

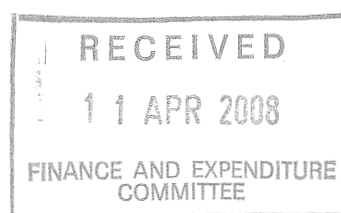


Hon Lianne Dalziel
MP for Christchurch East
Minister of Commerce
Minister for Food Safety
Associate Minister of Justice

FA/ADV/2

10 APR 2008

Charles Chauvel
Chair, Finance and Expenditure Select Committee
Parliament Buildings
WELLINGTON



Dear Charles

FINANCIAL ADVISERS BILL: CONSULTATION ON POLICY PROPOSALS

I would like to invite the Finance and Expenditure Select Committee to consider and, if the Committee thinks fit, to consult publicly on proposed changes to the Financial Advisers Bill. These changes relate to the definition of Financial Adviser and the institutional arrangements for the supervision of financial advisers.

The attached document discusses these issues and proposes alternative approaches to the regulatory framework. If the Committee considers it appropriate, it may wish to use the attached document as the basis of any consultation.

Yours sincerely

Hon Lianne Dalziel
Minister of Commerce

Cc Clerk of the Finance and Expenditure Select Committee

PROPOSED CHANGES TO THE FINANCIAL ADVISERS BILL

BACKGROUND

- 1 The Financial Advisers Bill (“the Bill”) is currently before the Finance and Expenditure Select Committee (“the Committee”). The Committee has called for submissions on the Bill, which close on 4 April 2008.
- 2 The Financial Advisers Bill is part of the Governments’ Review of Financial Products and Providers (RFPP) and is intended to come in to force in 2012 along with the other areas of the Review of Financial Products and Providers.

ISSUE: APPLICATION OF THE BILL

Objective

- 3 The key focus and objective of this Bill is to ensure that consumers can access advice tendered by skilled and competent financial advisers. To that end, the Bill aims to serve three specific objectives, namely:
 - Ensuring that consumers are able to make informed decisions about financial advice received from Financial Advisers;
 - Ensuring that Financial Advisers have the necessary competencies and skills to serve consumers’ needs; and
 - Ensuring that Financial Advisers are accountable for financial advice provided to consumers.
- 4 These objectives underpin any consideration of application. In order to ensure that the objectives are served for all parties involved, it is crucial that the legislation is well-targeted.
- 5 The application of the Bill was deliberately broad in order to focus submitters’ attention on who should be in or out of the regime and what level of supervision different financial advisers might require.



The Current Bill

- 6 The option set out in the Bill focuses on the functional aspect of financial adviser regulation and establishes the application of the regime through the definition of a financial adviser service that focuses on financial adviser service activities.

Proposed Change to Application of Bill

- 7 We propose to adopt an approach that would better reflect the occupational regulation framework underpinning the Bill.
- 8 We propose that the definition of financial adviser refer to those whose primary business is the provision of such advice, or who regularly provides such advice in the course of their business. We seek your views on whether this occupational approach is more suitable in defining the application of the Financial Advisers regime.

1. Do you agree with the occupational approach to the regulation of financial advisers?
2. Is the definition of a financial adviser (being a person whose primary business is the provision of financial advice, or who regularly provides such advice in the course of their business) suitable?
3. Is the definition of financial advice sufficiently clear? Are there people who are likely to be caught within the definition of a financial adviser that should not be caught? How could such people be dealt with?

Financial Decision

- 9 The Bill currently defines financial advice as “any advice relating to the financial implications of a financial decision.” A financial decision is subsequently defined to cover a range of activities including decisions contemplated in respect of saving money, holding property or incurring a debt. These activities are too broad because they could cover a range of advice on a range of activities that need not be taken by financial advisers, such as advice provided by retailers on the hire purchase options in relation to consumer goods. This is likely to fall within the definition currently provided in the Bill of providing guidance on the implications of borrowing money. A further issue is that the terms used in defining financial decisions are undefined. This has the potential of creating uncertainty and confusion when determining the parameters of a financial decision.
- 10 We propose to replace the terms currently used to define a financial decision and narrow the definition to the buying, selling or holding of financial products. A financial product will include the following products:
- a Securities (as defined by the Securities Act 1978).

- b Any contract of life insurance, disaster insurance or general insurance (as defined in the in the Insurance Companies (Ratings and Inspections) Act) and medical insurance. It should also be noted that as the insurance work streams under the RFPP are progressed, new definitions for insurance are likely to be developed. These definitions may be replaced when the insurance legislation is enacted.
 - c Any consumer credit contract (as defined by the Credit Contracts and Consumer Finance Act 2003). It should be noted that this currently excludes credit contracts provided to corporate entities.
- 11 We propose that the Bill include a regulation-making power to enable any other product or class of products to be prescribed as a financial product. This will ensure that the legislation has appropriate coverage as products develop which are not covered by the definition above but are clearly financial products that should be included.
 - 12 We propose that real property not be included in the legislation as financial products because advisers on real property are covered by the Real Estate Agents Bill. However we are aware that there are investment products that are attached to land that may or may not be caught by the Real Estate Agents Bill. For those that we clarify are not caught by the Real Estate Agents Bill, we propose to use a regulation making process that would define these investment products as financial products to bring them within the application of the regulatory framework.
 - 13 Further we propose that any advice made by a person whose primary occupation is to provide advice in relation to any savings or investment planning be covered by the Bill. This would ensure that financial planners providing services relating to savings or investment decisions will fall within the proposed framework, without inadvertently capturing other unrelated occupations. The objective of these proposals is to ensure that people providing advice that is not product-related but are nonetheless traditionally viewed as financial advisers are included in the application of the Bill.
 - 14 This definition aims to exclude people such as retailers who provide advice on hire purchase options in relation to consumer goods. It is likely that the proposed definition of financial advice will result in excluding advice on credit contracts that are not consumer credit contracts, contracts of guarantee or personal property.

4. Is the list of financial products appropriate? Are there additional financial products that ought to be specified in the legislation or is the regulation-making power sufficient?
5. How should advice on investments linked to real property be dealt with under the Bill?
6. Should advisers who provide advice that is not related to products be brought into the regime? How?

Specified Occupations and Occupations holding themselves out as Financial Advisers

- 15 In addition we propose the Bill include a regulation-making power to prescribe certain occupations to be included as financial advisers. This will enable regulations to be developed which will identify certain occupations as financial advisers, even if they do not fit the definition of financial advice, as provided above.
- 16 This regulation making power will allow additional conditions to be applied to any specific occupation. These conditions may exempt or impose additional requirements on any specified occupation.
- 17 This option will also allow flexibility when dealing with specific occupations and would enable a more catered response to the needs of any particular sector. To provide certainty, we currently envisage that these regulation-making powers would be subject to some criteria in legislation. These criteria are likely to include that any regulations promulgated be consistent with the purposes of the Bill and that the Minister undertake appropriate consultation prior to recommending the promulgation of any regulations.

7. Do you think that such a regulation making power is needed?
8. What sorts of occupations may need to be specified in any such regulations? Why?
9. Should any criteria be specified in the legislation in relation to the exercise of such regulation making power? What criteria should be included?
10. How, in your view, could you distinguish between those that hold themselves out as Financial Advisers and those that do not? Is a form of name reservation appropriate? Why? Why not?

Institutional Accreditation

- 18 Several institutions, such as banks, operate as financial advisers because of the nature of their business. This includes employing people to provide advice, providing websites or explanatory material that would cause the corporation to fall within the definition of Financial Adviser. If the regime attempted to accredit all the individuals working in the institutions as Financial Advisers this would result in substantial costs for the employing corporate entity. Such an approach would also fail to meet the objectives of the regime as it is the corporation that is producing the advice for its customers, rather than the advice being the unique opinions or recommendations of an individual.
- 19 To ensure that the objectives of the regime are met we propose to develop an accreditation system for institutions that effectively operate as financial

advisers. An accredited institution is an institution that elects to become an accredited institution under the proposed regulations.

- 20 To be accredited, the institution will need to demonstrate that it has appropriate processes in place to monitor the provision of advice within the institution. For example, institutions will need to demonstrate that they have the appropriate processes in place to ensure that the relevant staff have appropriate product and client knowledge and that the organisation is accountable for advice tendered by the organisation (for example, by ensuring that consumers have access to a complaints resolution mechanism) and the appropriate improvement cycles are in place.
- 21 The fundamental principle underlying institutional accreditation is that the institution is responsible for ensuring that advice being tendered by employees of that institution is appropriate to the needs that the advice is serving.
- 22 Any employee of an accredited corporation who provides financial advice will have the option of becoming individually accredited, but will not be required to do so. This option will only apply if the employee is providing advice on products offered or sold by that corporation.
- 23 However, any employee of an authorised institution would be caught by the legislation if that employee was providing advice on products offered by other institutions.

11. Do you believe that an accreditation approach for institutions is appropriate? What risks are there with such an approach?

12. What are the types of criteria that would be relevant to such institutional accreditation?

Budget Advisers

a Our intention is not to regulate Budget Advisers. This would include people who offer support in the community to help individual or families manage their financial affairs. However, it is equally important to ensure that financial planners or other financial advisers do not pass themselves off as Budget Advisers, simply to avoid the requirements of the Bill. We are currently considering options that would serve both these objectives. As a first step, we propose that the Financial Advisers Bill would exempt people who are employed (whether paid or unpaid) by a voluntary, community based or welfare organisation.

13. Should Budget Advisers be exempted from the Financial Advisers regime? What should be the criteria for such an exemption to be granted?

ISSUE: INSTITUTIONAL ARRANGEMENTS

Objectives

- 24 The objective of the Bill is to have a regulatory body that is created upon and conforms to the principles of a good regulator, these principles are: accountability; support for economic progress; innovation; competition; confidence and credibility; effective and efficient enforcement and discipline; clarity; transparency; integrity; proportionality and positive impact on members.
- 25 This paper identifies two options for the institutional arrangements for regulatory supervision of financial advisers, including the APB model (the status quo) and a central regulator model.

The Status Quo – The Approved Professional Body Model (APB)

- 26 The Bill develops a co-regulatory model for the supervision of financial advisers. The co-regulatory model was the preferred option for the regulation of financial advisers, over enhanced self regulation or direct government supervision. Under the co-regulatory model, industry-led approved professional bodies (APBs approved by the Minister of Commerce) and the Securities Commission would work together to regulate financial advisers. Financial advisers would be required to belong to an approved professional body; be subject to disclosure and conduct obligations when providing financial advice and subject to dispute resolution and disciplinary procedures.
- 27 The co-regulatory model, however, has created several challenges that need to be examined when determining the most appropriate regulatory model for Financial Advisers. These include ensuring all sectors with financial advisers are able to set up an APB. Further issues could occur if the APBs were to compete with each other. This could result in reduction in the number of APBs over time and possible market responses are to either reduce standards to the lowest common standards or probably more likely increase the required standards, so as to increase the associated returns for a financial adviser. The increased barriers to entry could deter registration of some financial advisers.
- 28 The first of these issues arises where there is “silo-like” behaviour by the potential or currently expected APBs. The APBs are likely to be designed to reflect the needs that the existing professional body is already serving. This industry-centric focus of existing professional bodies may create a possibility that certain small sectors may not have an APB established, which, in turn, may have the consequence of excluding legitimate advisers from the market for lack of an approved co-regulatory body.
- 29 Experience with occupational regulation suggests that the more likely outcome of a limited number of APBs is the raising of competency standards to raise the barriers to entry and increase the price charged for such services.

Proposed Change to Regulatory Oversight

- 30 An alternative regulatory model may be developed where the Securities Commission undertakes the functions and has the powers, instead of APBs. The Commission will oversee the new regime and be responsible for oversight, ongoing monitoring, discipline and enforcement, licensing, registration, education and acting as an interface between consumers and Financial Advisers.
- 31 We believe that the Securities Commission is the optimal organisation to undertake this function. The Commission already has the appropriate infrastructure and expertise in this area.
- 32 This model would place the rule making and enforcement powers with the Commission, with checks and balances, and a degree of public oversight and public accountability through industry consultation requirements.
- 33 It is probable with this change we would be able to fast-track the implementation for the regime. Under the current Bill, it is envisaged that the regime would be implemented by 2012. If the proposals were accepted, this regime could be fully implemented by 2010.

The Mechanics of the Securities Commission as Regulator

- 34 Two of the benefits of this approach are that the costs and time involved in the establishment of the regulatory body would be less. As the regulator for Financial Advisers would be an existing Independent Crown Entity, much of the infrastructure required for the establishment of a regulatory body, would not be required in this instance. However, it would be necessary for some amendments to be made to the Securities and the Financial Advisers legislation to enable the Securities Commission to undertake these functions.
- 35 Under this proposal, the Securities Commission would undertake all of the functions contemplated for APBs. Specific amendments would be needed to enable the Commission to undertake the new functions. This would include requirements that the Commission provide the Registrar of Financial Service Providers with all necessary information relating to Financial Advisers in the same way APBs would under the current approach in the Bill. It also should be noted that the proposal is for the Commission to undertake all of the new functions in a manner that is consistent with its existing powers.

Establishment

- 36 Further, the Securities Commission will have all the powers of the Securities Commission under Part 4 of the Securities Act 1978, in relation to monitoring, investigating or enforcing compliance with the rules established by the Commission.
- 37 It is, however, important to ensure that the Commission is able to discharge its various functions appropriately and independently. Specifically, it is important that the Securities Commission is able to undertake its enforcement functions separately from its supervision and compliance functions. On one hand it is

important that the Commission is able to discharge its enforcement functions effectively. However, it is equally important that the Commission serve as an appropriate supervisor of financial advisers. This would require ensuring that the Commission would be able to manage financial advisers through potential difficulties without necessarily relying on its enforcement powers. This would require the Commission to establish a division, as per section 14B of the Securities Act 1978, to establish rules for financial advisers. This division would be able to undertake all compliance and supervisory related functions and would be able, for example, to retain information received from advisers in confidence. The enforcement and investigatory functions may then be undertaken by other parts of the Commission.

- 38 We further propose that the membership of the Commission be extended to include at least one person suitably experienced and qualified in the Financial Adviser industry. This Member will be appointed under sections 28-31 of the Crown Entities Act 2004. The appointment must also be published in the Gazette. All other relevant provisions in the Crown Entities Act relating to the members of a Board of a statutory Entity will also apply to this Member.

14. Do you agree with the concept of the Securities Commission having the role as outlined above? Why? Why not?

15. Should the way the Commission discharges its new functions be specified in the legislation?

Financial Adviser Rules

- 39 Under this option the Financial Advisers Bill will need to be amended to enable the Minister of Commerce, on recommendation of the Securities Commission to establish rules for financial advisers or class of financial advisers relating to:
- Minimum standards of competency;
 - Requirements for ongoing professional development;
 - Minimum standards of conducts and ethics; and
 - Disciplinary procedures.
- 40 To ensure that there are appropriate checks and balances on the establishment of these rules, the recommended rules would need to be consistent with the objectives and purposes of the Financial Adviser legislation and any regulations made under that legislation. To ensure that the rules developed appropriately reflect the needs of the industry, we propose that the Securities Commission be required to engage in consultation with interested parties prior to making any recommendation to the Minister regarding the establishment of any such rules. We further propose that the Minister may withdraw her approval for the rules with an appropriate period of notice, if the

Minister is satisfied that the rules are no longer consistent with the objectives and purposes of the Financial Adviser legislation and regulations.¹

16. Do you agree that the Securities Commission may recommend the development of rules to the Minister of Commerce for approval in relation to minimum standards for financial advisers?

17. Do you agree Securities Commission should develop rules on all of the issues set out in the list in paragraph 42? If not please provide modified or alternative means by which the rules for financial advisers could be established.

Enforcement

41 The primary legislation would provide the Securities Commission with the power to impose penalties where a Financial Adviser has breached the rules established. Penalties range from the ability to impose a fine, through to ordering an adviser to pay compensation, to suspension and prohibition from performing financial adviser services. The disciplinary provisions relating to the rules as drafted by the Commission and approved by the Minister would, where possible, reflect existing frameworks in other occupational regulation. The frameworks provided by legislation such as sections 67-74 of the Registered Architects Act provide a good precedent for the development of such frameworks in the financial adviser regulatory regime.

42 Any adviser who is subject to an adverse finding in any disciplinary action by the Commission may appeal that decision. Any financial adviser that faces disciplinary action by the Commission and has unsuccessfully appealed may subsequently appeal to the District Court on any issue of law or fact, relating to the Commission's determination.

18. Do you agree with the enforcement and disciplinary mechanisms proposed here for financial advisers?

19. Should there be an administrative appeal right for financial advisers on determinations by the Securities Commission, prior to appealing to Court? Who should be that appeal body?

20. Are the checks and balances provided on the exercise of disciplinary action sufficient? Are there additional requirements that should be imposed, or existing requirements that should be removed?

¹ Note the earlier discussion on the use of regulation as opposed to rules for the establishment of some of the accreditation requirements