
    e) Their complaint procedure.

90. AFAs are also required to provide one or more secondary disclosure statements that describe the specific nature of the service that the adviser will provide to the client, what it will cost and how the adviser will be paid. This includes detail of any commission that the adviser will receive and any other conflicts of interest. Because this information could vary significantly between advisers there is no set format for secondary disclosures.

16	Are the current disclosure requirements for AFAs adequate and useful for consumers?
17	Should any changes be considered to improve the relevance of these documents to consumers and to reduce the costs of producing them?

[4] *http://www.med.govt.nz/business/business-law/current-business-law-work/dims-and-custody/cabinet-paper-dims.pdf*

Code of Professional Conduct

91. The majority of obligations that apply to AFAs are set out in the Code of Professional Conduct for Authorised Financial Advisers. The Code sets out minimum standards of ethical behaviour, client care, competence, knowledge and skills, and for continuing professional training.[5].
92. The Code is set by a Code Committee, whose members are appointed by the FMA on the basis of their knowledge of the financial adviser industry, or, in respect of one member, their knowledge of consumer affairs. Code Committee members are responsible for the development of the Code and for reviewing the Code to ensure that it remains fit for purpose. The Code must be subject to broad consultation and requires approval by both the FMA and the Minister of Commerce and Consumer Affairs.

18	Do you think that the process for the development and approval of the Code of Professional Conduct works well?
19	Should any changes to the role or composition of the Code Committee be considered?

93. The FMA monitors AFAs' compliance with the Code and with the general conduct provisions set out in the FA Act. The FMA can refer any perceived breaches of the Code to the Financial Advisers Disciplinary Committee (FADC).
94. The jurisdiction of the FADC is significantly narrower than that originally proposed by the Financial Intermediaries Taskforce, in that it cannot consider complaints against RFAs or QFE advisers. As of March 2015, the FADC had only considered cases against 7 advisers.

20	Is the Financial Advisers Disciplinary Committee an effective mechanism to discipline misconduct against AFAs?
21	Should the jurisdiction of this Committee be expanded?

Qualifying Financial Entities

Approval of Qualifying Financial Entities

95. The FA Act allows the FMA to confer QFE status on an entity if it is satisfied that the QFE will ensure that its advisers comply with their obligations under the FA Act and terms and conditions of QFE status, and will maintain procedures to ensure that its retail clients receive adequate consumer protection. This standard requires the QFE to apply similar standards to those in the Code in respect of category 1 products. Prospective QFEs apply for approval by providing an ABS that sets out how they will meet these requirements.
96. Approval as a QFE allows an entity's financial advisers to provide personalised advice in respect of any category 2 products as well as category 1 products issued by the QFE, without being individually registered and authorised. The QFE is responsible for ensuring that its advisers comply with their obligations and is liable for any breaches of these obligations.

Note: The merits and drawbacks of the QFE model are discussed on page 47- 48.

[5] The current code standards are available here: *http://www.financialadvisercode.govt.nz/assets/Code-of-Professional-Conduct-for-AFAs/Code-of-Professional-Conduct-for-AFAs-May-2014.pdf*

QFE Conduct Obligations

97. The bulk of a QFE's obligations are set through the conditions that the FMA places on its approval. The standard conditions that apply to all QFEs are available on the FMA's website and include capacity, reporting and disclosure requirements. These standard conditions require the QFE to ensure that its governance and compliance arrangements and procedures meet the commitments made in the QFE's ABS. Given that a QFE's ABS contains commercially sensitive information the details of these obligations are not publicly available.

22	Does the limited public transparency around the obligations of QFEs undermine public confidence and understanding of this part of the regulatory regime?
23	Should any changes be considered to promote transparency of QFE obligations?

QFE Disclosure

98. QFEs acting through a QFE adviser are required to disclose the following information to clients before providing them with personalised advice:

a) The name and contact details of the QFE

b) The QFE's dispute resolution procedures and the details of the dispute resolution scheme that it belongs to

c) Information about the business, including, in relation to category 1 products, a general description of how the QFE and its advisers are remunerated for the advice

d) Information about the service being provided in relation to category 1 products, including the fees charged for the advice, and any relevant commissions or other incentives.

24	Are the current disclosure requirements for QFE advisers adequate and useful for consumers?
25	Should any changes be considered to improve the relevance of these documents to consumers or to reduce the costs of producing them?

Brokers and Custodians

99. In addition to financial adviser services, the FA Act also regulates the provision of "broking services" defined in section 77B as the receipt of client money or client property in relation to a financial product by a person and the holding, payment, or transfer of that client money or client property.

100. A person can be providing broking services (and therefore be a "broker") without being involved in the provision of financial advice. The broking section of the FA Act therefore has wide application across the financial sector, and is the primary way that the holding of client money and property is regulated. As at February 2015, 1,187 persons were registered to provide a broking service.

Broker requirements

101. All brokers are required to exercise care, diligence and skill and not to engage in misleading or deceptive conduct in relation to the broking service. Additional obligations for handling client assets apply to brokers in relation to retail clients. Client assets are required to be held in a separate trust account, with clear records and must not be used in any other way than is expressly directed by the client.

102. The FA Act also allows for upfront disclosure requirements for brokers to be prescribed in regulations, although no such regulations have been made.

103. Client money held by an insurance intermediary is excluded from a number of these requirements as this is regulated under the Insurance Intermediaries Act 1994. This legislation allows insurance intermediaries to benefit from investing client funds for a period before transferring the funds to the insurer.

26	How well understood are the broker requirements in the FA Act? How could understanding be improved?
27	Are these requirements necessary and/or adequate to protect client assets? If not, why not?
28	Should consideration be given to introducing disclosure requirements for brokers? If so, what would need to be disclosed and why?
29	What would be the costs and benefits of applying the broker requirements in the FA Act to insurance intermediaries?

Custodian obligations

104. A "custodial service" is a subset of broking service, where the client money or property is held by a person on behalf of its beneficial owner. Custodians typically hold client assets as part of a DIMS or as part of an investment platform service and will often provide other services such as executing transactions and undertaking corporate actions.

105. The Financial Advisers (Custodians of FMCA Financial Products) Regulations 2014 apply additional requirements to custodians, including requiring custodians to regularly report on holdings directly to clients and to obtain an assurance engagement from an auditor examining the performance of their systems.

30	Are the requirements on custodians effective in reducing the risk of client losses due to misappropriation or mismanagement?
31	Should any changes to these requirements be considered?

FA Act exemptions

106. The FA Act exempts some persons from these requirements. In particular, lawyers and accountants are exempt from the application of the Act to the extent that they provide a financial advice service or broking service in the ordinary course of their business. Non-profit organisations are also exempt in respect of free financial adviser services.

107. The exemptions for incidental advice provided by accountants and lawyers has been controversial among advisers, who have argued that it is not appropriate for these occupations to be giving advice without being subject to the same conduct and qualification requirements as advisers. The original basis for these exemptions was that these professions were already subject to regulatory oversight and that the benefits of requiring them to comply with the FA Act in relation to financial advice that they might provide as part of their normal activities were not justified.

108. It is also worth noting that one of the reasons why an exemption was needed was because of the wide reach of the FA Act in comparison to other regulatory frameworks. For example, a

financial adviser could discuss how the law applies without being a lawyer under the Lawyers and Conveyancers Act 2006.

32	Is the scope of the FA Act exemptions appropriate? What changes should be considered and why?

Monitoring and enforcement of the FA Act

109. The FMA is responsible for the monitoring and enforcement of the FA Act. In addition to authorising AFAs and approving QFEs, it also monitors all financial advisers' ongoing compliance with the FA Act's provisions and has a wide range of formal and informal tools through which to respond to non-compliance. The FMA has extensive enforcement powers under the FA Act, the FMC Act and the Financial Markets Authority Act 2011, including the ability to require information, to direct a financial adviser to take steps to comply with the Act and ultimately to withdraw the authorisation/approval of AFAs and QFEs.

110. The FMA's enforcement policy states that it focusses its enforcement resources on conduct that harms or presents the greatest likelihood of harm to the function of open, transparent and efficient capital markets. The FMA therefore targets its activities on a risk assessed basis, informed by its surveillance and intelligence activities.

111. The FMA also periodically releases guidance documents, outlining providers' regulatory responsibilities and how to comply with relevant legislation, and information and fact sheets on issues relevant to the industry. Respondents to MBIE's survey of financial advisers report that they tend to find the information and guidance provided by the FMA useful.

33	Does the FA Act provide the FMA with appropriate enforcement powers? If not, what changes should be considered?
34	How accessible and useful is the guidance issued by the FMA? Are there any improvements you would like to see?

Chapter 6 – Key FA Act questions for the review

Goal 1: Consumers have the information they need to find and choose a financial adviser

112. We seek feedback on the following key questions relating to the goal of consumers having the information they need to find and choose a financial adviser.

113. We note that the question of whether the Register could be a better tool for providing consumers with information about financial service providers (as discussed on page 60-61) is also relevant to this goal.

Do consumers understand the regulatory framework?

114. The categorisation of clients, types of advice and financial products within the FA Act was an attempt to ensure that regulatory requirements are appropriate for the wide range of different types of activities captured by the FA Act. However, it has resulted in a regulatory regime that is significantly more complex than was initially anticipated.

115. As a result, a significant majority of consumers (including clients of advisers) spoken to by MBIE have indicated that they do not really understand the differences between classes of financial advisers and their different obligations and abilities to advise on different products and to give different types of advice.

> *"Well I think at the moment there is some confusion, I was only reading the other day that apparently there are two different certifications, one's a financial advisor and the other's a financial professional or something like this, and that's just a sure-fire recipe for utter confusion" – participant in New Zealand Shareholders Association focus group.*

116. Advisers and product providers have also reported that they consider the current framework too complex and confusing for consumers. MBIE's adviser survey respondents reported that their clients tend to have a fairly poor understanding of the differences between types of advisers, the conceptual differences between class advice and personalised advice, and the purpose of disclosure and what is being disclosed to them.

117. This lack of understanding is a concern because uncertainty about the different adviser designations runs counter to the rationale that regulating can reduce consumer information asymmetries so that consumers are able to choose an adviser who best meets their needs. It may also contribute to a lack of confidence in the financial markets, thereby reducing consumer participation.

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

Should there be a clearer distinction between advice and sales?

118. The FMA's 2015 Strategic Risk Outlook identifies sales and advice practices as one of its seven strategic priorities, with a particular focus on the mis-selling of financial products. The FMA's aim is to ensure that sales processes and advisory services reflect the best interests of investors and consumers. We have heard concerns that investors may be unaware of the extent to which their adviser is acting in their interests, or whether they are acting with other

motivations. We would like to canvass your views on whether the way that the FA Act regulates sales practices helps to achieve this aim.

In whose interests do advisers act?

119. In well-functioning markets, clear distinctions can typically be drawn between the role of a salesperson and that of an adviser :

   a) In ***pure sales*** arrangements, the producer employs a salesperson to sell their product to customers. In these situations the producer is the principal and the salesperson is their agent and must act in their best interests (that is, by aiming to maximise sales revenue)
   b) In ***pure advice*** arrangements, the customer uses an adviser to give recommendations on which products to buy (or not buy) from various different producers. In these situations the customer is the principal and the adviser is their agent and must act in their best interests.

120. The definition of financial advice in the FA Act is broad, captures some activities that might otherwise be considered sales or marketing, and does not draw a clear distinction between these sales activities and pure advice.

121. The FMA has provided guidance that it considers sales processes that only *imply* a recommendation or opinion are potentially within the definition of financial advice. Although there is some scope in the FA Act to allow for "non-advice" sales, these situations are likely to be fairly limited, and the apparent lack of clarity may be inhibiting the provision of some potentially helpful financial information.

122. Including sales practices within the definition of financial advice provides the FMA with a tool with which to address mis-selling practices. However, there is a question of whether the FA Act should apply to sales activities at all. The labelling of some sales activities as financial advice may have unintended consequences. In particular, by defining sales activities as financial advice, and those who sell financial products as advisers, the FA Act may give consumers an inaccurate impression about the extent to which the "adviser" is their agent and is acting in their best interests (rather than their own interests or those of the product distributor).

Box 1: International comparison

In response to similar issues in Australia a recent Parliamentary inquiry proposed relabeling "general financial advice" (the equivalent of class advice in New Zealand) as "product sales information".

Similarly the United States draws a distinction between "investment advisers" who owe a fiduciary obligation to their clients and "broker dealers" who are treated as primarily having a sales role.

123. A division between sales and financial advice immediately raises the question of what obligations are appropriate for each, and what incentives these different obligations might create for market participants. If the term financial adviser were clearly limited to those with a fiduciary role, this would suggest stronger requirements to act in the best interests of clients and to manage (or possibly eliminate) any conflicts of interest. These obligations, however, would still need to be set in such a way as not to unduly restrict access to financial advice.

124. Appropriate obligations for salespeople, however, would not appear to be as clear-cut. There is an argument that the sale of financial products is not fundamentally different from the sale of any other product, and that nothing further than the general prohibition on misleading and deceptive conduct is required. On the other hand, information asymmetries between customers and sales people may be more pronounced in relation to financial products for the reasons outlined in Chapter 4 and additional conduct or disclosure requirements may be appropriate.

125. An example of this approach is the sale of credit contracts under the amended Credit Contracts and Consumer Finance Act 2003. This requires lenders to comply with lender responsibility principles (including being satisfied that it is likely that the credit or finance will meet the borrower's requirements and objectives and to assist the borrower to reach an informed decision about entering into the credit agreement).

126. Complying with lender responsibility principles does not necessarily require lenders to provide financial advice. However, restrictions on who can provide financial advice and personalised financial advice could inhibit the provision of potentially helpful information to consumers.

127. Concerns about the suitability of financial products being promoted to retail investors also raise a question of whether any suitability requirements should sit with the issuer or the person advising on or selling a financial product. A number of other jurisdictions have moved towards requiring issuers to consider the suitability of their products for retail investors. The absence of any such requirements in New Zealand might influence what requirements are appropriate for advisers or salespeople.

A commonly cited issue by financial advisers in MBIE's March 2015 survey was that compliance costs and meeting regulatory requirements not only form barriers to entry for newcomers, but also prevent more established advisers from remaining viable and competitive.

36	To what extent do consumers understand that some financial advisers' primary roles may be selling financial products, rather than solely acting as an unbiased adviser to their clients?
37	Should there be a clearer distinction between sales, information provision, and advice? How should such a distinction be drawn? What should or should not be included in the definition of financial advice?

How should we regulate commissions and other conflicts of interest?

128. Internationally, policy makers and regulators have paid increasing attention to the conflicts of interest generated by the way in which some financial advisers are paid (known as conflicted remuneration). The most common form of conflicted remuneration is commission payments where at least part of the adviser's income is dependent on his or her clients purchasing certain financial products.

129. The advantage of using commissions for product providers and employers is that it aligns the incentives on a representative or intermediary with those of the provider. Commissions are a common form of remuneration in sales industries as they incentivise stronger engagement with the consumer in emphasising the benefits of a product or service.

130. However, there is potential for adverse outcomes with some commission arrangements. Financial product providers offering commission to advisers can incentivise the adviser to recommend products with higher commission rates rather than the best product for the client.

131. The existence of commissions may also create a perception that advisers are less trustworthy and do not have consumers' best interests at heart. This can have the flow-on effect of damaging public confidence in financial advisers.

"I think [you have to] be very careful about people who are selling insurance including commission because [it's in] their self-interest to sell it to you and they do push." – Insurance advice client.

"Friends and family are best because they have your best interests at heart." – Non-user of insurance and investment advice.

Box 2: International approaches to commissions

Following the global financial crisis and the loss of many investors' life savings on the back of questionable financial advice, adviser commissions have attracted a good deal of regulatory scrutiny. Many countries have responded by changing regulatory requirements:

- In Australia: through the Future of Financial Advice reforms, 'conflicted remuneration' was prohibited from July 2013 (though life insurance products are exempt) – effectively banning the use of commissions.
- In the United Kingdom: commissions on new sales were banned from the beginning of 2013.
- In the United States: mandatory information disclosure continues to be the main approach to dealing with conflicts of interest.

132. Anecdotally, commissions are now a less prevalent remuneration model in the provision of investment advice by AFAs, but almost all insurance and mortgage advice is remunerated through commissions. As discussed further below, the lack of mandatory information disclosure for registered financial advisers (which most insurance advisers are) is therefore of some concern.

Does information disclosure solve conflicts of interest?

133. Since 2011, to mitigate conflict of interest issues New Zealand has required AFAs and QFE advisers to disclose commissions and other conflicts of interest to their clients. This follows from the recommendations of the Taskforce on Financial Intermediaries that "… enhanced disclosure and consumer financial literacy can assist consumers to compare intermediaries and contribute to greater competition between intermediaries, more innovation in relation to best practice standards, and greater consumer choice."[6]

134. 2014 changes to the Code introduced the explicit requirement for AFAs to effectively manage any conflicts of interest and, if they are unable to do so in a way that meets their obligation to act in the best interest of the client, to decline to act.

135. As outlined in Chapter 5 (see page 27), AFAs must disclose conflicts of interest as follows:

- Firstly through a primary disclosure document that sets out high level information about the adviser's business and how the adviser is paid.
- Subsequently through a secondary disclosure statement, which provides more detailed information about the commission the adviser may receive and any other possible conflicts.

136. In theory, creating minimum disclosure requirements can reduce the information gap between advisers and those they advise, and allow recipients of advice to discount or ignore advice if they suspect it has been unduly influenced by a conflict.

[6] Recommendation 4, Confidence, Change and Opportunity: Final Report of the Task Force of Financial Intermediaries (2005).

"I think for me, it [disclosure] makes me both aware and wary of their recommendation, but also confident that I know that that's on the table, and I can factor that into my decision." – Investment advice client.

137. However, a number of behavioural studies[7] on the impact of disclosure on advised individuals' behaviour indicate that disclosure may not always be effective in assisting consumer decision making. Disclosure is most useful when it is short and simple, standardised (allowing for comparisons between advisers), clear about risks and benefits, is meaningful (information is presented in a way that people can relate to and understand), and well presented. The less that these attributes feature in information disclosures, the less useful it will be for consumers.

138. Finally, recent studies have called into question the usefulness of information disclosure in helping consumers with the problem of conflicts of interest,[8] concluding that:

- Following disclosure, advisers feel comfortable giving more biased advice than they otherwise would.
- People receiving advice do not properly adjust for adviser bias and generally fail to sufficiently discount biased advice.
- Following adviser disclosure, clients can feel uncomfortable turning down the advice they receive, as it may indicate a lack of trust in their adviser. In fact, upon receiving information disclosure, clients tend to trust their adviser more, on the basis that they perceive an adviser declaring a conflict is a sign they are acting ethically.

Box 3: Churn

"Churn" is the practice of advisers persuading clients to move from one financial product to another for the purpose of receiving a high up-front commission. The FMA has identified churn in relation to some types of insurance and KiwiSaver as a key strategic risk.

Switching insurance policies, for example, can be a positive indication of a competitive market and can be driven by consumer expectations rather than by advisers. However, it is important that advisers ensure that the new policy meets the client's needs and that the client understands any differences in policy coverage. Similarly, it is important that there is a strong competitive dynamic in the KiwiSaver market, but incomplete or inaccurate advice motivated by upfront commissions has the potential to cause significant harm to investor outcomes.

139. Anecdotal feedback from consumers and advisers indicates that AFA disclosures are seldom read by consumers and almost never relied upon when deciding whether to make an investment decision. Concerns raised include consumers finding the disclosures to be confusing, overly long and complicated, and a lack of a standard form of disclosure to allow for effective comparisons to be made.

---

[7] Many of these studies are summarised in the MBIE Occasional Paper, F*inancial Product Disclosure: Insights from Behavioural Economics*, available at ***http://www.mbie.govt.nz/about-us/publications/occasional-papers/2015-occasional-papers/15-01.pdf/view***

[8] For a fuller discussion, see Loewenstein, G., Cain, D., and Sah., S (2011), "The Limits of Transparency: Pitfalls and Potential of Disclosing Conflicts of Interest", American Economic Review: Vol. 101 No. 3

140. Further, it can be difficult for consumers to understand the impact of a conflict of interest on the advice being offered, even if disclosure documents are read and understood. In most cases, by the time a consumer is given an adviser's secondary disclosure statement they have already decided that their adviser is trustworthy and is acting in their best interests, effectively making the disclosure redundant.

38	Do you think that current AFA disclosure requirements are effective in overcoming problems associated with commissions and other conflicts of interest?
39	How do you think that AFA information disclosure requirements could be improved to better assist consumer decision making?

Should all advisers be required to disclose potential conflicts?

141. One issue that we specifically seek comment on from submitters is whether **all** advisers should be required to disclose their commissions. Currently only AFAs and QFE advisers have a positive obligation to inform clients of conflicts of interest. However insurance advisers (who are almost all RFAs) almost exclusively derive their income from commissions received for placing clients with a risk provider, and are not required to actively disclose conflicts to their clients. This may contribute to some of the risks that the FMA has identified about the sale of personal insurance products (see box 3).

40	Do you support commission and conflict of interest disclosure requirements being applied to all financial advisers? If so, what requirements are appropriate for different adviser types?

Should commissions be banned or restricted?

142. As set out in box 2, a number of jurisdictions responded to adviser misconduct exposed as a result of the recent global financial crisis by banning financial advisers from receiving commissions or other remuneration that generates a conflict of interest. A number of stakeholders have suggested that similar measures should be introduced in New Zealand. The Commerce Committee's 2011 inquiry into finance company failures noted that commission payments to advisers appeared to play a significant role in some advisers' decisions to recommend investing in finance companies. That report recommended that the Government investigate the possibility of banning conflicted remuneration structures.[9]

Box 4: Effect of UK commission ban

Financial advisers in the United Kingdom were banned from receiving commissions from the beginning of 2013. A post-implementation review found that the ban:

- Reduced product bias from adviser recommendations, reflected in a decline in the sale of products which paid high commissions before the ban.
- Made it easier for consumers and advisers to compare platforms, increasing competitive pressure and leading to significant reductions in charges.
- Reduced the price of financial products by at least the amounts paid in commission before the ban.

143. In New Zealand it is often argued that a large number of consumers are unwilling to pay to receive financial advice (particularly in relation to insurance), and that commissions are a cost effective way for consumers to access advice that they may not otherwise be willing to pay

[9] See: http://www.parliament.nz/resource/en-nz/49DBSCH_SCR5335_1/0d9cfef1280ab5ba97f9569c8f965bfd7374305f

for. A frequent concern raised with the concept of banning commissions is that it will ultimately limit the availability of advice, and that consumers will accordingly be worse off. In this view, commissions are seen to be a method of providing advice to people without charging an upfront fee, although consumers effectively bear the ultimate cost through higher charges by financial product providers.

144. We have also heard suggestions that insurance commissions should be restricted, rather than banned, to reduce the incentive on advisers to "churn" clients (see box 3). The Financial Systems Inquiry in Australia proposed that upfront insurance commissions be set at the same level as ongoing commissions, while the recent Australian *Review of Retail Life Insurance Advice* produced by John Trowbridge proposes setting a maximum amount for upfront commissions.[10]

41	Do you think that commissions should be restricted or banned in relation to financial advice, and if so, in what way? What would be the costs and benefits of such an approach?

Goal 2: Financial advice is accessible for consumers

145. We seek feedback on the following key questions relating to the goal of consumers being able to access financial advice.

Does the FA Act unduly restrict access to financial advice?

146. One of the measures we have identified as an indicator of a well-functioning financial advice market is that people are able to access the level of advice appropriate to them on reasonable terms.

147. Access can be affected by a number of factors. Some of the more important factors affecting the ease and cost of access to financial advice are:

- The level of competition in the market for financial advice.
- Regulatory constraints on advice and boundary issues.
- Costs of complying with government regulation.

Financial advisers surveyed by MBIE in March 2015 estimated that the main concern for their clients when seeking financial advice is the ability to access quality advice (52.9 per cent).

Another primary concern for their clients is the ability to access advice when they need it (47.6 per cent).

Level of competition in the market for financial advice

148. Competition between financial advisers can help to limit the price of advice and/or improve the quality of advice. In turn, this helps to make advice more accessible and effective for a wider population of consumers.

149. Government regulation can have an effect on the level of competition in a market. For example, in the financial advice market a range of regulatory requirements aimed at establishing minimum quality standards (such as the authorisation requirements for AFAs) can make it harder for potential competitors to enter the industry, which may reduce the level of competition between advisers.

150. Anecdotal evidence suggests that there are relatively low levels of entry to the financial adviser market. A commonly cited reason is that graduates and others entering the work force do not consider being a financial adviser to be a proper profession, in the same way as being a lawyer or an accountant, for example. Arguably these other professions have much

[10] See: http://www.fsc.org.au/downloads/file/MediaReleaseFile/FinalReport-ReviewofRetailLifeInsuranceAdvice-FinalCopy(CLEAN).pdf

higher barriers to entry, but are sufficiently desirable that they attract much higher levels of new entrants.

151. The most commonly reported barriers to entry identified by respondents to MBIE's survey of financial advisers include compliance costs, understanding and meeting regulatory requirements and difficulties in finding clients.

42	Has the right balance been struck between ensuring advisers meet minimum quality standards and ensuring there is competition from a wide range of providers (and potential providers)?
43	What changes could be made to increase the levels of competition between advisers?

Regulatory constraints on advice and boundary issues

152. One area raised by stakeholders is whether regulatory rules relating to what needs to be taken into account when giving advice, restrictions on which adviser designations can give personalised advice and on what financial product category they can give advice on may be preventing consumers from receiving otherwise beneficial advice.

"I'll make a distinction here. I think at a macro level it's been positive because it has kept the cowboys out and has engendered a better trust in the industry and so on. But on a personal level I'll come back to the fact that I get less advice than I used to. So at a micro level it's not been beneficial for me." – Investment advice client.

153. We have heard concerns that the requirements on AFAs when giving personalised advice mean that they are unwilling to do so unless it is part of a full financial plan. AFAs are required under Code Standard 8 to take reasonable steps to ensure that the personalised advice is suitable for the client, including making reasonable enquiries to ensure that AFA understands the client's situation, needs, goals and risk profile. While the client can issue a written instruction relieving the AFA from this obligation, we have had feedback that this does not necessarily work in practice.

154. While the FMA has issued guidance on the provision of limited-personalised advice, we have had feedback that the FA Act is still restricting the availability of more transactional advice in relation to investments. A commonly cited example is the limited availability of advice to prospective investors in the Government's Mixed-Ownership Model share offers.

Box 5: Access to KiwiSaver advice

As KiwiSaver balances rise and the New Zealand population ages, there is likely to be a growing need for access to quality KiwiSaver-related advice. For some, KiwiSaver funds may be their main source of retirement income, making access to good financial advice even more essential. It is important that the regulatory settings do not constrain KiwiSaver members' ability to access such advice.

155. Confusion about how the regulatory regime works may also be artificially preventing consumers from accessing the best type of advice for their circumstances. For instance, restrictions on the products RFAs and QFEs can advise on necessarily lead to their recommending the purchase of financial products that they are permitted to provide advice on. However, regulatory complexity may mean consumers interpret these as a recommendation on the best overall product for them, rather than the best product the adviser is permitted to give a recommendation about. In these situations it may be more

appropriate for the consumer to seek the advice of an AFA, but poor understanding about the distinctions between advisers may stop this from happening.

44	Do you think that the Code of Professional Conduct for AFAs strikes the right balance between requiring them to understand their clients and ensuring that consumers can get advice on discrete issues?
45	To what extent do you think that the categorisation of types of advice and advisers is distorting the types of advice and information that is provided?

How can compliance costs be reduced under the current regime without limiting access to quality financial advice?

156. Financial advisers and financial adviser professional bodies have also expressed concerns with the extent to which these regulatory requirements are imposing additional costs on their businesses. Costs may get passed on to consumers, and may be limiting consumers' access to advice or preventing access altogether. Anecdotally, some advisers report they will not take on new clients with net assets below a certain pre-defined threshold. Advisers have also indicated that there is a significant cost associated with preparation and review of client information before providing personalised advice.

157. Financial advisers face a number of costs in common with other businesses. However, we are interested in submissions on the unique costs of regulation that financial advisers face, and whether these are unduly burdensome, or are limiting consumers' access to good quality financial advice.. We understand that costs for an AFA, can include:

- The costs of registering on the Financial Service Providers Register.
- Five yearly costs of licencing as an AFA.
- The costs of being a member of a dispute resolution scheme.
- The costs of record keeping and annual reporting of compliance with the Anti-Money Laundering and Countering Financing of Terrorism Act (AML-CFT Act).
- Attending, keeping up to date with, and recording participation in continued professional development (CPD) activities.
- Record keeping and preparation of annual regulatory returns

158. Adviser businesses have indicated to us that they are increasingly relying on external specialist consultants to assist them with their compliance activities due to the time taken and specialisation required to meet government regulatory requirements.

159. Advisers have also raised concerns that compliance costs may have reduced the availability of independent financial advice. We understand that some smaller adviser businesses have chosen to take advantage of the support provided by being associated with a product provider to reduce the costs of compliance with system requirements. While these arrangements can spread the compliance costs faced by advisers and make it easier for advisers to have appropriate systems in place, they may restrict access to advice about financial products that are not part of these distribution networks.

160. Since June 2013, financial advisers providing advice on category 1 products have been subject to the AML-CFT Act. This Act fulfils New Zealand's obligations under the Financial Action Task Force (FATF) Recommendations to require financial institutions to undertake adequate customer due diligence measures. Compliance with FATF Recommendations is important in order to maintain New Zealand's international reputation and to avoid significant difficulties for New Zealand businesses internationally.

161. While it is out of the scope of this review to propose any specific changes to the AML-CFT Act, we are interested in understanding the costs that it is imposing on advisers and any impacts that it is having on access to advice. The Ministry of Justice will consider this feedback when it looks at possible improvements to the current AML-CFT regime as part of its implementation of phase 2 of the regime (which is expected to incorporate lawyers and real estate agents).

46	Are there specific compliance requirements from the FA Act regulation that have affected the cost and availability of independent financial advice?
47	How can regulatory requirements be made less onerous without reducing the quality and availability of financial advice?
48	What impact has the Anti-Money Laundering and Countering Finance of Terrorism Act had on compliance costs for advisers? How could these costs be minimised?

How can we facilitate access to advice in the future?

162. We have identified a number of factors which may influence either the demand for, or supply of, financial advice in future. We seek stakeholder input on the relative importance of these factors and any changes to the FA Act that might be needed to accommodate them.

KiwiSaver withdrawals

163. With an ageing population, more New Zealanders will reach 65 and begin drawing down their KiwiSaver balances. Access to financial advice may become particularly critical once KiwiSaver members start reaching retirement with higher balance amounts that they will need to slowly withdraw (or decumulate) throughout their retirement. Longer life expectancy, combined with an uncertain investment climate, point to the need for access to sound financial advice to ensure that these retirement savings are not prematurely exhausted. This is of particular concern for the large number of New Zealanders for whom KiwiSaver is the primary form of retirement savings. As already noted, the accessibility of KiwiSaver advice is an area of ongoing concern.

164. Retirees will be faced with a number of important and complex decisions on how to invest these balances, particularly given the limited availability of decumulation products (such as annuities) that can help spread the risk of outliving capital by allowing retirees to draw down funds in a sustainable and incremental way.

165. Retirees have varied needs and risk profiles and there is unlikely to be a one size fits all solution. With this in mind, financial advice and its regulation must be understandable, consistent and flexible.

166. We are interested in stakeholder views on the role of financial advice in assisting retirees with the transition to the decumulation phase of their investments and whether and how the regulatory regime could better enable advisers to fulfil this role.

49	What impact do you expect that KiwiSaver decumulation will have on the market for financial advice in New Zealand? Are any specific changes to regulation needed to specifically promote the availability of KiwiSaver advice?

Introduction of the Financial Markets Conduct Act

167. The introduction of the FMC Act may have an impact on the demand for advice. One of the key purposes of the FMC Act is to provide for timely, accurate and understandable information for the public to use when making decisions relating to financial products or the provision of financial services, with the aim of increasing overall participation in financial markets.

168. If the FMC Act is successful in achieving this goal and New Zealanders become more engaged in financial markets, it may increase the long term demand for advice. For example, the facilitation of "stepping-stone" markets such as NZX's NXT market for small, high-growth businesses, as well as exemptions for same-class offers, small offers and crowd-funding and peer-to-peer investments may well increase the range of financial products that New Zealanders may seek advice on.

169. Questions have been raised about whether the FA Act could limit access to advice on some of these new investment products. For example, the more limited amount of information available about investments through equity crowd funding platforms may make it more difficult for an AFA to meet the requirement for having a reasonable basis for a recommendation, which may limit the availability of advice in relation to crowd funded investments. On the other hand, it is unclear why an adviser should be able to recommend investing in a particular product without a reasonable basis for doing so.

50	What impact do you expect that the introduction of the FMC Act will have on the market for financial advice in New Zealand? Should any changes to the regulation of advice be considered in response to these changes?

Internationalisation

170. A core part of the Government's Business Growth Agenda is to ensure New Zealand remains open to international investment flows that create jobs and overall growth. With the increasing internationalisation of the investment industry, we are interested in whether the FA Act adequately addresses international financial advice (both to and from New Zealand) and whether there is a realistic prospect of such advice being more common in future.

171. One of the original aims of the FA Act reforms was to facilitate trans-Tasman mutual recognition of advisers. Given the differences between the regulatory approaches taken in New Zealand and Australia, full mutual recognition has not been possible, although there is mutual recognition of adviser qualifications. We would appreciate feedback how well these arrangements are working.

51	Do you think that international financial advice is likely to increase? Is the FA Act set up appropriately to facilitate and regulate this?
52	How beneficial are the current arrangements for trans-Tasman mutual recognition of qualifications? Should further arrangements be considered?

Opportunities and challenges of technological change

172. One area where we do expect to see further international participation in New Zealand's advice market is in advice provided through online platforms. As digitisation of knowledge-intensive services increases, the use of technology to guide investor decision-making will only become more prevalent. Technological progress presents opportunities to make financial advice more accessible and affordable, but at the same time care must be taken to ensure

that regulatory protections of investors keep up with the pace of change. We seek submissions on how this can be achieved as technology continues to change the landscape of financial advice.

173. New technologies can help advisers offer new services and reach new client segments, as well as making existing relationships more efficient to manage. In particular, the development of online algorithm-based portfolio management services that take into account clients' risk tolerance, personal financial goals, and demographic characteristics (colloquially referred to as "robo-advice") provides opportunities for people to receive what could be described as personalised advice services at a fraction of the cost that this advice could be provided for through traditional advice channels.

174. The use of these types of platforms in overseas markets is growing steadily among young, internet-savvy investors who would otherwise be shut out of the market for financial advice due to having insufficient funds to invest for a traditional adviser to service. This simplified approach to investing therefore has the potential to open the market to a large spectrum of investors that are otherwise not catered for.

175. Currently, under the FA Act personalised advice can only be provided by a natural person; either an AFA, RFA or QFE adviser. This restriction ensures there is an individual responsible for advice meeting the standards of the FA Act and the Code (where relevant) and promotes professionalism amongst advisers. Unlike class advice, personalised advice is taken to be a service that would, by its very nature, be provided from one individual to another.

176. The advent of 'robo-advice' and other new technologies present a challenge to this form of regulating for quality financial advice. As technology develops further there is the potential that these systems may become more sophisticated and better placed to provide personalised advice and may enter the market for financial planning and more extensive asset management.

177. Besides posing a serious challenge to traditional advice models, technological developments of this type pose a risk for consumers, who may have little in the way of a course for redress for losses suffered as a result of poor automated financial advice. The legal status of such advice platforms is unclear; nor is it clear where accountability lies for poor investment advice delivered remotely – potentially from servers based in overseas jurisdictions. While the FA Act applies to all financial advice provided to New Zealanders, regardless of the location of the adviser, it would be difficult, if not impossible, to enforce such requirements against websites based in most other jurisdictions.

178. The extent to which technology will encroach upon the traditional role of financial intermediaries cannot yet be known. In order to respond to any developments as they arise, it will be important to ensure that legislation provides flexibility to respond to the introduction and development of innovative advice solutions, and is robust enough to provide appropriate controls around them.

53	In what ways do you expect new technologies will change the market for financial advice?
54	How can government keep pace with technological developments to ensure that quality standards for advice are maintained, without inhibiting innovation?

Goal 3: Public confidence in the professionalism of financial advisers is promoted

179. We seek feedback on the following key questions relating to the goal of promoting public confidence in the professionalism of financial advisers.

Should we lift the professional, ethical and education standards for financial advisers?

> *Respondents to MBIE's survey of financial advisers tend to agree that the Code of Professional Conduct has resulted in advisers both ensuring their continuing professional training and increasing their competence and knowledge.*
>
> *Respondents generally agree or are neutral that the Code of Professional Conduct has resulted in advisers improving their ethical behaviour and promoting client care.*

180. As discussed in Chapter 4, one of the concerns that led to the regulation of financial advice is that in an unregulated market, consumers may not be able to accurately assess the expertise and trustworthiness of different advisers, potentially resulting in poor consumer outcomes. One way to mitigate this problem is by setting minimum professional, ethical and education standards for financial advice.

181. The FA Act sets minimum standards of ethical behaviour, client care, competence and CPD in the Code. These requirements are additional to the general care, diligence and skill obligation for all financial advisers. The Code is binding on AFAs, and QFEs are required to ensure that QFE advisers are subject to similar standards in relation to advice on category 1 products. The Code does not apply to RFAs.

182. Each Code Standard consists of an overarching principle, together with additional details about the application of the Standard. For example, Code Standard 5 requires that "an AFA must effectively manage any conflicts of interest that may arise when providing a financial adviser service" and provides high-level guidance on what an AFA would be expected to do meet this standard.

183. We have discussed the operation of the client care obligations, which set out what an AFA must do when providing advice, on page 27.

Ethical requirements

184. The ethical standards in the Code (standards 1 to 5) are aimed at setting clear principles regarding AFA's ethical obligations are in relation to their clients. The paramount obligation is set in Code Standard 1, which requires an AFA to place the interests of the client first, and to act with integrity. The general feedback from stakeholders is that the Code sets appropriate standards in relation to ethical behaviour. The broader issue of how commissions and conflicted remuneration should be dealt with is discussed in detail from page 34.

185. Some stakeholders have argued that similar ethical standards should apply to all types of financial advisers, including RFAs.

55	Are the minimum ethical standards for AFAs appropriate and have they succeeded in fostering the ethical behaviour of AFAs?
56	Should the same or similar ethical standards apply to all types of financial advisers?

Qualification requirements

186. Currently the minimum qualification for AFAs is the National Certificate in Financial Services (Financial Advice) (Level 5). Completing this qualification usually takes one semester of full-time study. The Code also requires AFAs to maintain and keep current a CPD plan that includes at least 30 hours continued professional development activities approved by the FMA in any two year period. There are no minimum qualification or CPD requirements for RFAs, though a number have voluntarily met the requirement set in the Code.

187. We have heard that the minimum qualification requirements have made some progress in creating a more professional advice market for AFAs. Many stakeholders have argued that similar, if not the same, requirements should apply to all financial advisers, including RFAs.

50.2 per cent of respondents to MBIE's adviser survey stated they believe that the minimum professional training requirements for AFA status are adequate.

In terms of value, 19.2 per cent disagreed that the cost of carrying out the training required for AFA status is good value for money.

82.9 per cent thought that there should be set minimum professional training requirements for RFAs.

188. We have, however, heard from a number of stakeholders that the current minimum qualification for AFAs is broadly inadequate for investment advice and that it should be increased, for example to a Level 7 qualification such as a Graduate Diploma. The Code Committee has previously noted that it considers it likely that these minimum standards would be raised in the future. Others within the industry have expressed concern that many aspects of the qualifications regime are not fit for purpose.

189. We have also paid attention to developments in Australia aimed at raising the level of professional, ethical and education standards of its advisers. The Financial Systems Inquiry recommended raising the competency of financial advisers, and a recent Parliamentary Joint Committee report recommended a range of measures to lift advice standards in Australia.[11]

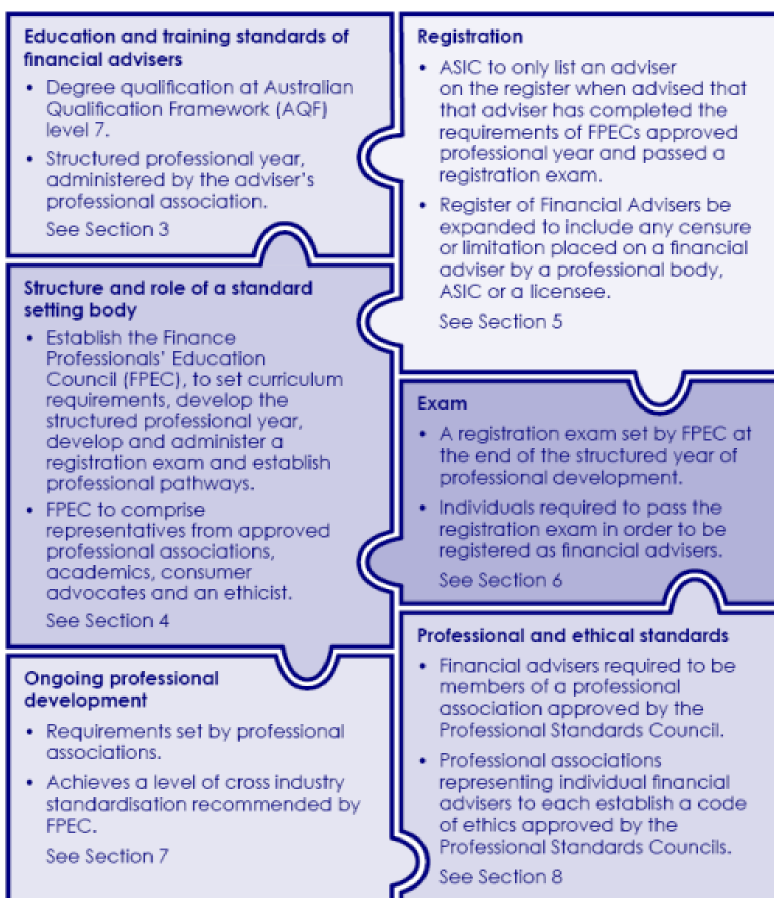
In response the Australian Government is currently consulting on requiring financial advisers (in relation to more complex financial products) to hold a relevant tertiary degree, complete a year of professional mentoring followed by an exam, pass a registration exam, and to undertake ongoing professional development.[12] Figure 1 outlines the proposed standards.

---

[11] The reports can be viewed here: ***http://fsi.gov.au/publications/final-report/*** and here: ***http://www.aph.gov.au/~/media/Committees/corporations_ctte/financial_services_industry/report.pdf***

[12] See:http://treasury.gov.au/~/media/Treasury/Consultations%20and%20Reviews/Consultations/2015/Lifting%20the%20standards%20in%20the%20financial%20services%20industry/Key%20Documents/PDF/Professional_standards_consultation_paper.ashx

Figure1: Proposed Australian adviser standards



190. If these changes are implemented they are likely to lead to an end to, or the narrowing of, the current recognition given by Australian Securities and Investments Commission to the qualifications of AFAs and QFEs advisers, unless New Zealand's adviser qualifications are aligned to a similar level.

191. We would appreciate stakeholder views on whether the current qualification requirements for the different types of financial advisers are appropriate. Changes to AFA requirements could be referred to the Code Committee for consideration rather than requiring legislative change.

57	What is an appropriate minimum qualification level for AFAs?
58	Do you think that RFAs (for example insurance or mortgage brokers) should be required to meet a minimum qualification relevant to the area of advice they specialise in? If so, what would be an appropriate minimum qualification?
59	How much consideration should be given to aligning adviser qualifications with those applying in other countries, particularly Australia?

The role of professional bodies

192. As part of Australia's proposed financial adviser reforms, all financial advisers will be required to belong to an approved professional body, which will set rules of ethical behaviour.

Advisers will be able to have input into minimum qualifications and ongoing development requirements through membership of an approved body.

193. The proposed Australian model has a number of strong parallels with the model proposed by the Financial Intermediaries Taskforce (outlined on page 10). However, this approach was abandoned in New Zealand due to concerns about complexity and inconsistent standards. Professional bodies currently have no formal role in the final regulatory regime.

194. There are a range of professional bodies in New Zealand that specifically focus on representing, advocating for, and providing services to financial advisers. The largest of these are the Professional Advisers Association, the Institute of Financial Advisers and the Insurance Brokers Association of New Zealand, though a number of smaller associations exist which cater to different subsets of the adviser industry.

195. In many other regulated occupations– both in New Zealand and internationally – professional bodies often play a more formal role in the regulation of their industries. For instance, under Part 4 of the Lawyers and Conveyances Act 2006, the New Zealand Law Society has the role of frontline regulator in relation to lawyers, with oversight by the Ministry of Justice.

196. Co-regulatory systems (such as that proposed by the Taskforce) have a number of advantages over direct regulation by government, as professional bodies typically have a much greater technical knowledge and knowledge of industry developments. Where there is a single professional body for an occupation, it has strong incentives to maintain standards, as transgressions reflect on the entire industry. However, having a single body risks creating an incentive for the professional body to set restrictive entry criteria in order to reduce levels of competition for its members.

197. An ability to licence multiple professional bodies can reduce this risk but could weaken the incentive to maintain quality standards and risks confusing consumers.

60	How effective have professional bodies been at fostering professionalism among advisers?
61	Do you think that professional bodies should play a formal role in the regulation of financial advisers and if so, how?

Should the individual adviser or the business hold obligations?

198. A key choice when regulating financial advice is whether obligations should be placed on the individual person who provides the advice or on the entity that carries on the business that includes the provision of financial advice. This decision can have significant impacts on the incentives, costs of compliance for advisers and the effectiveness of enforcement actions.

199. Regulating financial advisers as individuals is consistent with the way that other professions such as lawyers, accountants and engineers are regulated. Attaching obligations to the individual who performs the service reflects the fact that personalised advice is provided by one individual to another. It also ensures that poor performing individuals are able to be removed from the industry.

200. Placing obligations on the business allows for the businesses' broader systems and processes to be considered and allows consumers greater access to compensation in the event of a dispute. It also reflects the fact that financial advice is often provided by large financial institutions that have a large degree of control over the advice provided and that there may not be an individual who is clearly responsible for published class advice.

201. The FA Act takes a mixed approach on this matter. Only an individual is permitted to provide personalised advice, on an assumption that such advice will always be provided on a one-to-

one basis. Both AFAs and RFAs are required to be registered as individuals. The authorisation criteria for AFAs focus on the individuals' qualifications and good character, rather than any assessment of the business they work within. However, AFAs have joint responsibility for their obligations under the FA Act with any business they provide advice on behalf of, in respect of personalised advice. In respect of class advice the business has sole responsibility for these obligations.

202. The QFE model was designed to reflect the fact that some financial institutions have a large number of financial advisers and can exercise a high degree of control over the advice provided. The QFE approval process (as outlined on page 28) focusses on ensuring that the provider has adequate systems and procedures to monitor its advisers and to ensure that they are subject to appropriate standards. The QFE, rather than the individual QFE adviser, is responsible for the QFE adviser's obligations under the FA Act.

203. We frequently hear from some advisers that there is a perception that the QFE model allows financial institutions to get away with applying lower standards than those facing AFAs. This perception may be exacerbated by the lack of transparency about the specific requirements applying to each QFE. However, the model does provide QFEs more flexibility to monitor their own advisers and individual QFE advisers have less direct responsibility for the advice they provide.

204. On the other hand the FMA's ability to examine a QFE's business more broadly allows it to examine systematic advice issues. It is also more consistent with the licensing framework under the FMC Act, which assesses whether the entity's management is fit and proper and whether the application is capable of performing the relevant service effectively.

205. In Australia entities rather than individuals (in practice) are licensed to provide financial advice through their representatives. The licensing process focusses on the entities' compliance arrangements, organisational competence and resourcing. The licensee is responsible for ensuring that its representatives are adequately qualified and is largely liable for any breaches by their advisers. In this respect the Australian approach is broadly analogous to New Zealand's QFE model.

206. Recent concerns about the quality of financial advice in Australia and the competency of advisers have led to calls for more responsibility to be placed on individuals. Australia has recently introduced a register of the individual financial advisers who represent licensees and the Australian Treasury is consulting on increased qualification requirements that advisers would need to meet in order to be registered. However, a recent parliamentary inquiry decided not to recommend shifting to individual licensing, based partly on advice that entity level licensing provides many more mechanisms to compel good behaviour and minimises overall compliance costs.

207. We seek stakeholder comment on whether changes to relative obligations of individuals and businesses under the FA Act are required in respect of either the RFA/AFA model or the QFE model.

62	Should any changes be considered to the relative obligations of individual advisers and the businesses they represent? If so, what changes should be considered?
63	Is the QFE system achieving its goals in terms of consumer protection and reducing compliance costs for large entities? If not, what changes should be considered?

Part 3 – The Financial Service Providers (Registration and Dispute Resolution) Act 2008

Chapter 7 – Development of the FSP Act

208. The FSP Act is made up of three parts: preliminary provisions (Part 1), registration (Part 2) and dispute resolution (Part 3). It requires all financial service providers to be registered and, if they provide services to retail clients, to belong to a dispute resolution scheme. These requirements are aimed at promoting confident and informed participation of businesses, investors, and consumers in fair, efficient, and transparent financial markets.

209. The FSP Act required the dispute resolution part to be reviewed by September 2013 and the registration part to be reviewed by August 2015. Given the dispute resolution part of the FSP Act was reviewed only a short amount of time after it came into force (three years) and given the extensive inter-relationship between the FSP Act and the FA Act, it was decided that a joint review of the two Acts would be most effective.

210. MBIE will still provide a report on the operation of the registration part of the FSP Act in August of this year. That report will make recommendations based on findings up until that point, but will note that further recommendations relating to the FSP Act may be made following further consideration of its interaction with the FA Act. A report on the operation of the FA Act will be provided to the Minister of Commerce and Consumer Affairs by 1 July 2016.

211. For both stages of review of the FSP Act, a first principles approach will be taken, consistent with the approach for the FA Act review.

Financial Intermediaries Taskforce

212. In 2005, the Financial Intermediaries Taskforce identified widespread concerns with shortcomings in complaints and dispute resolution mechanisms. In particular, specific issues the Taskforce identified included that:

    a) The only two existing voluntary industry-based dispute resolution schemes at the time (the Banking Ombudsman and the Insurance and Savings Ombudsman) did not extend to a significant part of the financial sector.
    b) The voluntary nature and limited jurisdiction of the existing schemes meant decisions lacked binding force with firms in theory able to withdraw in response to adverse decisions.
    c) High levels of variability in compensation awarded made it difficult for consumers to assess whether it was worthwhile seeking redress, with many disputes going unresolved as a result.
    d) The time, cost and complexity of initiating court action was also dissuading many consumers from pursuing disputes.

213. The Taskforce considered that universal access to timely, efficient and cost-effective dispute resolution would engender greater consumer confidence in the industry, and recommended all financial intermediaries be subject to the jurisdiction of a single dispute resolution body.

Review of Financial Products and Providers

214. A 2006 Review of Financial Products and Providers (RFPP) recommended that all financial service providers join either a dispute resolution scheme approved by the Minister of Commerce or the government-established reserve scheme. Given that it was anticipated that sector-specific dispute resolution schemes would be created, a reserve scheme was needed for sectors that might not be covered.

215. The RFPP also recommended the introduction of a comprehensive register of financial service providers that would:

   a) Identify financial service providers and apply negative assurance criteria (e.g. ensuring directors and management are subject to criminal background checks)
   b) Allow for more effective monitoring and evaluation of the financial system
   c) Assist the regulator to identify risks in the sector and make it easier to find incidents of failing to comply with statutory requirements
   d) Provide consumers with information about financial service providers, their products and the applicable dispute resolution scheme
   e) Give consumers confidence in the integrity of the people running financial institutions.

216. This register would also satisfy New Zealand's international obligations under the Financial Action Task Force (FATF) Recommendations. The FATF Recommendations include requiring the licencing or registration of all financial institutions to ensure effective monitoring is in place to confirm financial institutions are meeting their anti-money laundering obligations.

The FSP Act

217. The FSP Act introduced compulsory membership of an approved dispute resolution scheme for providers of financial services to "retail clients" and established the Financial Service Providers Register.

The Financial Service Providers Register

218. From 1 December 2010 anyone providing a financial service (such as insurers, banks, lenders and financial advisers) has been required to be registered on the Financial Service Providers Register (the Register) operated by the Companies Office. The qualification requirements for registration are similar to those for a director of a New Zealand company, including not being an undischarged bankrupt or convicted of a crime involving dishonesty in the previous five years.

219. The Register records the name, address and (if applicable) the dispute resolution scheme of the provider, along with the services it is registered to provide and any relevant licences it has under other legislation. Approximately 13,000 financial service providers are currently registered.

FSP Dispute Resolution

220. Financial service providers were required to join an approved dispute resolution scheme from 1 December 2010 and financial advisers were required to do so from 1 April 2011. The

Government approved three dispute resolution schemes: the Banking Ombudsman (which accepted banks as members), the Insurance and Savings Ombudsman and Financial Service Complaints Limited (which accepted all types of financial service providers). In addition, FairWay Limited operated the government-owned reserve scheme.

221. In 2014, amendments to the FSP Act were made through the Financial Service Providers (Registration and Dispute Resolution) Amendment Act 2014. These amendments removed the requirement for a government-run reserve dispute resolution scheme (which was no longer required following the approval of the schemes listed above). The amendments also provided that the Registrar can refer an application for registration to the FMA where an application or registration could create a misleading appearance as to how the provider provides financial services in New Zealand or will be regulated by New Zealand law, or otherwise damages the integrity or reputation of New Zealand financial markets.

222. With the disestablishment of the reserve scheme, the Government approved FairWay Limited to run an approved dispute resolution scheme, called Financial Dispute Resolution Scheme, which accepts all types of members.

2013 Review of Dispute Resolution

223. The FSP Act required MBIE to review the operation of dispute resolution and report to the Minister by the end of September 2013 (Part 3 of the FSP Act). That review undertook surveys and interviews with consumers, the schemes and financial service providers. It investigated how the regime was operating against the six dispute resolution principles in the FSP Act.

224. Overall, the review concluded that dispute resolution increases consumer confidence in financial markets but that there are low levels of consumer awareness of the dispute resolution process.[13]

[13] The full report can be found at: ***http://www.consumeraffairs.govt.nz/pdf-library/for-consumers/FSPAct_DisputeResolution_Part3_Report_FINAL.pdf***

Chapter 8 – Role of financial service provider registration and dispute resolution

Why do we have a financial service provider registration regime?

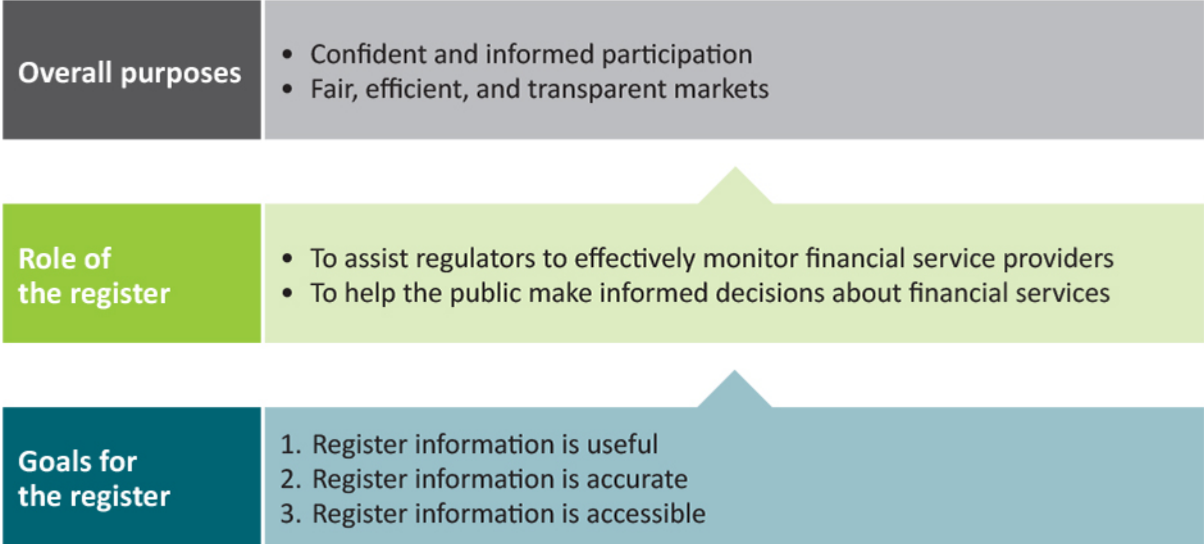
225. Before the introduction of the FSP Act in 2010, there was no comprehensive way to identify or monitor financial service providers, which caused issues for policy makers, regulators and consumers. In particular:

a) Policymakers could not identify the number of people who could be affected by any regulatory actions being contemplated.
b) Regulators found it difficult to identify the regulated population.
c) No public record existed of who was permitted to provide certain types of financial services, potentially giving rise to public confusion and uncertainty.

226. The Register was introduced to address these issues. It also satisfies New Zealand's obligations under the FATF Recommendations by allowing AML-CFT supervisors to identify financial institutions with obligations under the AML-CFT Act.

Goals for an effective registration system

227. We have developed the following draft framework for assessing the effectiveness of the financial service provider registration regime. This framework is based on the original policy intent for and statutory purposes of the Register. It identifies three goals for the Register which, if met, will mean it is fulfilling its intended role and in turn contributing to Government's broader policy objectives for financial markets:



1: Register information is useful

228. To be an effective tool, the information on financial service providers contained on the Register must meet the needs of the Register's users, including both regulators and the general public.

229. The public may wish to use the Register for a number of reasons, including:

a) Finding and/or confirming information about a provider that they are already using.
b) Comparing providers to choose one that meets their needs.

230. Regulators can use the Register to:

a) Identify the regulated population to better focus oversight activities.
b) Easily ascertain the services that each regulated provider on the Register supplies.
c) Check contact details, including director contact details, to make it easier to engage with individual financial service providers when undertaking monitoring and regulatory activities.

2: Register information is accurate

231. For the Register to assist the public to make informed financial decisions and to assist the regulators in fulfilling their roles, it must provide an accurate and complete record of financial service providers.

232. The accuracy of the Register is dependent on: (a) financial service providers correctly complying with their obligations to register; and (b) the Registrar and the FMA effectively monitoring and enforcing these requirements.

3: Register information is accessible

233. To be an effective tool for both regulators and the public, the information on the Register needs to be easily accessible. Functionality is a key component in ensuring users can access information on the Register efficiently and effectively. Functionality includes how the information is presented and how the Register can be searched and providers compared.

64	Do you agree that the Register should seek to achieve the identified goals? If not, why not?
65	What goals do you consider should be more or less important in reviewing the operation of the Register?

What is the role of dispute resolution schemes?

234. Financial dispute resolution provides an avenue for consumers who have a dispute with a financial service provider to seek redress in a quick, efficient and cost-effective manner.

235. Access to redress has long been identified as a key contributor to consumer confidence in financial markets. Without dispute resolution, consumers' primary recourse for redress would be through the courts which, due to high cost and uncertain outcomes could deter consumers from seeking redress, in turn reducing confidence in financial markets.

236. In contrast, access to a dispute resolution service reduces consumers' assessment of the risks of engaging with financial service providers they do not know or trust (or have imperfect information about). Consumers will know that they can seek a low cost remedy if things go wrong and that financial service providers will be held to account, increasing their confidence in financial markets.

"This is good, it gives me more confidence knowing there is a back-up."
– Non-user of insurance and investment advice.

237. For financial service providers, dispute resolution mechanisms can create an incentive to take more care when providing products and services (and with its internal dispute resolution processes) if there is a real likelihood of consumers being able to receive redress. Precedents established through dispute resolution procedures can also provide a measure of consistency and predictability in decision-making that may otherwise be absent (due to consumers being disinclined to seek redress through the courts), allowing financial service providers to shape their conduct accordingly.

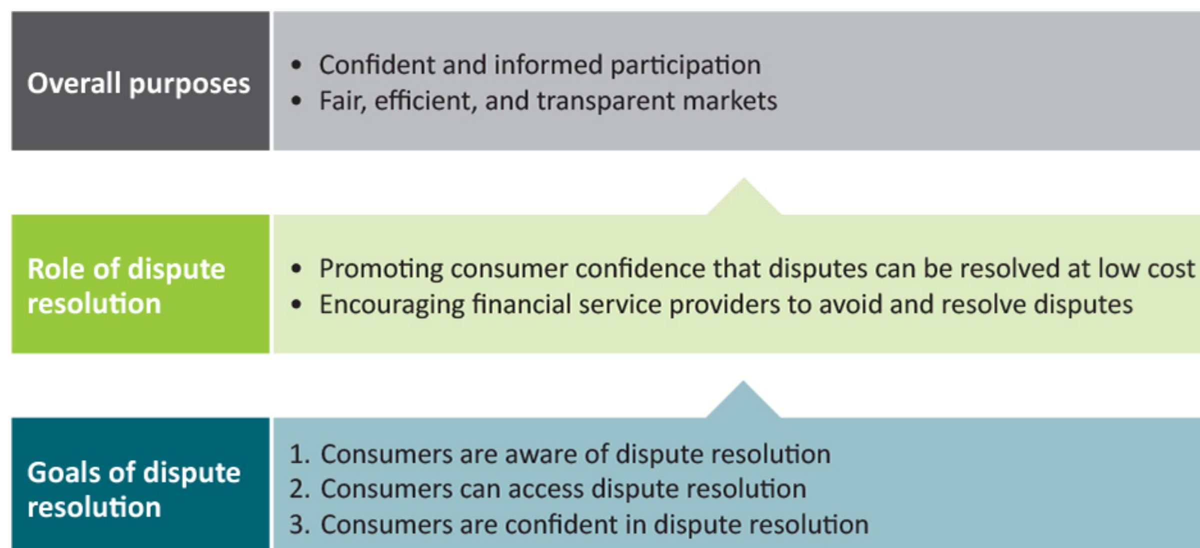
238. As well as enhancing market participation, effective access to redress may also lead to greater efficiencies more generally, as fewer resources will be needed to resolve disputes, and may reduce pressure in the justice system.

Framework for an effective dispute resolution regime

239. We have developed the following draft framework for how dispute resolution can contribute to the Government's broader financial markets goals. This framework is based on the original policy intent and statutory purposes of dispute resolution in the FSP Act. It also takes into account the following internationally accepted principles of effective dispute resolution:

a) Accessibility
b) Independence
c) Fairness
d) Accountability
e) Efficiency
f) Effectiveness

240. The draft framework identifies three goals for dispute resolution, which if achieved will contribute to the Government's broader objectives for financial markets.



1: Consumers are aware of dispute resolution

241. For consumers to seek a low cost remedy if things go wrong and know that financial service providers will be held to account, they must be aware of the dispute resolution mechanisms available to them, and the general process through which they may progress a dispute with a financial service provider. Provision of information through multiple channels is important to foster awareness of different dispute resolution mechanisms available, who can access them

and how. This information should be accurate, consistent and easily accessible to a diverse audience.

2: Consumers can access dispute resolution

242. It is important that consumers can readily access dispute resolution mechanisms that hold broad jurisdiction over the financial sector, and that clear boundaries are drawn in terms of compensation limits, the specific industries a scheme serves and what exactly constitutes a complaint. It is also important that consumers can easily identify the scheme relevant to their circumstances. A high level of consistency of practice, customer assistance and flexibility in how complaints are made across all schemes is necessary to foster confidence that grievances will be dealt with in a timely manner.

3: Consumers are confident in dispute resolution

243. Whether or not a complainant's desired outcome is achieved, it is important that consumers have confidence that dispute resolution mechanisms are fair, impartial, transparent and independent. An effective dispute resolution service should inspire confidence in consumers by making consistent rulings, communicating regularly with all parties, clearly explaining why a decision is made and seeking feedback to improve overall performance.

66	Do you agree that the dispute resolution regime should seek to achieve the identified goals? If not, why not?
67	What goals do you consider should be more or less important in reviewing the dispute resolution regime?

Chapter 9 – How the FSP Act works

Registration

244. The FSP Act creates a mandatory registration regime for financial service providers in New Zealand. Only people registered on the Financial Service Providers Register are permitted to provide financial services as part of their business. The definition of financial service covers financial advisers, banks, insurers, lenders, fund managers, issuers and other types of financial market participants.

245. The FMA takes primary responsibility for ensuring that providers register correctly. However a lack of available evidence makes it difficult to ascertain how widely this requirement is being met. In addition, when the FMA finds instances of non-compliance with registration requirements (whether accidental or deliberate), its only options are either to require the provider to register or to prosecute them for committing an offence under the FSP Act.

68	Does the FMA need any other tools to encourage compliance with FSP registration? If so, what tools would be appropriate?

246. The FSP Act applies some minimum requirements for registration:

- The person must have any licence required under legislation to provide the service they provide (for example, to manage funds a person would be required to be registered as an investment manager for an offer under the FMC Act).
- The person (or for an entity, its controlling owners, directors and senior management) must not be disqualified. Disqualification grounds include being an undischarged bankrupt, being prohibited from being a director, promoter or manager of an incorporated or unincorporated body, or having committed a dishonesty offence within the past five years.

69	What changes, if any, to the minimum registration requirements should be considered?

247. When applying to be registered, a prospective financial service provider must provide the Registrar with their details and information on the financial services they intend providing, and pay the registration fee and relevant FMA levy. Financial service providers are then required to confirm their details annually and pay the annual registration fee and applicable FMA levy.

Note: MBIE is separately reviewing these registration fees and FMA levies. We expect to consult publicly on these in the coming year.

248. The FSP Act applies to persons ordinarily resident in New Zealand or with a place of business in New Zealand. It also applies to persons required by other legislation to be licenced or registered under the FSP Act. The FMA also has the power to direct the Registrar to decline a registration (and subsequently to deregister a financial service provider), for example if it considers that the registration would create a false or misleading appearance as to the extent to which the provider will actually be regulated by the New Zealand Government.

249. Once registered, the financial service provider's name, address and the financial services that they are registered and (if applicable) licensed to provide are available on the publicly accessible Register.

250. The Registrar can also share any information that it holds on financial service providers with enforcement agencies, such as the FMA, the Commerce Commission and the New Zealand Police, as well as with their international counterparts.

Note: One of the purposes of the Register is to provide information to regulators and anti-money laundering supervisors about the population which they are regulating. We will be consulting with the relevant regulators on whether the Financial Service Providers Register is effective in this regard.

Dispute resolution

251. Financial service providers who provide services to retail clients are required to be members of an approved dispute resolution scheme. The retail client definition is similar to that in the FA Act (see page 22).

70	Does the requirement to belong to a dispute resolution scheme apply to the right types of financial service providers?

252. Financial service providers are required to provide information on their dispute resolution membership to the Registrar within ten working days of registration, and before providing financial services to retail clients. This information is also displayed on the Register.

253. At present there are four approved dispute resolution schemes:

- The Banking Ombudsman (BOS)
- Financial Dispute Resolution Service (FDRS)
- Financial Services Complaints Limited (FSCL)
- The Insurance and Savings Ombudsman (ISO)

254. Each scheme has been approved by the Minister of Commerce and Consumer Affairs as having the competency and capability to effectively resolve disputes and as having compliant rules, in light of the following dispute resolution principles:

a) Accessibility
b) Independence
c) Fairness
d) Accountability
e) Efficiency
f) Effectiveness

255. A recent trans-Tasman review of these dispute resolution principles confirmed their continuing importance and relevance as key standards for dispute resolution schemes.[14]

71	Is the current framework for the approval of dispute resolution schemes appropriate? What changes, if any, should be considered?

256. The schemes are required to provide an annual report to the Minister of Commerce and Consumer Affairs and to be independently reviewed every five years. So far, ISO, the BOS and FSCL have received their independent reviews, which are available on their websites. While the recommendations of these reviews varied, they all encouraged the dispute resolution schemes to make changes to their rules and procedures to promote consumer awareness and accessibility.

[14] http://ccaac.gov.au/2013/04/24/review-of-the-benchmarks-for-industry-based-customer-dispute-resolution-schemes/

72	Is the current framework for monitoring dispute resolution schemes adequate? What changes, if any, should be considered?

257. Financial service providers pay an annual fee or levy to belong to a dispute resolution scheme. These vary between providers and generally depend on the type of financial service being offered and the size of the provider.

73	Is the existence of multiple schemes and the incentive to retain and attract members sufficient to ensure that the schemes remain efficient and membership fees are controlled?

258. Consumers are able to complain to a financial service provider's dispute resolution scheme free of charge if they have a dispute that they are unable to resolve with the provider directly. The schemes will generally seek assurance that the consumer and the financial service provider have reached deadlock (i.e. there is no prospect of the dispute being resolved by the provider's internal dispute resolution mechanisms). If this is the case, the scheme will generally charge the financial service provider a fee for consideration of the dispute.

259. The particular procedures and jurisdiction of each scheme are set out in their scheme rules. Broadly, the schemes are able to consider disputes up to the value of $200,000 and are able to make binding orders on their members. These orders can be for monetary compensation, or non-monetary in nature (for example, requiring the provider to accept a hardship application in relation to a consumer credit contract).

260. MBIE recently consulted on whether to change the jurisdictional limit of the dispute resolution schemes from claims of up to $200,000 to up to $350,000 in relation to property insurance disputes.[15] This proposal was aimed at addressing the perceived inadequacy of current jurisdiction in relation to insurance disputes (for instance, $200,000 will generally be inadequate where a person has lost their home through accident) and at ensuring that schemes' jurisdictions are aligned in this area.

74	Should the $200,000 jurisdictional limit on the size of claims that dispute resolution schemes can hear be raised in respect of other types of financial services, and if so, what would be an appropriate limit?

261. While a consumer can choose to reject a scheme's findings and progress their dispute through the courts, financial service providers are not able to appeal a scheme's orders. In the event of non-compliance with a scheme's order, the scheme can apply for an order from the district court requiring that the member comply.

262. However, in situations where the provider has become insolvent and does not have any alternative arrangements in place (such as professional indemnity insurance), consumers may not actually receive any compensation. In Australia, financial service licensees are required to have adequate arrangements in place to ensure that they can pay any compensation due to consumers, such as professional indemnity insurance.

75	Should additional requirements to ensure that financial service providers are able to pay compensation to consumers be considered in New Zealand?

[15] See: ***http://www.med.govt.nz/business/business-law/current-business-law-work/approved-dispute-resolution-schemes-minimum-compensation-cap-for-insurance-disputes/discussion-document.pdf***

263. Schemes will not typically consider matters of commercial judgement, such as a decision not to provide a financial service to a person. They do not have the same procedures and powers as a court and are more limited than the courts in their ability to make judgements based solely on competing recollections of events.

264. The dispute resolution schemes are required to inform the relevant regulator (e.g. the FMA or the Commerce Commission) if there is a series of material complaints about a particular provider or class of providers.

Note: We will be consulting with the schemes and regulators on whether information sharing is working to assist regulators' monitoring and intelligence gathering activities.

Chapter 10 – Key FSP Act questions for the review

Goals for the Register: The Register information is useful, accurate and accessible

Could the Register be used to provide better information to the public?

265. One purpose of the Register is to provide consumers with easy access to information about financial service providers. While usage of the Register has steadily increased since its introduction (from around 95,000 unique users in 2011 to 150,000 in 2014)[16] we have received feedback that it not widely accessed by consumers. This was reflected in focus group discussions commissioned by MBIE in March 2015, where participants stated they were not aware of the Register. Even when the participants were informed of the existence of the register, there were mixed views about the value it provided:

"I think that's good there is a register, [but] the value to the public of the register I would have thought is pretty minimal. Because most people aren't going to use it." – Insurance advice client.

"…it gives a level of confidence, but I wouldn't use it [as a way to evaluate my advisor]." – Investment advice client.

266. Several factors may explain why consumers rarely use the Register:
    a) Consumers are unaware the Register exists.
    b) The Register lacks useful information.
    c) The Register has limited functionality, e.g. limited search functions that help consumers. easily find what they are looking for.

267. The Register provides financial advisers' names, addresses and authorisation details. Searching is possible by name, financial service provider number, and location, though we have heard this is not straightforward. The FMA and the Companies Office provide guidance on how to search the Register through their websites,[17] and a number of websites have emerged with the sole purpose of assisting people to locate an adviser. These developments indicate there is scope for the Register to be more user-friendly.

On 31 March 2015 Australia introduced a Register of individual financial advisers. When fully functional it is expected the Register will include details of advisers' qualifications and disciplinary history.

268. A financial adviser's primary disclosure document contains further important information, intended to enable the consumer to compare advisers and select the one best suited to their needs. However, this document is not available via the Register. Consumers usually only receive this information once they are at an appointment with an adviser; by that stage the decision on which adviser to use has already been made.

269. On this basis, a more useful and effective register could help consumers to more easily and quickly find and select a suitable financial adviser. This could contribute to greater

[16] Data provided to MBIE from the Companies Office
[17] See **http://www.fma.org.nz/compliance/lists-and-registers/** and **http://www.business.govt.nz/fsp/about-the-fspr/searching-the-fspr**

competition between advisers, and, if transparent and up to date, could enhance overall public confidence and trust in advisers.

270. Any changes to improve the functionality of the Register would require additional capital expenditure and potentially increased ongoing operating costs. It is therefore important that any changes add value and are proportionate to the costs they incur, likely to be recuperated through registration fees.

76	What features or information would make the Register more useful for consumers?
77	Would it be appropriate for the Register to include information on a financial adviser's qualifications or their disciplinary record?

How can we avoid misuse of the Register by overseas financial service providers?

271. We are aware of instances of foreign-based financial service providers, particularly foreign exchange operators, registering on the Register - primarily to take advantage of New Zealand's reputation as a well-regulated jurisdiction. The FSP Act only applies to persons ordinarily resident in New Zealand, those with a New Zealand place of business, or those who are required by other legislation to be licenced or registered under the Act. Some offshore providers have gone to some lengths to set up shell New Zealand operations.

272. While this may not have an impact on New Zealand businesses or consumers directly (as these providers typically avoid offering services to New Zealanders), it creates a risk to both New Zealand's reputation as a well-regulated jurisdiction and to the reputation of legitimate New Zealand financial service providers. It also causes issues for dispute resolution schemes who receive complaints from overseas consumers.

273. In 2014, the FMA was given powers to direct the Registrar to decline a registration or deregister a financial service provider following a referral from the Registrar. This is allowed if the FMA considers that the registration creates the false or misleading impression as the extent the provider is regulated in New Zealand. It is still too early to say whether this power will be effective in addressing the problem, although initial data from the Companies Office suggests that the number of applications for registration involving offshore providers is decreasing but still significant.

274. Other similar jurisdictions do not have this issue (or at least to the same extent) because they typically license all types of financial service providers. In contrast, New Zealand opted largely for a registration regime because licensing can impose significant costs on financial service providers, thereby creating a barrier to entry and reducing competition.[18]

78	Do you consider misuse of the Register by offshore financial service providers is a significant risk to New Zealand's reputation as a well-regulated jurisdiction and/or to New Zealand businesses?
79	Are there any changes to the scope of the registration requirements or the powers of regulators that should be considered in response to this issue?

[18] New Zealand has introduced a licensing regime for some services where it has been considered necessary, such as some types of financial advisers under the FA Act and fund managers under the FMC Act.

Goals for dispute resolution: Consumers are aware of, confident in, and can access dispute resolution

What is the impact of having multiple dispute resolution schemes?

275. We are interested to learn more about the effect that multiple dispute resolution schemes may be having on the accessibility, awareness and efficiency of the dispute resolution regime. New Zealand's dispute resolution regime is unusual in that it has a number of different schemes effectively competing for financial service providers as members. As part of the review we will be considering the impact of this competitive dynamic.

276. We have had feedback that the competition between dispute resolution schemes may be constraining the activities of some schemes. If this is restricting the ability of schemes to promote awareness, introduce new rules or work collaboratively with other schemes, then this could have a negative impact on compliance with the dispute resolution principles and ultimately in consumer confidence in dispute resolution. However, we have had no indication that competitive tensions influence schemes' judgement or independence in relation to individual disputes.

277. Aside from competition between the schemes themselves, the existence of overlapping schemes with differing rules and jurisdiction has some potential negative effects. Consumers may lose confidence in dispute resolution if it becomes apparent that a complaint would have a different outcome depending on which scheme the provider belongs to. While the current differences between approved dispute resolution schemes are relatively small, we would be interested in whether stakeholders think that differences in scheme rules are causing any issues at present.

278. Inconsistencies between the assistance each scheme provides consumers with may also give rise to accessibility issues. For example, schemes may give different levels of assistance to a consumer who has not yet complained to their financial service providers directly and do not know how to progress the dispute. These differences may confuse consumers and lead to a reluctance to participate in dispute resolution where this might otherwise be beneficial.

279. The existence of multiple schemes is also commonly cited as a reason for lack of consumer awareness and/or confusion as to how the dispute resolution regime works. The 2013 review of the operation of dispute resolution schemes identified that having four schemes potentially created an "additional hurdle for vulnerable consumers". This was based on feedback the review received that it is hard for consumers to ascertain which scheme is responsible for their specific complaint.

280. A potentially positive feature of having multiple schemes is that competition between schemes may lead to lower fees for financial service providers and create incentives for schemes to develop more innovative and improved service levels for their members. There is also potential for schemes to develop specialist expertise in a particular sector. This suggests there may be a trade-off between having multiple schemes and a 'one-stop-shop' service.

80	What are the effects of (positive and negative) competition between dispute resolution schemes on effective dispute resolution?
81	Are there ways to mitigate the issues identified without losing the benefits of a multiple scheme structure?
82	Are the current regulatory settings adequate in raising awareness of available dispute resolution options? How could awareness be improved?