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

The New Zealand Law Society (Law Society) welcomes the opportunity to comment on the issues paper published by the Ministry of Business Innovation and Employment on the first stage of its review of the Financial Advisers Act 2008 (FAA) and the Financial Service Providers (Registration and Dispute Resolution) Act 2008 (FSPA). The Law Society appreciates the extension of time afforded by the Ministry.

The numbering below reflects the numbering of the questions in the issues paper.

Key issues

The purpose of the legislation is primarily concerned with occupational regulation. In the Law Society's view, the current definition of "financial advice" is so wide that it captures the sales process for financial products and services. Consequently, all financial products and services must be sold with a "side-order" of financial advice.

The Law Society's experience indicates that consumers do not trust or value financial advice in the sales process.

These submissions propose that work is done to:

- enable a sales process that does not stray into "financial advice"; and
- require that product providers and distributors are subject to positive obligations as to the suitability of the financial product or financial service.

Effects

In the Law Society's view, the complexities in the current regime for financial adviser services should be addressed as follows:

- There should be no distinction between class and personalised advice. All financial advice should be personalised.
- There should be no Registered Financial Adviser (RFA)/Authorised Financial Adviser (AFA) distinction. Instead, it would be preferable if only AFAs can provide financial advice. Anyone who distributes financial products or financial services must be registered on the Financial Service Providers Register as a distributor or be part of a Qualifying Financial Entity (QFE).
- There should be no distinction between category 1 and category 2 products in terms of providing financial advice.
- Consideration should be given to whether there is a need for the wholesale/retail distinction in the FAA, and whether this could be dealt with by the Financial Markets Conduct Act 2013 (FMCA) fair dealing provisions.

Impact of proposed changes on current market participants

- Consumers should recognise, trust and value financial advice as the product of the financial advisers profession. Consumers should have greater clarity about the distinction between product sales and advice.
- The current matrix of suitability obligations should be clarified and simplified.
- RFAs could become distributors or apply to be authorised as AFAs.
- The QFE structure should remain to ensure efficiency of sales process and to manage risks of conflict for AFAs within QFEs (assuming there is no appetite for all AFAs being independent).
- Interactions between wholesale participants should be governed solely by the fair dealing provisions of the FMCA, not the FAA.

Other big picture issues

Boundary issues for an investment planning service

The definition of "investment planning service" in the FAA creates boundary issues affecting AFAs, and others. The impacts of this include:

- AFAs have to be cautious about providing any financial advice so that advice is not deemed to be an investment planning service (and therefore beyond the terms of the AFA's authorisation).
- Non-AFAs cannot recommend plans even if they involve category 2 products (even if just based on class goals).
- QFE advisers who are not also AFAs cannot provide any advice that is a plan (even if it is contemplated by their employer QFE's authorisation).

Boundary issues between personalised advice and class advice

The Law Society questions whether the boundaries between personalised and class advice are too complicated for advisers and clients alike.

Alignment of the FAA with the FMCA

The FAA does not appear to easily allow financial advisers to advise clients on the new capital raising opportunities created in the FMCA, such as under the new small offer exemption, crowd funding and peer to peer lending. The issue appears straightforward for IPO or listed stocks because they are supported by offer documents and/or (typically) some broker research.[1] It is important that investors get the financial advice they need when investing in small offers, employee share schemes or peer-to-peer lending or crowd funding platforms that are exempt from the normal disclosure requirements.

The march of technology

So much activity occurs online and this trend will continue. Much preliminary work and even advising about products can be conducted online, without personal contact (for example, when booking an overseas flight and getting an automatic prompt about travel insurance). This advice might be seen as personalised advice to a retail client (if it is tailored to clients and their specific trips) and raises the question whether it needs to be provided by an individual (i.e. an AFA). The development of "Robo-Adviser" models and marketing of financial products over the internet means that consideration must be given to allowing entities to take responsibility for providing personalised financial advice.[2]

Harmonisation with Australia

There is effectively one trans-Tasman market for many securities. Hence Australia, with a generation's head-start on compulsory saving and investment culture, is highly relevant. The moves in Australia to ease some of the restrictions (such as on commission sales) should be watched closely.

Comments on Chapter 4 – Role and regulation of financial advice

Goals for financial adviser regulation

1. Do you agree that financial adviser regulation should seek to achieve the identified goals? If not, why not?

The goals articulated in paragraph 64 are that:

- consumers have the information they need to find and choose a financial adviser;
- financial advice is accessible for consumers; and
- public confidence in the professionalism of financial advisers is promoted.

These three goals could well be goals of the review, but the goals of financial adviser regulation are wider.

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1 Although we are aware that the lack of such research in advance of the IPOs of Mighty River Power, Meridian and Genesis is regarded by some as an indictment on the industry.

2 Paragraph 173 of the issues paper notes that "robo-advice" are online algorithm-based portfolio management services that take into account clients' risk tolerance, personal financial goals, and demographic characteristics.

These three goals focus on the parts of the FAA regime that have been identified as not working well. The purpose of the legislation suggests that the FAA goals should also include creating well-functioning financial markets and minimising compliance costs.

2. What goals do you consider should be more or less important in deciding how to regulate financial advisers?

The consumer should be put at the centre of any reforms. But it is important not to lose sight of the importance of creating well-functioning financial markets, and the benefits that brings consumers. The Law Society considers that the recent announcements from the Financial Markets Authority (FMA) regarding its Investor Capability Strategy, which aims to build knowledge, understanding and confidence about making investment decisions, points in this direction but there still seems to be a mismatch with the impact of the FSP/FAA regimes. Specifically, the Law Society considers that regulation of financial advisers should:

- Involve a principles-based approach to simplify (and future proof) the legislation, reduce cost and improve consumer protection. This approach involves moving away from reliance on detailed, prescriptive rules and relying more on high-level, broadly stated rules or principles to set the standards by which regulated firms must conduct business;[3] and

- Create sound and efficient regulatory outcomes. Firms and their management are better placed than regulators to determine what processes and actions are required within their businesses to achieve a given regulatory objective. So it makes sense to define the outcomes that firms are required to achieve rather than prescribing the processes or actions that firms must take.[4]

The current structure has inefficient regulatory outcomes which diminish the resources of the regulator and expose market participants to cost and risk. As an example, many Category 2 financial service providers obtained QFE status to manage risk in the sales process for Category 2 products. Their business models do not include providing personalised advice so they could operate as registered financial advisers with employees providing class advice. However, the current regime does not allow for a sales process – only an advice process.

Section 15(1)(b)(ii) of the FAA provides that financial advice is personalised if:

> "*a client would, in the circumstances in which the service is provided, reasonably expect the financial adviser to take into account the client's particular financial situation or goals (or any 1 or more of them)*".

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3 *Making a success of Principles-based regulation* Julia Black, https://www.lse.ac.uk/collections/law/projects/lfm/lfmr_13_blacketal_191to206.pdf

4 Ibid.

Accordingly there is a significant risk that anyone selling a financial product will be held to be providing personalised financial advice. This is not a sound regulatory outcome. Only those entities who truly want to act as "frontline regulators" should be QFEs.

Comments on Chapter 5 – How the FAA works

How is financial advice defined?

3. Does this definition [of *financial advice*] adequately capture what financial advice is? If not, what changes should be considered?

This definition is so wide that it captures the sales process for financial products. The goal of the legislation was not to require all financial products to be sold with a side-order of financial advice. This ambiguity does not benefit consumers. As the sales process is treated the same as "financial advice", consumers may believe that their best interests are being taken into consideration.

Further consideration should be given to:

- enabling a sales process which does not stray into "financial advice";
- introducing a positive obligation as to the suitability of the financial product;
- ensuring that the 'sales' process is properly regulated as a financial service.

Product providers and any sales person or financial adviser should be subject to positive obligations as to the suitability of the financial product. This could be achieved by:

- relying on sections 20 and 21 of the FMCA plus FMA guidance; or
- a new section 33B and amended section 20F of the FAA introducing and imposing responsibility for suitability in sales, or
- by developing the concept of "responsible financial service provider"[5] in the FSPA.

Any legislative requirement for suitability should be backed by non-binding guidance issued by the FMA.

In structuring a suitability requirement consideration should be given to:

- Section 29 of the Consumer Guarantees Act 1993 which guarantees that a service supplied to a consumer will be reasonably fit for purpose.
- Sections 20 and 21 of the FMCA which prohibit conduct that is liable to mislead the public as to suitability for a purpose of financial products or services.
- The FMA suitability requirements in FMCA derivative licensing conditions.
- Code 8 of the Code of Professional Conduct for Authorised Financial Advisers.

[5] Repealed s 23 Financial Service Providers (Registration and Dispute Resolution) Act 2008.

- The equivalent requirements for credit contracts: lender responsibility principles and Responsible Lending Code.[6]
- The recommendations of the recent Financial System Inquiry in Australia.[7]
- United Kingdom firms that provide investment advisory and discretionary portfolio management services must take reasonable steps to ensure that the personal recommendations they provide to their clients and their decisions to trade are suitable for them.[8] There are also suitability requirements in chapters 4 and 8 of the Mortgages and Home Finance: Conduct of Business sourcebook (MCOB) and chapter 5 of the Insurance: Conduct of Business sourcebook (ICOBS).
- The European Union requirements on regulated product governance arrangements, and the International Organization of Securities Commissions suggestion that issuers evaluate whether their general distribution strategy is appropriate for the target market, particularly for structured products.

What are the different types of financial advice?

4. Is the distinction in the FAA between wholesale and retail clients appropriate and effective? If not, what changes should be considered?

Large institutions are able to make their own decisions on suitability of products and obtain their own financial advice. However, caution is necessary in allowing further carve outs from the regime through the wholesale provisions. Because of the profile of New Zealand businesses, many non-retail investors have significant information asymmetry and are not able to assess their own suitability for financial products.

Consideration should be given to whether the current wholesale regime supports the best functioning of financial markets. In particular, the supervision of interactions between wholesale participants can be simplified to ensure consistency between the FSP/FAA regime

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6 Credit Contract and Consumer Finance Act 2003 requires every lender to comply with the lender responsibility principles which include:
- exercise the care, diligence, and skill of a responsible lender
- make reasonable inquiries, before entering into the agreement, so as to be satisfied that it is likely that—
  - the credit or finance provided under the agreement will meet the borrower's requirements and objectives; and
  - the borrower will make the payments under the agreement without suffering substantial hardship; and
  - assist the borrower to reach an informed decision as to whether or not to enter into the agreement and to be reasonably aware of the full implications of entering into the agreement….
  - the terms of the agreement are expressed in plain language in a clear, concise, and intelligible manner….
  - the agreement is not oppressive:

Compliance with the Responsible Lending Code is evidence of compliance with the lender responsibility principles.

7 http://fsi.gov.au/files/2014/12/FSI_Final_Report_Consolidated20141210.pdf, page 203.

8 In chapter 9 of the FCA's Conduct of Business sourcebook (COBS 9)

(aimed at retail investors) and making it clear that the rights and remedies of wholesale investors lie elsewhere.

The FMCA introduces significant powers on the part of the FMA to regulate fair dealing in relation to any financial products and financial services. Consideration should be given to whether dealing between wholesale participants would be governed more appropriately by the fair dealing provisions of the FMCA not the FAA.

In any event, the FAA and FMCA wholesale provisions should be further aligned. The provisions for wholesale advice should fit better with the current FMCA Schedule 1 provisions for wholesale investors.

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?

This aspect of the regime has increased costs for market participants while not, based on our observation, delivering better consumer outcomes. A principles-based regime which makes a distinction between sales and financial advice with a suitability requirement for all services would remove the need for the class/personalised distinction.

6. Is it appropriate to have different requirements on advisers depending on the risk and complexity of the products they advise upon?

The categorisation of 'product' makes the regime unnecessarily complex and is a blunt tool in consumer protection as it does not relate to the consumer. What is important to the sound functioning of the financial markets is that consumers have confidence in those markets. Where advice is given it should be tailored to the needs of the consumer – not pre-determined characteristics of the product.

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?

No, because without a consumer the product has no risk. A short-hand way of achieving this goal is to remove the categorisation of products. Product providers, their sales force and any financial adviser should be subject to positive obligations as to the suitability of the financial product. Where there is financial advice, with no transfer of financial product, that advice would be subject to the statutory duty of care and the AFA Code of Professional Conduct ('the Code') (or industry body equivalent, if such a co-regulatory model is adopted).

Who can provide different types of financial advice?

Registered Financial Advisers

Becoming an RFA

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?

Long titles and three letter acronyms are generally not helpful in promoting consumer engagement or understanding. Consumers do not need to understand the mechanics of regulation, but they do need to have confidence in it. Consumer confidence would be increased if consumers understood that:

- all financial advisers are qualified; and
- product providers are responsible for:
    - their sales force; and
    - the suitability of their products.

Further consideration should be given to there being only one designation of financial adviser. The lessons from overseas are that it is important to keep track of individuals within entities. The QFE model should continue to reflect this.[9]

RFA conduct requirements

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

A requirement that the product be suitable should be added (see response to question 3).

Most New Zealanders hold their wealth in their homes and have a life insurance policy, but do not own substantial investment portfolios. This means that, for most New Zealanders, most of their wealth consists of, or is protected by, life or general insurance products. Advice on these products can be given by an RFA.

Currently the Code of Professional Conduct for AFAs only applies directly to AFAs and indirectly to QFE advisers who supply Category 1 products.[10] Consideration should be applied to requiring any person or entity who provides financial advice to retail customers to comply with the minimum standards of professional conduct set out in the section E of the Code.

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9 FAA s74(4)).

10 QFE Adviser Business Statement Guide, page 7 – the QFE must compare its conduct and compliance standards for QFE advisers on category 1 products with those of the Code, and, if they are not the same, explain why not.

RFA disclosure

10. (a) Do you think that disclosing this information is adequate for consumers?; and (b) Should RFAs be required to disclose any additional information?

Disclosure is a cornerstone of regulation. Globally, there is increasing acknowledgement that it is not sufficient.[11] Disclosure plays a part in engaging consumers and encouraging them to take responsibility for their investment decisions. Accordingly, it will always play a part in well-functioning markets. However, the value of disclosure decreases if:

- financial service providers do not take a mature and responsible approach to selling their products; and
- disclosure is not clear, concise and effective.

The current disclosure regime does not allow consumers to properly assess conflicted behaviour. Anyone who provides financial advice should disclose all benefits they receive as a result of that advice and any other factors that may cause conflict. However, this disclosure should be clear, concise and effective, in line with the current FMCA requirements. Diagrams would be useful, for example pie charts that show how much commission is received in relation to the first year's premium on a life insurance policy.

Where a sales process is used, consumers should be encouraged to seek this information and if it is provided it should be fully accurate and not misleading.

RFA entities

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

RFA entities can only provide class advice through their employees. Class advice is an intrinsically flawed concept as any interaction between two people involves an implicit acknowledgement that personal characteristics will be taken into consideration. (An advantage of online advice is that it may allow the delivery of true class advice.) Further consideration should be given to a model where sales and suitability provide protection for consumers outside the class advice model.

Authorised Financial Advisers (AFAs)

Authorisation

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

Currently there is a risk that an Adviser Business Statement is overly legalistic and does not act as a business tool to enable the adviser business to manage the business.

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[11] "The current regulatory framework focuses on disclosure, financial advice and financial literacy, supported by low-cost dispute resolution arrangements. Product disclosure plays an important part in establishing the contract between issuers and consumers. However, in itself, mandated disclosure is not sufficient to allow consumers to make informed financial decisions." Financial Systems Inquiry, Final Report page 193 at http://fsi.gov.au/files/2014/12/FSI_Final_Report_Consolidated20141210.pdf.

Investment planning services

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?

There is a risk that the time and compliance costs of providing an investment planning service are so great that it restricts access to advice. Moving to a more principles-based regime would increase access to financial advice. Only a financial adviser should be able to provide a financial adviser service. That service should be suitable. Accordingly an investment planning service should only be provided by a financial adviser who is properly qualified and is able to communicate with and understand the needs and situation of the client.

DIMS

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?

The Law Society understands that the FMA has produced guidance on contingency DIMS. It has no experience of how this is working in practice.

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?

See comment in paragraph 14.

16. Are the current disclosure requirements for AFAs adequate and useful for consumers

See comments in paragraph 10.

17. Should any changes be considered to improve the relevance of these documents to consumers and to reduce the costs of producing them?

Disclosure should be clear, concise and effective, as noted in paragraph 10.

Code of professional conduct

18. Do you think that the process for the development and approval of the Code of Professional Conduct works well?

The development of the Code was a useful tool for change management and for engaging and educating financial advisers. However, the low level matters considered by the Financial Advisers Disciplinary Committee to date suggests that it is not playing an informed, engaged and active role in the provision of quality advice. We understand that although seven matters have been referred, they related to only five advisers.

Consideration should be given to changing the structure of the Code and its application.

Each standard in the Code consists of an overarching principle identified as a Code Standard, together with additional provisions that contain further detail about the application of the Code Standard. The additional provisions can be given an unnecessarily legalistic interpretation

making business less effective, when it appears that the intention was to set out examples of the spirit of the Code. The additional provisions should be issued separately from the Code Standards as guidance. Consideration should be applied to allowing approved professional bodies to issue guidance on the Code Standards – each relevant to their particular membership.

Consideration should also be given to allowing approved professional bodies to enforce the Code – or their version of the Code. Co-regulation through approved professional bodies could increase public confidence in the professionalism of financial advisers and provide better regulatory outcomes.

19. Should any changes to the role or composition of the Code Committee be considered?

The Code could be applied through approved professional bodies.

20. Is the Financial Advisers Disciplinary Committee an effective mechanism to discipline misconduct against AFAs?

The Law Society has no experience of its effectiveness, but the low number of cases considered suggests that it may not have exposure to sufficient disciplinary matters.

21. Should the jurisdiction of this Committee be expanded?

No, see comments above.

Qualifying Financial Entities (QFEs)

QFE conduct obligations

22. Does the limited public transparency around the obligations of QFEs undermine public confidence and understanding of this part of the regulatory regime?

No. The Law Society understands that consumers (incorrectly) believe that bank deposits are government guaranteed and that all financial service providers take responsibility for the products and financial advice they or their salesforce provide. As noted above, there is no need for members of the public to understand the mechanics of regulation, but they do need to have confidence in it. Public confidence would be increased if:

- all financial advisers are qualified; and
- product providers are responsible for:
    - their sales force; and
    - the suitability of their product

The QFE model provides opportunities for financial service providers to take frontline compliance responsibility for their employees and distribution channel. Generally the model works well and provides an opportunity for the FMA to use its resources as efficiently and for consumers to access “deep pockets” if there is a problem.

However, the current definition of "financial advice" catches sales practices. Financial service providers should be able to responsibly sell their financial products without providing "financial advice". As an example, financial service providers which sell only Category 2 products only obtained QFE status to manage risk in the sales process. This unnecessary regulation:

- increases costs which are passed on to customers in increased costs;
- gives customers an impression that they are receiving financial advice that is in their best interests;
- exposes those QFEs to regulatory risk: if being a QFE is not central to the business model, the entity is less likely to properly comply with the obligations of being a QFE. Currently Category 2 QFEs are perceived as being "lower risk" and may not receive the regulatory oversight that Category 1 QFEs receive. This devalues the QFE brand.

Only those entities who truly want to act as "frontline regulators" should be QFEs.

23. Should any changes be considered to promote transparency of QFE obligations?

No, there is no need for consumers to understand the details of the QFEs business. The QFE ABS contains commercially sensitive information about the QFE's business. There is an advantage in releasing this information to the FMA so the FMA can assess whether the QFE should take "frontline compliance responsibility" for its QFE Advisers. The Law Society understands that consumers do not read the information currently disclosed to them in the QFE disclosure statement. Accordingly, it is unlikely that transparency would achieve anything other than releasing commercially sensitive information to competitors.

QFE disclosure

24. Are the current disclosure requirements for QFE advisers adequate and useful for consumers?

See general comments on disclosure in paragraph 10.

The Law Society considers that the key issue is not commission, but rather the conflict of interest that any entity that distributes through branches or an approved product list has as a result of that distribution model. In making clear, concise and effective disclosure, any QFE operating through a branch structure must ensure that it deals adequately with the conflict of interest inherent in operating through branches.

25. Should any changes be considered to improve the relevance of these documents to consumers or to reduce the costs of producing them?

There should be a requirement that disclosure is clear, concise and effective. Consideration should be given to the amount of disclosure required to ensure that disclosure is as meaningful as possible for the consumer.

Broker requirements

26. How well understood are the broker requirements in the FAA? How could understanding be improved?

Most people understand that a broker is a person who sells insurance. It is confusing to use the term in the FAA to mean something different.

27. Are these requirements necessary and/or adequate to protect client assets? If not, why not?

The Law Society has no information on this point, although the requirements appear to be prudent when dealing with another person's money.

28. Should consideration be given to introducing disclosure requirements for brokers? If so, what would need to be disclosed and why?

Consideration needs to be given to whether another set of disclosures will improve the customer's understanding of risk or expose the customer to significantly less risk.

29. What would be the costs and benefits of applying the broker requirements in the FAA to insurance intermediaries?

The Law Society has no information on this point.

Custodian obligations

30. Are the requirements on custodians effective in reducing the risk of client losses due to misappropriation or mismanagement?

The Law Society has no information on this point.

31. Should any changes to these requirements be considered?

For the reason noted in the preceding point, the Law Society has no comment.

FAA exemptions

32. Is the scope of the FAA exemptions appropriate? What changes should be considered and why?

A provision should be included to enable a sales process that would be a financial service but would not amount to providing financial advice. (See response to question 37 for more detail.)

Lawyers are exempt from the application of the FAA to the extent that they provide a financial advice service or broking service in the ordinary course of their business.

The Law Society made detailed submissions on the Financial Service Providers (Pre-Implementation Adjustments) Bill and amendments proposed in Supplementary Order Paper No 113. A copy of those submissions is **attached**. The Law Society recommended an exemption for lawyers from the operation of the FAA principally for the reason stated in the

issues paper: that lawyers are already fully regulated under the Lawyers and Conveyancers Act 2006 and the regulations and rules made under that Act.[12] The Law Society has also provided detailed guidance in relation to what is considered to be "in the ordinary course of business". There is no benefit in requiring lawyers to comply with the FAA in relation to financial advice that they might provide as part of their normal activities. The Law Society's view remains that there should be an exemption for lawyers, for the reasons detailed in those submissions.

Monitoring and enforcement of the FAA

33. Does the FAA provide the FMA with appropriate enforcement powers? If not, what changes should be considered?

The FAA provides the FMA with enforcement powers for each type of financial adviser. The FMA does not have significant powers over RFAs, except the general power under section 97 to investigate any complaint it receives concerning financial advisers. Consideration should be given to whether the FMA requires further powers to regulate suitability. The Law Society's initial view is that the FMA has significant powers under the FMCA and the Financial Markets Authority Act 2011. The powers should be consistent, although not necessarily replicated, across legislation.

34. How accessible and useful is the guidance issued by the FMA? Are there any improvements you would like to see?

Guidance should be aimed at resolving a problem or difficulty. It is of most value when it offers clarity in areas of uncertainty. Accordingly, guidance should strive to assist market participants in navigating through grey areas as well as black and white. Guidance should not be binding on market participants, who should develop their own methods of complying with legislation. Complying with guidance should prima facie be evidence of compliance.

Comments on Chapter 6 – Key FAA questions for the review

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

Do consumers understand the regulatory framework?

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.

Consumers do not need to understand the regulatory framework. That in itself is not a necessary part of encouraging informed and confident participation in financial markets. However, the regulation is so complex that in many circumstances market participants do not feel confident that they can comply without obtaining legal advice. The distinctions between Category 1/Category 2 products, RFAs/AFAs, wholesale/retail and personalised/class advice make the regime very complex.

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12 Note that the Law Society recommended full exemption for lawyers and recommended omitting the words "if the advice, decision or broking is a necessary incident of legal practice" from the Bill and Supplementary Order Paper.

Introducing a requirement that sales of financial products and services be suitable would significantly simplify the regime (see response to question 3 above).

Generally, consideration should be given to moving toward more principles-based regulation and away from the current prescriptive regime. This could simplify and future-proof the legislation, reduce cost and improve consumer protection. The needs of the customer should be put at the centre of the regulation, without losing sight of the additional purposes adopted from the FMCA such as facilitating the development of fair, efficient and transparent financial markets and cutting compliance costs.

Greater emphasis should be given to product providers and any sales person or financial adviser positive obligations as to the suitability of financial products. This could be introduced by way of a new section 33B and amended section 20F of the FAA or developing the concept of a "responsible financial service provider"[13] in the FSPA. The legislative requirement for suitability should be backed by non-binding guidance issued by the FMA (see question 3 for more detail).

In keeping with the comments above, of particular concern is the lack of clear understanding about the relevant boundaries. One starting point may be to spell out, clearly, scenarios that do not constitute a financial adviser service or financial advice. The point being that the differences between:

- a recommendation of a product to a client in their circumstances (personalised advice);
- a recommendation of this product generally to all clients (class advice); and
- providing some information which recommends this product (no advice),

appear to be too subtle for clients (and possibly many advisers).

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?

The data in the issues paper suggests that consumers are aware that they are being sold a product, but are being told that they are receiving financial advice. This disparity between what a consumer understands and what he or she is told, may go some way to explaining the lack of confidence consumers have in the industry and financial advisers.

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?

Consideration is needed in creating a bright line test for sales. Currently, most sales are made by people, not computers, and therefore the regime has to deal with the infinite complexity of

[13] Repealed s23 Financial Service Providers (Registration and Dispute Resolution) Act 2008

human communication and behaviour. Fitting human behaviour into legal definitions is never easy, but sales and advice could be distinguished by:

- a bright line exclusion from the definition of "financial advice",
- placing greater emphasis on a product providers' positive obligation to ensure the suitability of the financial products (see s 21 FMCA and s 29 Consumer Guarantees Act) (see also our response to question 3), and
- appropriate warnings, training and record keeping.

Amendment to s 10(3) of the FAA could provide one possible means of carving out sales from the financial advice regime. Section 10(3) provides that

> *"However, a person does not give financial advice for the purposes of this Act merely by—*
> *(a) providing information (for example, the cost or terms and conditions of a financial product); or*
> *(b) making a recommendation or giving an opinion relating to a class of financial products; or*
> *(c) making a recommendation or giving an opinion about the procedure for acquiring or disposing of a financial product; or*
> *(d) transmitting the financial advice of another person (unless A gives A's own financial advice in doing so or holds out the transmitted financial advice as A's own financial advice); or*
> *(e) recommending that a person consult a financial adviser."*

A new 10(3)(ba) could state:

> *"Making a recommendation or giving an opinion about a financial product when the prescribed warning has been given."*

As an example, the warning could state:

> *"WARNING: I am selling this financial product on behalf of [name of financial service provider]. It is my job to sell this product and I may be rewarded for this sale. I have not taken into account your particular financial situation or goals. If you want financial advice you should talk to an authorised financial adviser."*

Consideration should be given as to whether the warning includes an explanation of suitability. Processes around giving the warning could be developed based on section 36U of the Fair Trading Act (extended warranties).

How should we regulate commissions and other conflicts of interest?

38. Do you think that current AFA disclosure requirements are effective in overcoming problems associated with commissions and other conflicts of interest?

No. In keeping with many elements of the regime, such disclosures appear far too complicated for many retail clients to grasp. This would be improved by requiring all disclosure to be clear,

concise and effective. Furthermore the focus should not only be on RFA and AFA disclosure of commission, but also on the conflict inherent within the structure of any QFE that operates through branches or uses an approved products list.

39. How do you think that AFA information disclosure requirements could be improved to better assist consumer decision making?

As noted above, disclosure is a cornerstone of regulation. Globally there is increasing acknowledgement that it is not sufficient.[14] Disclosure plays a part in engaging consumers and encouraging them to take responsibility for their investment decisions. Accordingly, it will always play a part in well-functioning markets. However, the value of disclosure decreases if:

- financial service providers do not take a mature and responsible approach to selling their products; and
- disclosure is not clear, concise and effective.

The current disclosure regime does not allow customers to properly assess conflicted behaviour. This is a product of both the complexity of the disclosure and the conflicts that are inherent in any distribution network – particularly in the case of QFEs. Anyone who provides financial advice should disclose all benefits they receive a result of that advice and any other factors that may cause conflict. However, this disclosure should be clear, concise and effective, in line with the current FMCA requirements. Diagrams would be useful, for example pie charts that show how much commission is received in relation to the first year's premium on a life insurance policy.

Where a sales process is used, consumers should be encouraged to seek this information and if it is provided it should be fully accurate and not misleading.

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?

Yes. Consideration should be given to there being only one category of financial adviser who would be required to disclose relevant information including commission (see also response to questions 38 and 39).

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?

Consideration should be given to whether financial advice can be provided when the adviser is paid by any means other than a fee from the client.

There is a view that consumers will never value advice until they pay for it. However, online advice models suggest that in the future advice will be "free". Furthermore, there is little

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14 "The current regulatory framework focuses on disclosure, financial advice and financial literacy, supported by low-cost dispute resolution arrangements. Product disclosure plays an important part in establishing the contract between issuers and consumers. However, in itself, mandated disclosure is not sufficient to allow consumers to make informed financial decisions." Financial Systems Inquiry, Final Report page 193 at http://fsi.gov.au/files/2014/12/FSI_Final_Report_Consolidated20141210.pdf.

appetite amongst New Zealand consumers to pay for financial advice, except in limited circumstances where they are prepared to pay a fee for a financial plan. Accordingly, an industry solution should be sought for commission, similar to the Trowbridge Report.[15]

With regard to lawyers, even if clients are able to provide informed consent to lawyers receiving these commission, the payments create a risk of conflict between the financial interests of the lawyer and the lawyer's duty of fidelity to the client. For that reason the ability for lawyers to earn commission for the sale of financial products is not appropriate and any commissions received should be rebated to the client.

Goal 2: Financial advice is accessible for consumers

Does the FAA unduly restrict access to financial advice?

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)?

Any individual who provides financial advice should be competent to do so. The lack of competency requirements for RFAs raises questions about the ability of these individuals to provide adequate financial advice.

43. What changes could be made to increase the levels of competition between advisers?

The Law Society has no information about this point.

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?

Consideration should be applied to enabling the Code to be owned and governed by industry associations so that it can be closer to the profession and given a less legalistic interpretation. The Code Standards themselves are reasonable, but the guidance given beneath each standard can be given an overly legalistic interpretation that is restrictive. Experience also indicates that such guidance is very complicated because of the complexity of the regime. It is difficult to see how this helps the industry, participants or ultimately clients.

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?

The Law Society has no information about this point.

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15 The recommendations include the "Reform Model" for adviser remuneration i.e after a 3yr transition period, upfront commission (renamed an "initial advice payment") will be limited to 60% of the first year's premium (capped at $1,200) and level commissions limited to 20%. So that's 80% in year 1 and 20% thereafter http://www.fsc.org.au/downloads/file/MediaReleaseFile/FinalReport-ReviewofRetailLifeInsuranceAdvice-FinalCopy(CLEAN).pdf.

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

46. Are there specific compliance requirements from the FAA regulation that have affected the cost and availability of independent financial advice?

The Law Society has no information about this point, except to note that many entities became QFEs to manage the risk that they would be providing personalised advice because of the wide definition in section 15(1)(b)(2) of the FAA.

47. How can regulatory requirements be made less onerous without reducing the quality and availability of financial advice?

It is important to focus on providing quality advice. The current confusion between sales and advice is detrimental to the financial advice profession.

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?

The Law Society has no information about advisers generally. The compliance costs for the legal profession are currently limited to having to provide information to financial intermediaries. The second phase of the implementation of the legislation will impose duties on the legal profession. The Ministry of Justice has not yet set a date for that implementation.

How can we facilitate access to advice in the future?

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?

Generally increasing the confidence of consumers in financial advice and the financial markets will have a beneficial effect. Similarly, working with product providers to encourage the development of annuity products will promote engagement with financial advisers at the de-cumulation stage.

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?

The two pieces of legislation should be consistent and produce a coherent regulatory regime with no confusing terms. For example the current definition of wholesale client and wholesale investor is unhelpful.

To the extent that the FMCA will affect advice about purchasing physical property, such as land, unless the property is purchased through an investment scheme, the transaction will generally not be captured by the FMCA.

51. Do you think that international financial advice is likely to increase? Is the FAA set up appropriately to facilitate and regulate this?

Financial services is one of the last areas to be impacted by digital disruption. Increasingly, advice will be provided from overseas and will be provided from New Zealand to overseas jurisdictions. The Law Society supports the amendments to the FSPA to regulate this.

52. How beneficial are the current arrangements for trans-Tasman mutual recognition of qualifications? Should further arrangements be considered?

The Law Society understands that the current competency levels for financial advisers in New Zealand pose issues for the international recognition of our regime.

53. In what ways do you expect new technologies will change the market for financial advice?

The Law Society understands that online advice will have a significant effect on the advice market. It is necessary to amend the FAA to deal with circumstances where personalised advice is provided by an organisation through a computer rather than by an individual.

54. How can government keep pace with technological developments to ensure that quality standards for advice are maintained, without inhibiting innovation?

The government needs to work with industry to ensure that it understands and supports innovation.

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

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

55. Are the minimum ethical standards for AFAs appropriate and have they succeeded in fostering the ethical behaviour of AFAs?

The minimum ethical standards in the Code are appropriate for AFAs and should apply to all financial advisers (see response to question 56 below). We have no information on whether the minimum ethical standards for AFAs have succeeded in fostering ethical behaviour of AFAs.

56. Should the same or similar ethical standards apply to all types of financial advisers?

All financial advisers must comply with the current conduct requirements of FAA sections 33 – 36 and the proposed suitability requirements (see response to question 3 above). Consideration should be given to co-regulation through approved professional bodies which can enforce the Code, or their version of the Code. Currently the Code does not function well. It is given an unnecessarily legalistic interpretation making business less effective. That only seven cases have been considered under the Code by the Financial Advisers Disciplinary Committee suggests that is the Code is not assisting the industry or advisers to play an informed, engaged and active role in the provision of quality advice.

57. What is an appropriate minimum qualification level for AFAs?

The Law Society's experience, particularly experience gathered from QFEs which operate on both sides of the Tasman, is that New Zealand's qualification levels are lower than other jurisdictions. The efficient functioning of our markets would be improved by enabling our financial advisers to have their status recognised overseas, particularly in Australia.

One solution would be to require all financial advisers to obtain, at the minimum, a Level 5 Certificate in Financial Services (Financial Advice). This level would not apply to people who only provide a sales service. However, in order to ensure that the suitability requirements were met (see question 3), product providers would need to ensure that their salesforce were suitably trained and managed. This may or may not include obtaining Level 5 Certificate in Financial Services.

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?

Please see response to the preceding question suggesting that all financial advisers should meet the obtain Level 5 Certificate in Financial Services (Financial Advice). However, the distinction between sales and advice proposed in the response to question 37 above means that insurance or mortgage brokers may decide that their business is a sales rather than an advice business.

59. How much consideration should be given to aligning adviser qualifications with those applying in other countries, particularly Australia?

Wherever possible, New Zealand qualifications should align with those overseas, particularly Australia, unless there is a significant reason why such expertise is not, and will not become, necessary in the New Zealand market.

60. How effective have professional bodies been at fostering professionalism among advisers?

The Law Society has no information about this point.

61. Do you think that professional bodies should play a formal role in the regulation of financial advisers and if so, how?

The Law Society believes the model that was originally proposed by the Financial Intermediaries Taskforce should be reconsidered. This was a co-regulation model through authorised professional bodies. Unlike the FMA which acts primarily as a regulator,[16] authorised professional bodies would seek to improve confidence in the financial advice profession. They would have more ready access to information, more motivation to enforce

[16] See the comments in paragraph 2 about the FMA's Investor Capability Strategy, which aims to build knowledge, understanding and confidence about making investment decisions.

and investigate (whereas the FMA has to balance the needs of the conduct of the entire market).

Should the individual adviser or the business hold obligations?

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?

Both businesses and individuals should be traceable where financial advice is provided or a sale is made. It is important that the consumer always has access to the product provider wherever possible and does not have to seek redress through an intermediary who may be of little financial worth. Imposing a suitability requirement on all businesses (not just QFEs) would encourage them to train and incentivise their sales or advisory force appropriately.

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?

The FMA's Strategic Risk Outlook 2015 identifies the mis-selling of KiwiSaver and insurance churn as key monitoring themes, suggesting that more consumer protection may be required.[17]

Our understanding from QFEs is that obtaining and maintaining that status has significantly increased the costs of doing business. However, those entities are keen for the QFE structure to remain.

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

Goals for an effective registration system

64. Do you agree that the Register should seek to achieve the identified goals? If not, why not?

Yes.

65. What goals do you consider should be more or less important in reviewing the operation of the Register?

All three goals are equally important. It would be useful to have more information on the register – such as information about disciplinary proceeding, insurance and competency.

Framework for an effective dispute resolution regime

66. Do you agree that the dispute resolution regime should seek to achieve the identified goals? If not, why not?

Yes.

17 https://www.fma.govt.nz/assets/Reports/150130-FMA-Strategic-Risk-Outlook-2015.pdf.

67. What goals do you consider should be more or less important in reviewing the dispute resolution regime?

All these points are important, but accessibility is probably the most important.

Comments on Chapter 9 – How the FSP Act works

Registration

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

The Law Society has no information about this point, except to note that the FMA's powers against RFAs are very general in nature.

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

A requirement that RFAs have insurance and that they meet minimum competency standards (for those who provide financial advice) would enhance the usefulness of the register.

Dispute resolution

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

Yes.

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

No comment.

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

No comment.

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?

No comment

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?

Yes. The Christchurch earthquakes demonstrated that the $200,000 limit is too low. However, financial service providers should have the ability to go to the courts where there is a point of legal principle to be decided or the information is particularly technical in nature and the dispute resolution providers do not have the necessary expertise to provide a solution.

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

Yes. Particularly around the late payment of insurance claims.

Comments on Chapter 10 – Key FSP Act questions for 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?

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

Information about insurance, qualifications, certifications, disciplinary proceedings, employment history and numbers of years of experience.

77. Would it be appropriate for the Register to include information on a financial adviser's qualifications or their disciplinary record?

Yes.

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

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?

Yes.

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?

The Law Society has no information about this point.

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?

80. What are the effects of (positive and negative) competition between dispute resolution schemes on effective dispute resolution?

The Law Society has no information about this point, except to note that it is unusual for a jurisdiction as small as New Zealand to have so many providers.

81. Are there ways to mitigate the issues identified without losing the benefits of a multiple scheme structure?

No comment.

82. Are the current regulatory settings adequate in raising awareness of available dispute resolution options? How could awareness be improved?

Yes. The Law Society has no detailed knowledge that awareness needs to be improved, although there is some anecdotal evidence that clients see complaints or disputes as being the sole preserve of the FMA. This is not unusual: clients are often confused about where disputes regarding matters as routine as disputes over electricity bills are dealt with.

Conclusion

This submission was prepared by the Law Society's Commercial and Business Law Committee. The committee convenor, Stephen Layburn, can be contacted through the committee secretary, Karen Yates on 04 463 2962, karen.yates@lawsociety.org.nz.

Yours sincerely,

Allister Davis
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