

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

**SUBMISSION
TO THE
FINANCE AND EXPENDITURE
SELECT COMMITTEE
ON THE
FINANCIAL ADVISERS BILL**

4 April 2008



I.S.I

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 22 members and 18 associate members who collectively manage over \$60 billion in collective investments on behalf of 1.3 million New Zealanders. A list of ISI members is attached as an appendix to this document.
- 1.3 ISI members for the most part rely on financial advisers as the interface between the product provider and the consumer. Consequently, ISI has maintained a keen interest in the development of adviser regulation and has previously made submissions to the Task Force on the Regulation of Financial Intermediaries and to the Ministry of Economic Development's 2006 discussion document: *Financial Intermediaries*.

2.0 General Comments

- 2.1 ISI supports the intention of the Financial Advisers Bill ("the Bill") to require financial advisers to demonstrate competence and accountability and to disclose any conflicts of interest. We consider that it is in the best interests of the community as well as the financial services industry for there to be a strong, confident and competent body of advisors and for them to have the respect and confidence of the public.
- 2.2 ISI supports the key features of the co-regulatory framework proposed in the Bill, with the requirement for each financial adviser to belong to an Approved Professional Body ("APB"), to be registered and to be a member of an approved dispute resolution scheme.

- 2.3 We recognise that the Bill is drafted with a broad scope in order to cover the activities of a wide variety of advisers who provide some form of financial advice to the public. There are some instances where we consider that broad scope will not work well in practice and we have recommended amendments accordingly.
- 2.4 We also have some concerns with specific parts of the Bill and they are outlined in the Executive Summary below, and covered in more detail in the following paragraphs.

3.0 Executive Summary

ISI recommends that:

- 3.1 Clause 7 should be amended to exclude a financial product provider from paragraph (b) of the definition of financial adviser service in Clause 5.
- 3.2 Clause 7 should be amended to remove financial product providers from the entire definition of financial adviser service in Clause 5 other than to the extent they provide financial advice.
- 3.3 Clause 6 (4) (b) should be deleted.
- 3.4 Clause 6 (3) should be amended to define more explicitly the boundary between ‘information’ and ‘advice’.
- 3.5 Clause 5 (2) (b) should be amended to apply to persons whose principal business is the provision of a financial service.
- 3.6 Clause 5 (2) (c) should be amended to increase the sum specified from \$500,000 to \$10 million.
- 3.7 Clause 19 should be amended to apply equally to all financial advisers.

- 3.8 Clause 53 (p) should be amended to allow corporate membership of an APB by a financial advice provider that complies with rules to ensure the competencies of its adviser agents and adviser employees.
- 3.9 Clause 53 should also allow a financial service provider to undertake responsibility for its salaried advisers, ensuring their registration, compliance with rules and standards and membership of an approved dispute resolution scheme.
- 3.10 Clause 53 (p) (ii) should be deleted.
- 3.11 Clause 61 (1) should be amended to require the Commission to be notified only when an investigation has found an allegation of misconduct to have substance.
- 3.12 Clause 61 should be amended to provide a specific pathway for disciplinary actions from approved dispute resolution schemes and APBs to the Commission and the Court.
- 3.13 Clause 63 should be amended to allow 5 months from the end of the reporting year for audited statements to be sent to the Commission.
- 3.14 Consideration should be given to consistency in the level of penalties in this Bill and the Real Estate Agents Bill.

4.0 Discussion

Definition of Financial Adviser

- 4.1 The definition of financial adviser is very broad and needs to be tightened. The definition in Clause 7 refers to a person who performs a financial adviser service. We understand that the purpose of the Act is to regulate the financial advice component only. However, paragraph (b) of the definition of financial adviser service in Clause 5 includes (amongst other things) the receipt of money if it is connected to or the result of a financial decision. That creates some confusion as to the separate roles of financial adviser and financial product provider.
- 4.2 On the assumption that paragraph (b) of the definition of financial adviser service in Clause 5 is intended to cover financial advisers handling client money on behalf of the financial product provider, Clause 7 should be amended to exclude a financial product provider. The exclusion should also be consistent with exclusions currently in the definition of ‘investment adviser and adviser’ in the Securities Markets Amendment Act 2006. That is, it should exclude the entities described in paragraph (c) of that definition i.e. an issuer or a promoter or a trustee or a statutory supervisor. We would also recommend the specific exclusion of an administration manager and an investment manager otherwise they may be inadvertently captured by the broad definition of financial adviser service in Clause 5.

Definition of Financial Advice

- 4.3 Clause 6 (3)(b) of the definition of financial advice includes ‘information as to the financial advantage or disadvantage of a financial product or a financial decision’. This is so broad as to include typical product advertisements. It is perfectly reasonable and expected that a financial product advertisement would stress the advantages of a financial product but it is unnecessary to include this as ‘financial advice’ subject to the full requirements of the Act. The protections of the Fair

Trading Act are reasonable for general financial advertising and, where greater control is considered necessary, specific product requirements should be covered in the relevant legislation, e.g. securities or insurance without implying financial adviser obligations. The Bill needs to clearly differentiate between advice and information – at present Clauses 6(2) and 6(3)(b) are inconsistent.

- 4.4 We do not consider that advice that is general financial information given in the course of an investment seminar, or over the radio or television or via newspapers to the general public, should be considered to come within the definition of financial advice in Clause 6 (3) of the Bill. If and when the consumer progresses to receiving personalised advice they will receive full disclosure from the adviser. It should be sufficient for general advice to be accompanied by a health warning that the information is general and not necessarily suited to individual circumstances. Further, it is impractical for full disclosure by an adviser to listeners or readers when the general information is communicated over the radio, television or in the newspaper.

We recommend that Clause 6 (4) (b) is deleted.

- 4.5 The definitions of financial advice, financial adviser and financial decision are sufficiently broad that they will apply in a wide range of situations and in industries that have previously not been considered to be financial services. Clause 6 (3) (b) could apply to employees of motor vehicle traders and appliance retailers giving guidance on consumer credit options. We recommend that Clause 6 (3) should be revised to ensure there can be no uncertainty over the boundary between advice and information.

Member of the Public

- 4.6 Clause 5 (2) (b) excludes from the definition of ‘member of the public’ a person ‘whose principal business is the investment of money’. That phrase has been adopted from the definition in section 3 (2) (a) of the Securities Act 1978 and

needs to be amended to reflect the wider scope of this Bill. We recommend that it be amended to read:

‘a person whose principal business is the provision of a financial service or who, in the course of and for the purposes of business, habitually undertakes any of (a) to (n) of section 5 of the Financial Service Providers (Registration and Disputes Resolution) Act’.

- 4.7 We also recommend amendment of Clause 5 (2) (c) to increase the sum of money from \$500,000 to \$10 million. We consider that the sum of \$500,000 is too low; taking into account that structuring advice to include the value of a home or farm would push most people over the limit and exclude them from the protection of the Bill.

We query the use of the term ‘security’ in Clause 6(5)(e) as the usage here does not appear to be consistent with the definition of ‘security’ in Clause 5.

Indemnity Insurance

- 4.8 We see no justification for Clause 19 to require disclosure of whether or not the adviser has professional indemnity insurance only when the adviser gives advice in respect of securities. We recommend that the same disclosure requirement should apply to all financial advisers.

Financial Adviser Conduct Obligations

- 4.9 Clauses 30 to 35 cover the actions of investment brokers (as the term is used in the Securities Markets Act) which are included under the definition of financial adviser in this Bill. Unless financial product providers are exempted from paragraph (b) of the definition of financial adviser service in Clause 5, as we have recommended, they will also be subject to those requirements.
- 4.10 We recommend that application of Clauses 30 to 35 should be consistent with our proposed amendments to the definition of financial adviser service (see

paragraphs 3.1 and 3.2). That would accord with the Securities Markets Amendment Act 2006 exemption of ‘*an issuer or a trustee (within the meaning of the Securities Act 1978 or the Unit Trusts Act 1960)*’ from the definition of investment broker.

Approved Professional Bodies

- 4.11 The required content of rules for APBs set out in Clause 53 needs clarification. Sub-clause 53(p) allows for corporate membership of an APB with the corporate member taking responsibility for its ‘officers and employees’. That wording appears to exclude the many financial advice providers that do not have employee advisers from the opportunity to become a corporate member of an APB.
- 4.12 We recommend that a financial advice provider should be able to join an APB as a corporate member and comply with the rules ensuring the competence and activities of those advisers through which it provides financial adviser services to the public (in the terms of Clause 11).
- 4.13 We also recommend that a financial service provider should be able to undertake responsibility for its salaried advisers, ensuring their registration, compliance with rules and standards and membership of an approved dispute resolution scheme.
- 4.14 We recommend that Clause 53 (p) (ii) should be deleted. The level of financial solvency of an adviser, whether individual or corporate, is not an area of risk for a consumer and such rules should not be a requirement for an APB. The current wording of the clause would require corporate members that are banks to comply with APB rules for their financial solvency. That is neither necessary nor appropriate. Financial advice by itself is not a capital-intensive activity – there appears to be confusion between capital adequacy needs for the financial product provider (e.g. insurance or banking) and the solvency of financial advice intermediaries.

Notifying Commission of Investigations

- 4.15 Clause 61 (1) requires an APB to advise the Commission of ‘the commencement of any investigation by the approved professional body of an allegation of misconduct against a member’. There is no definition of ‘misconduct’ and the requirement does not allow for the likelihood of a number of inconsequential allegations that will nevertheless have to be investigated by the APB before they are dismissed. We recommend that Clause 61 (1) be amended to require the Commission to be notified only when an investigation by the APB has found an allegation of misconduct to have substance.

Annual Reports to the Commission

- 4.16 We recommend that Clause 63 be amended to allow 5 months from the end of the reporting year for an annual report including audited financial statements to be sent to the Commission. That timing is consistent with the Financial Reporting Act.

Enforcement and Remedies

- 4.17 The provisions for enforcement and remedies have been carried over from the Securities Markets Amendment Act with very little change, despite the fact that the Securities Markets Amendment Act applies to an environment without approved dispute resolution schemes and APBs. That has created some confusion in the Bill as to the enforcement and remedies boundaries of the various bodies. For instance, Clause 67 allows the Commission to make a prohibition order or a corrective order if it is satisfied that a person has contravened a financial advisers’ obligation or exemption. That is essentially the same as section 42 of the Securities Markets Amendment Act. It is not clear whether the Commission would act independently or on the recommendation of an APB or an approved dispute resolution scheme, following an investigation.

- 4.18 In the ISI submissions to the Review of Financial Products and Providers we recommended that the primary recourse for consumers should be to an independent Financial Services Ombudsman. In cases of persistent or extreme misconduct by an adviser the Financial Services Ombudsman could apply to the Commission for stronger action such as a temporary banning order or action through the Court.
- 4.19 Our recommendations to the RFPP also envisaged the APBs having a role in investigating complaints of misconduct or non-compliance with the rules of the APB. It is not clear in the Bill how the disciplinary processes of the APB are intended to link in with the Commission and whether an APB would be able to expel a member (or refuse to accept an applicant) without reference to the Commission and/or a decision in the Courts.
- 4.20 We recommend an amendment to Clause 61 of the Bill to provide a specific pathway for disciplinary actions from the approved dispute resolution schemes and APBs to the Commission and the Courts. That pathway should be consistent for all approved dispute resolution schemes and APBs.

Offences

- 4.21 We note that the maximum amount of the penalties that may be applied against a financial adviser under Clause 88 (\$1,000,000) and Subpart 4 (\$100,000 for an individual and \$300,000 for a body corporate) of the Bill are substantially greater than those proposed for real estate agents under Clauses 90 (\$10,000 for an individual or \$20,000 for a company) and 107 (\$15,000 for an individual or \$30,000 for a company) of the Real Estate Agents Bill currently before the House.

Regulations

- 4.22 Clause 130 allows the Governor-General, on the recommendation of the Minister, to make regulations prescribing the detail of existing requirements and extending

those requirements. While we recognise the benefit of having a facility for matters of detail to be dealt with by regulation, we are concerned that there is no requirement for public consultation on regulations and therefore no opportunity for submissions to be made. As a consequence, significant responsibilities can be imposed on the financial services industry without the opportunity to comment on the impact.

- 4.23 We also note that it is difficult to comment on the adequacy of the implementation timeframes in this Bill when we have yet to see the detail that will be in the regulations. We recommend that regulations should be drafted as a matter of urgency so that they may be considered in conjunction with the Bill. At the very least, a commitment should be made to include consultation with affected parties as part of the development of any regulations under this Bill.

ISI MEMBERS

AIG Life
AMP Financial Services
Asteron Life Ltd
AXA New Zealand
BNZ Life Insurance Ltd
BT Funds Management Ltd
CIGNA Life Insurance NZ Ltd
Dorchester Life Ltd
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
Swiss Re Life & Health Australia Ltd
TOWER New Zealand

Associate Members

Bell Gully Buddle Weir
Bravura Solutions
Burrowes & Co
Chapman Tripp Sheffield Young
Davies Financial & Actuarial Ltd
Deloitte Touche Tohmatsu
Ernst & Young
InvestmentLink (New Zealand) Ltd
Kensington Swan
KPMG
Melville Jessup Weaver
Mercer Human Resource Consulting Ltd
Morningstar Research Ltd
Phillips Fox
PricewaterhouseCoopers
Russell Investment Group Ltd
Russell McVeagh
Simpson Grierson