

**INVESTMENT SAVINGS & INSURANCE ASSOCIATION OF NZ
INC**

**SUBMISSION
TO THE
COMMERCE
SELECT COMMITTEE**

**ON THE
FINANCIAL SERVICE PROVIDERS (PRE-
IMPLEMENTATION ADJUSTMENTS) BILL**

25 March 2010



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INVESTMENT SAVINGS AND INSURANCE ASSOCIATION OF N.Z. INC.

1.0 Introduction

- 1.1 The Investment Savings and Insurance Association ("ISI") is the industry association representing the companies which issue or manage life insurance, superannuation and managed funds.
- 1.2 ISI has 23 members and 18 associate members who collectively manage over \$60 billion in collective investments on behalf of 1.3 million New Zealanders. ISI members include all of the 6 default providers of KiwiSaver.
- 1.3 ISI members also manage \$1.3 billion in annual premium income for life insurance risk products and, in the year to 31 December 2009, paid out \$950 million in insurance benefits.
- 1.4 A list of members appears at the end of this submission.

2.0 General Comments

- 2.1 ISI endorses the intention of the Financial Service Providers (Pre-Implementation Adjustments) Bill ("the Bill") to enable the new regime for the regulation of financial advisers to be implemented effectively and consistently.
- 2.2 We have appreciated the opportunity for discussions with officials since the enactment of the Financial Advisers Act and the Financial Service Providers (Registration and Disputes Resolution) Act, including in respect of the scope of the Qualifying Financial Entity ("QFE") regime.
- 2.3 We welcome the amendment of section 17 of the Act to widen the range of Category 1 products on which a QFE's employees and nominated representatives may give financial advice. While we recognise that the intention of the new regime was to regulate advisers as individuals rather than entity regulation on the Australian model, the amendment will allow more advice to be given within the scope of QFEs' responsibility which, in our view, will provide additional protection for consumers.
- 2.4 However, the need for individual authorisation of advisers providing a financial planning service and the uncertainty over the scope of 'financial planning service' and the promoter or issuer relationship between QFE and product, will mean that the majority of advisers under a QFE will need to be individually authorised. This will increase compliance costs.

- 2.5 We understand that the Securities Commission plans to issue guidance to clarify when a specific activity would be classed as coming within the definition of providing a financial planning service. It would have been very useful to have had that guidance before making this submission but we have tried to set out our views on what should and should not be classified as a financial planning service.
- 2.6 We welcome the clarification of term life insurance as a Category 2 “low risk” product which is well understood by the general public.
- 2.7 We do still have some concerns with specific parts of the Bill and they are listed below in the Summary of Recommendations and covered in more detail in the following paragraphs.

3.0 Summary of Recommendations

We recommend that:

- 3.1 The Financial Advisers Act be amended so that it applies only to financial adviser services provided to members of the public.
- 3.2 Whether or not the preceding recommendation is followed, the definitions of issuer and promoter need to be amended as follows:
 - The definition of promoter in clause 6 of the Bill and the definition of issuer in section 5 of the Financial Advisers Act should be amended to remove the cross references to the Securities Act.
 - The revised definitions should refer to financial products rather than securities and there should be no reference to ‘offered to the public’.
- 3.3 Clause 10 of the Bill should be amended to include products where the issuer or promoter is within the same group as the QFE.
- 3.4 Clause 10 should recognise ‘group QFEs’.
- 3.5 Clause 10 should be amended to allow the employees and nominated representatives of a QFE to be able to provide a financial planning service (as defined) on Category 2 products without being authorised.
- 3.6 Clause 10 should also allow other registered but non-authorised advisers to provide advice on Category 2 products following a needs analysis without it coming within the definition of financial planning service, subject to strict compliance with the conduct obligations of the Financial Advisers Act.

As noted earlier, we understand that the Securities Commission plans to issue some guidance and link the definition of financial planning service to section 33 of the Financial Advisers Act, requiring an adviser to exercise the “care, diligence and skill that a reasonable financial adviser would exercise in the same circumstances”.

- 3.7 Paragraph 4.6 contains other remedial recommendations.

Individual ISI members will make their own submissions on particular issues and one member has indicated that it does not support recommendations 3.5 and 3.6.

4.0 Discussion

4.1 Provision of financial adviser services to wholesale clients

- 4.1.1 The Financial Advisers Act does not distinguish between the provision of financial adviser services to wholesale and retail clients. As a financial adviser service can only be provided by an individual, anyone within a corporate who provides wholesale financial advice will need to be individually registered and authorised.
- 4.1.2 Wholesale financial advice will include advice between financial service providers that are, for example, a financial product provider and an entity that provides financial advice to the public. It could also be advice given by a wholesale investment management company to a retail financial product provider. Examples of other wholesale clients who may receive financial advice are corporate superannuation schemes, certain community and charitable trusts, crown financial institutions, local authorities and trustees/managers of collective investment schemes (including unit trusts and superannuation schemes).
- 4.1.3 In all such cases, these wholesale clients are sophisticated and knowledgeable investors and well able to understand the details of both the products involved and the advice received. We note that the recent Report of the Capital Markets Development Taskforce (December 2009) states that regulation of advice outside the retail market is not justified as non-retail investors are able to obtain information from their advisers, judge the competency of their advisers and verify the practices of their advisers without inflexible, mandated disclosure, codes of practice and competency standards. The Report also states that regulating wholesale advice is inconsistent with the Securities Act which imposes minimal obligations on those issuing to certain classes of investors. The Report recommends those advising investors who are outside the scope of the Securities Act be excluded from the obligations of the Financial Advisers Act. We support the views and recommendation of the Capital Markets Development Taskforce on this matter.
- 4.1.4 If financial adviser services provided to wholesale clients are not completely excluded from the Financial Advisers Act then the following definitions and references in the Financial Advisers Act need to be amended in order to make the application of the Act more workable in relation to wholesale clients:
- Definitions of ‘issuer’, ‘promoter’ and ‘authorised advertisement’ should not be restricted to the Securities Act definitions which apply only in the context of offers of securities to members of the public;

- The references in section 12(i) should not be restricted to the meanings in the Securities Act and Unit Trusts Act which apply only in the context of offers of securities to members of the public.

These definitions and references should be amended so that the concepts of these terms are captured but also apply to offers of securities and other financial products to wholesale clients (and are not limited to the context of offers of securities to members of the public).

- 4.1.5 We recommend that the Financial Advisers Act should be limited to financial adviser services that are given to members of the public. Section 3 of the Securities Act 1978 provides suitable wording for what constitutes offering to members of the public, in particular section 3(2)(a)(ii) which excludes “persons whose principal business is the investment of money or who, in the course of and for the purposes of their business, habitually invest money”.
- 4.1.6 If the application of the Financial Advisers Act is not limited to financial adviser services that are given to members of the public, then we recommend the amendments as set out in paragraph 4.1.4 above.

4.2 QFEs

- 4.2.1 The amendment in clause 10 of the Bill will enable employees and nominated representatives of a QFE to give advice on Category 1 products issued *or promoted* by the QFE *in the course of its business*. The effect of the amendment will be to enable the employees and nominated representatives of a QFE to give advice on products that the QFE is responsible for, without requiring the adviser to be an Authorised Financial Adviser (“AFA”). If, however, the adviser is providing a “financial planning service” the adviser will still need to be an AFA.
- 4.2.2 The inclusion of ‘promoter’ is positive. However, a problem remains in that an issuer or promoter will not usually be the employer of advisers so the new section 17 of the Financial Advisers Act would have very limited application. This could be addressed by extending the new section 17 to include products where the issuer or promoter is a company within the same group as the QFE. This would recognise the common industry practice whereby financial service organisations operate as a group of companies with different companies taking on different roles but the group is still ultimately responsible (we refer to our comments in paragraph 4.2.7 below).
- 4.2.3 The definitions of ‘issuer’ and ‘promoter’ are taken from the Securities Act so they only apply where the securities are offered to members of the public. This means that Category 1 products that are offered to wholesale clients are not captured. Unless the application of the Financial Advisers Act excludes financial adviser services provided to wholesale clients (as we recommend), then the definitions of ‘issuer’ and ‘promoter’ should not be limited to the context of offers

of securities to the public. We refer to our comments in paragraphs 4.1.3 and 4.1.4 above.

- 4.2.4 Another consequence of the definition of ‘promoter’ having been taken from the Securities Act is that other problems will arise when a QFE claims to be a promoter to take advantage of the exemption from the AFA requirement. The QFE and its directors will need to be named as promoters in the prospectus and will take on the corresponding Securities Act liability. It is not unusual for a financial services company to have products of another company on its authorised list of products on which its advisers can provide advice. In that case, although the financial services company may be a promoter of those products, and be responsible for selecting those products as being appropriate to meet customer needs, it would not be appropriate for the QFE to take on the liabilities of a promoter that are entailed by the Securities Act.
- 4.2.5 We recommend that the new section 17 be amended to include products where the issuer or promoter is a company within the same group as the QFE.

We recommend that the definitions of both ‘issuer’ and ‘promoter’ should be revised to remove the cross-reference to the Securities Act and to provide a stand-alone definition referring to financial products rather than securities and omitting any reference to “offered to the public”.

Group QFEs

- 4.2.6 Clause 10 refers to the adviser giving financial advice ‘in the course of the QFE’s business.’ We interpret this as meaning that a corporate group with different business lines managed in separate entities would not need to have a QFE for each of those separate entities.
- 4.2.7 Many financial service organisations operate as a group of companies. One entity may be the employer and/or party contracting with advisers and other entities may be the issuers of various products. For example, a financial services group may include separate entities that issue general insurance, life insurance and savings products and another entity that employs or contracts with advisers. Alternatively, the group may contain more than one entity that is both an issuer and employer/contractor of advisers.
- 4.2.8 In both of the scenarios outlined in paragraph 4.2.7 it would be appropriate to allow one entity within each group to become a QFE and to assume responsibility for the employees and nominated representatives of other entities within the group. The QFE would need to define the parameters of its business in its Adviser Business Statement to include that wider responsibility.

Nomination by Multiple QFEs

- 4.2.9 It is not clear from the Bill whether an individual may be a nominated representative of more than one QFE at the same time. This should be clarified.

If an adviser would be permitted to belong to more than one QFE we request clarification of how that would be regulated.

4.3 Definition of Financial Planning

4.3.1 The Financial Advisers Act 2008 defines *financial planning service* as:

...a service that analyses an individual's financial situation, identifies his or her financial goals, and develops financial options for realising those goals.”

That definition could be interpreted to include a needs analysis done by a diligent adviser as part of the process of advising on pure risk products, such as term life insurance, which clause 6 of the Bill defines as a Category 2 product.

4.3.2 As a financial planning service can only be provided by an AFA that would mean all risk advisers could need to become AFAs, even if they only ever give advice on Category 2 products. That would apply even for risk advisers who are nominated representatives of QFEs and not otherwise required to be registered or authorised.

4.3.3 We note that the comments by the Select Committee in April 2008, when releasing the *Financial Advisers Bill: Consultation on Policy Proposals*, indicated that the Committee expected the term ‘financial planning’ to be limited to advice in relation to savings and investment.

4.3.4 Typically, a risk adviser will meet with a prospective client to discuss whether the prospective client has adequate insurance cover in areas such as:

- Life insurance
- Income protection
- Health insurance
- Fire & General insurance.

In order to determine the appropriate level of cover in these areas, the risk adviser needs to do a needs analysis which involves collecting a significant amount of information about the prospective client, such as: age and health, employment status, income, assets and liabilities and dependants.

4.3.5 It is difficult to see the justification for treating the provision of advice on a simple Category 2 product as a financial planning service if it is given in conjunction with an appropriate needs analysis. While a sophisticated needs analysis on personal risk and product recommendations requires a high level of skill and competence it is likely to be counter-productive to have a rule that would consider an adviser (who gives advice only on Category 2 products) to have acted as a financial planner (and therefore required to be an AFA) if he or she carries out a needs analysis as part of giving advice on a Category 2 product.

- 4.3.6 The boundary between authorised financial advisers and advisers who are registered but not authorised is likely to lead to the perverse outcome of advisers giving less comprehensive advice on personal risk needs in order to avoid the need for individual authorisation. Also, a broad interpretation of ‘financial planning service’, together with the limited exemption for individual authorisation outlined in section 4.2 above, will mean significantly more advisers will need to be individually authorised.

For example, one of our members with 350 aligned advisers, and intending to be a QFE, advises that over 300 of its advisers will need to be individually authorised. This has the potential to significantly increase compliance costs for the industry and the Securities Commission unless there is significant streamlining of the authorisation requirements for such advisers under a QFE.

- 4.3.7 ISI does not have a unanimous view on whether advisers who only ever give advice on Category 2 products should be required to be AFAs. The majority view, however, is that it should be possible for advisers who are employees or nominated representatives of QFEs to provide a financial planning service, as defined, on Category 2 products without needing to be authorised. On the basis of the majority view, we recommend that clause 10 of the Bill should be amended to that effect.

- 4.3.8 We also recommend that other advisers who are registered but not authorised should be able to carry out a needs analysis in relation to Category 2 products without coming within the definition of providing a financial planning service. The proviso should be that those advisers must make absolutely clear the limitations on the scope of the service that they are able to provide. They must ensure that they do not hold themselves out to be able to consider or provide advice on Category 1 products.

4.4 Making Investment Transactions

We note that a Supplementary Order Paper has been released which amends the Financial Advisers Act in respect of investment transactions and submissions have been invited on that document.

4.5 Timing of Implementation

We welcome the provision in clause 19 for the Code of Professional Conduct to provide for transition periods for the implementation of its standards as that facility should provide some flexibility.

However, we do remain concerned at what is a very tight timetable for implementation of the Financial Services Providers (Registration and Dispute Resolution) Act and Financial Advisers Act, taking into account that the legislation is still being amended and the Code of Professional Conduct is still being drafted.

4.6 Other Recommendations

4.6.1 Clause 8.2 (2)

We recommend that clause 8(2) should be amended at line 25 to change “recommendation or opinion” to “recommendation, opinion or guidance” so that it is consistent with section 11 of the Financial Advisers Act.

4.6.2 Clause 9

Clause 9 (1) should be extended to include annual reports sent to unit trust unit holders and annual reports sent to members of KiwiSaver superannuation schemes so that these are not considered to be ‘financial advice’.

We also recommend that clause 9 should amend section 13 of the Financial Advisers Act so that it excludes from the definition of “financial advice” any advertisements for Category 2 life insurance products and financial products offered only to wholesale clients. Currently, amongst the exclusions in section 13 is anything contained in an ‘authorised advertisement’ which has the same definition as in the Securities Act and therefore applies only to securities that are offered to members of the public.

4.6.3 Clause 10

We recommend that section 19(1)(b) of the Financial Advisers Act be amended by changing the reference to “financial services” to “financial adviser services” so that it is consistent with section 10 of the Act.

4.6.4 Clause 17

We recommend an additional amendment to section 76(1) of the Financial Advisers Act. Section 76(1)(b) should be amended to refer to the “course of the QFE’s business” so that it is consistent with the changes made to sections 17 to 19 by clause 10 of the Bill. We recommend the wording be amended to “in relation to its employees and nominated representatives who are financial advisers, ensure compliance by each of those persons with his or her financial adviser obligations *if the financial adviser services that the employee or nominated representative performs are performed in the course of the QFE’s business;*”.

4.6.5 Clause 35

Clause 35 amends section 7 (2) of the Financial Service Providers (Registration and Dispute Resolution) Act 2008 to the effect that a nominated representative of

a QFE will not be a financial service provider and therefore will not be required to be registered.

In the event that our recommendation at paragraph 4.3.6 is not accepted, a problem will arise for those nominated representatives who need to become separately authorised. If a nominated representative is not a financial service provider he/she cannot be registered and cannot therefore comply with section 54 of the Financial Advisers Act which requires an adviser to be registered in order to be eligible to be authorised.

List of ISI Members

ISI MEMBERS

AIA New Zealand
AMP Financial Services
Asteron Life Ltd
AXA New Zealand
BNZ Investments and Insurance
CIGNA Life Insurance NZ Ltd
Dorchester Life
Equitable Group
Fidelity Life Assurance Co Ltd
Gen Re LifeHealth
Hannover Life Re of Australasia Ltd
ING New Zealand Ltd
Kiwibank Ltd
Medical Assurance Society NZ Ltd
Mercer
Munich Reinsurance Co of Australasia Ltd
Public Trust
RGA Reinsurance Co. of Australia Ltd
Sovereign Ltd
Southsure Assurance
Swiss Re Life & Health Australia Ltd
TOWER Limited
Westpac/ BT Funds Management Ltd

Associate Members

Bell Gully
BNP Paribas
Bravura Solutions
Burrowes & Co
Chapman Tripp
Davies Financial & Actuarial Ltd
Deloitte
DLA Phillips Fox
Ernst & Young
InvestmentLink (New Zealand) Ltd
KPMG
Kensington Swan
Melville Jessup Weaver
Minter Ellison Rudd Watts
Morningstar Research Ltd
PricewaterhouseCoopers
Russell McVeagh
Simpson Grierson