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Dear William,

Financial Advisers (Exemptions, Definitions, Voluntary Authorisation and Fees) Regulations 2010

The Investment Savings and Insurance Association (“ISI”) appreciates the opportunity to comment on the draft Financial Advisers (Exemptions, Definitions, Voluntary Authorisation and Fees) Regulations 2010. We provided comments on 17 September 2010 and 23 September 2010 on earlier drafts of the definitions of ‘investment-linked contract of insurance’ and ‘pure risk insurance contract of insurance’ and we note that those comments appear to have been taken into account to some extent in the current draft.

The specific questions posed in the MED email that accompanied the draft regulations are answered along with comments on specific aspects of the draft regulations.

Regulations 6 and 7 Telephone Advice

We understand that the drafting of the telephone advice exemption in Regulations 6 and 7 will mean that advisers providing advice on category 2 products over the phone will not be required to provide disclosure in writing unless requested by the client. This will effectively remove the burden of providing written disclosure to callers who do not proceed with action on the basis of the advice. We support the exemption.

Regulation 6 provides an exemption from section 22(1) of the Financial Advisers Act which requires disclosure of information prescribed by regulations. This means that information that Authorised Financial Advisers must disclose under the Code of Professional Conduct (for example, under Code Standard 7) is not covered by this exemption. The practical effect of this is that the Regulation 6

provides a limited (if any) exemption for AFAs, given the disclosures they must still make under the Code.

Does this provide reasonable certainty that adequately succinct disclosure can be made (subject to any terms and conditions under sub clause (2))? Would prescribed statements as a safe-harbour be desirable?

We do not consider that there is any need for prescribed statements as a safe harbour.

Regulation 9 Cash or Term PIEs

Our previous submission recommended that there should be no requirement for the issuer of the PIE to be the same as the issuer of the underlying securities. That is still our recommendation.

As Category 2 investments in a specified PIE are limited to debt securities issued by a specified bank, we do not believe that the specified issuer should be required to be a wholly owned subsidiary of and controlled by its registered bank parent.

As previously noted, we consider there could be less risk where PIE products are invested in third party securities as there is the opportunity for the PIE issuer to diversify and spread the risk between different issuers.

Regulation 10 Investment-linked Contract of Insurance

Preferred position

As we noted in our September submissions, we consider that the most appropriate starting point for regulation 10 would have been the Financial Advisers Act category 2 product definition, sub clause (i) 'a contract of insurance (other than an investment-linked contract of insurance)'. That definition establishes that all contracts of insurance are category 2, other than those defined as an exception to the rule, and the drafting of the regulations should be consistent with that.

With Category 2 established as the default position for contracts of insurance, 'investment-linked contract of insurance' could then be defined and carved out of that. In our view, the key feature of those policies is the consumer's exposure to some degree of investment risk, i.e. there is some uncertainty about the return in contrast with the guaranteed return of a bank term deposit, for example, which is a Category 2 product. A definition that *includes* these products is preferable to the proposed definition by exclusion which is circular and potentially confusing.

We also have concerns that the proposed definition of 'investment-linked contract of insurance' is broad and creates inconsistency with other legislation that affects the industry. For example, an endowment policy which is a 'security' under the Securities Act could not be a 'security' under the Financial Advisers Act but instead would be captured as an 'investment-linked contract of insurance'. The Insurance (Prudential Supervision) Act also uses the term 'investment –linked contract' but the definition is much narrower than the proposed definition for the Financial Advisers Act.

While we recognise that the regulations must be drafted in accordance with the Cabinet decisions made in October, we do not believe that our recommendations are contrary to those decisions.

Alternate position

We are aware, however, that there is some industry support for a definition of ‘pure risk contract of insurance’ in draft regulation 10 and, as a compromise, we would support an alternative definition such as:

10 Meaning of investment-linked contract of insurance

- (1) For the purposes of the Act, **investment-linked contract of insurance** means any contract of insurance other than -
- (a) a pure risk contract of insurance; and
 - (b) a contract of insurance that is of a class of contract specified by the Commission by notice in the Gazette.
- (2) In sub-clause (1)(a), **pure risk contract of insurance** means a contract of insurance for the payment of money on the happening of a contingency, other than a contingency dependent on the continuance of human life, that does not and never will have a value on its cancellation or surrender that is greater than the value of any unexpired premium relating to a period after the date of cancellation or surrender.
- (3) The Commission must not specify a class of contract of insurance for the purpose of sub-clause (1)(b) unless it is satisfied that, in respect of all contracts of insurance within the class:
- (a) the investment component of the contract is incidental or subsidiary to the principal purpose of the contract; and
 - (b) the contract is sufficiently non-complex that it is appropriate, in all the circumstances, for the contract to be designated as a category 2 product for the purposes of the Act.

We believe that the option to have a new product specified as Category 2 by the Commission will remove the potential risk of product innovation being stifled and will allow the Commission to specify products that may be designed to generate a return but without exposing the policy owner to investment risk.

The change in wording of ‘pure risk insurance contract’ from that in the draft regulation is necessary in order to remove:

- the ambiguity around ‘the term of the policy’
- the potential for the list of examples of contingent events to become too limiting.

Regulation 11 Meaning of Land Investment product

In sub clause (2) the reference to ‘associated persons’ should be revised to refer to the definition of ‘scheme promoter’ as there is no direct reference to associated persons in sub clause (1).

Regulation 12 Authorisation in relation to category 2 product

Regulation 12(b) provides that a financial adviser may be authorised under section 55(1)(d) of the Financial Advisers Act if they would not otherwise be ‘eligible’ to be authorised under the Act. We expect that this was intended to mean that the financial adviser could not be authorised under section 55 (1)(a), (b) or (c) of the Financial Advisers Act. However, the use of the word ‘eligible’ in Regulation 12 is confusing because section 54 of the Act sets out the requirements that any adviser

must meet in order to be 'eligible' to be authorised and section 55 states that an applicant must be 'eligible' for authorisation.

Regulation 12(b) should be amended to remove the word 'eligible' and instead specifically refer to advisers who are not being authorised under section 55(1)(a), (b) or (c) of the Act.

Please contact me directly if you would like to discuss any of our submissions.

Yours sincerely

Deborah Keating
EXECUTIVE OFFICER