

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

SUBMISSION

TO

FINANCE AND EXPENDITURE SELECT  
COMMITTEE

ON THE

SECOND INTERIM REPORT ON THE  
FINANCIAL ADVISERS BILL

**22 August 2008**



**I·S·I**

# **Financial Advisers Bill: Consultation on Policy Proposals**

## **1.0 Introduction**

The Investment Savings and Insurance Association ("ISI") is the industry association representing the companies which issue or manage life insurance, superannuation and managed funds.

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 given at the end of this document.

ISI members for the most part rely on financial advisers as the interface between the product provider and the consumer and will therefore be directly affected by the regulation of financial advisers.

ISI has provided a number of submissions during the development of the legislation. We broadly supported the key features of the Financial Advisers Bill and the amended approach proposed in the first interim report of the Committee, while recommending a number of changes that we considered would make the proposed regulatory regime more effective.

## **2.0 General Comment**

While ISI appreciates the opportunity to comment on the proposals in the Committee's second interim report, we are very disappointed with the process followed in amending the Financial Advisers Bill. After providing a submission on the Bill in April, we are once again given proposals to amend the Bill, written in very general terms.

Our comments on the second interim report are based on our interpretation of the Committee's intentions and we note the difficulty of making definitive comments without the opportunity to review actual wording of the new provisions in draft legislation.

We have asked for the opportunity to review revised legislation and it is still our wish that we will be able to do so.

### 3.0 Summary of Submissions

#### 3.1 Application of the Bill

- We agree that the application of the Bill needs to be narrowed.
- We consider that a clear distinction should be made between advice and information and have previously made that recommendation.
- We have reservations about defining financial advice with reference to “financial products” and would prefer the focus to be on the advice process.
- Although the advice may be for a ‘simple’ product, the advice process followed to reach that recommendation may have been complex.
- We have attached a revised definition of financial advice.

#### 3.2 The Tiered Approach

- The tiered approach to regulation could work, if the tiers are carefully distinguished in regulations by reference to different classes of financial product, but more information is needed to understand the detail of what is proposed.
- The proposal as written does not make it clear to what extent lesser standards would apply to the advice process for a ‘simple’ product. Our preference is that anyone who gives financial advice should be required to demonstrate a minimum standard of competence.
- It is not clear which products would be classed as ‘simple’ products and we recommend that pure risk life policies should be explicitly specified in that category.

#### 3.3 Certified Finance Institutions

- We support the proposal for certified finance institutions, if we understand correctly that any financial service provider could apply for approval as a certified finance institution if it was prepared to:
  - Take responsibility for the competence and performance of employees and agents and accept liability for the advice given;
  - Undertake membership of an approved dispute resolution scheme on behalf of all its employees and agents;
  - Ensure that those of its employees and agents who advise on Category One products are individually registered with the Registrar of Financial Advisers and Service Providers, comply with standards of competence set by the Minister and have adequate professional indemnity insurance;
  - Demonstrate financial and organisational capacity.

#### 3.4 Central Supervision

- We support the proposal to appoint a Commissioner of Financial Advisers on condition that there is a formal provision for representation of the financial services industry on the Rule-Making Committee and the Disciplinary Committee.
- We consider that regulation of financial advice is an area where industry input will be essential for the objectives of the legislation to be achieved.

## 4.0 Key Matters under Consideration

### 4.1 Application of the Bill

We agree that the definition of financial advice in the Bill is too broad and that the main difficulty arises from the need to distinguish between advice and information. Clarification of that boundary would remove many of the concerns about the wide spectrum of people that might otherwise be caught by the legislation.

We would prefer the focus of the legislation to be on the process of giving advice rather than on any specific product. However, we agree that it is necessary to put some boundaries around “advice” and that can be done by linking it to classes of product. We attach as Appendix One a revised definition of financial advice, based on our previous submissions.

Boundary problems always arise when legislation is written to include some things (people, products, activities) and exclude others. Regulations will need to clarify which products are covered by the legislation and which category (simple or complex) they belong to.

### 4.2 The Tiered Approach

The proposal appears to be based on the view that, if financial advice is defined with reference to financial products, it would be relatively easy to divide those products into ‘simple’ and ‘complex’ and specify more stringent requirements for advisers giving advice on ‘complex’ products.

As we have noted in previous submissions, consumers would benefit most from the legislation focusing on the advice process rather than the product recommendation at the end of the process. A very complex advice process, taking into account all aspects of the client’s financial situation, could result in a recommendation for a simple product. In that situation, the adviser needs to have the appropriate competence and business standards to work through a complex advice process.

There are some products that may be regarded as relatively simple in one set of circumstances but may be considered complex in another situation. It is not clear to which category risk-only life insurance products would belong and their application may be ‘simple’ in some contexts and ‘complex’ in another. Similarly, a mortgage may be classed as a ‘simple’ product but complex advice may be given regarding its use as part of gearing for a major investment.

The interim report refers to ‘authorised financial advisers’ giving advice on ‘complex securities or investment and savings planning’. Our preference is that anyone who gives financial advice should be required to demonstrate a minimum standard of competence. If compliance requirements are to be significantly more stringent for those advising on ‘complex’ products, it will need to be absolutely clear to which category each product belongs and, as noted above, regulations will need to be carefully drafted to deal with boundary issues. In the event that the Committee

decides to proceed on this basis, we recommend the pure risk life insurance policies should be included in the category of 'simple' products.

The legislation also needs to cover the situation where the client receives the advice and the product from different people. For example, a client may be advised by one person (eg an accountant or a financial planner) to choose direct investment in shares rather than managed funds and may then arrange the share purchase from a share broker. In that case, the accountant or financial planner needs to be competent to give that advice and the client needs to have recourse to that person if the advice is not appropriate.

Our recommendation would be for the legislation to establish a framework and for the detail to be covered in regulations, drafted with industry input. Having said that, it is essential that the regulations are drafted early in order that the industry has adequate time to prepare for implementation.

We are anxious to avoid a repeat of the situation surrounding the implementation of the Securities Markets (Investment Advisers and Brokers) Amendment Regulations 2007. Those regulations were signed by the Governor-General on 3 December 2007, with an amendment signed on 25 February 2008, for implementation from 29 February 2008.

### 4.3 Certified Finance Institutions

ISI supports the proposal for Certified Finance Institutions, if we are correctly interpreting the Committee's intention that the Certified Finance Institution would be an expanded version of the Accredited Institutions proposed in the first interim report.

ISI supported the accreditation option for institutions in the first interim report but recommended that it should be expanded to include all financial service providers prepared to take responsibility for the actions of the advisers they use to deliver their services. ISI also recommended that it should apply to products offered or sold by financial service providers.

We would support a financial service provider being eligible to become a Certified Finance Institution if the financial service provider takes responsibility for the actions of its advisers, whether they are employees, agents or independent contractors. We would **not** support limiting the responsibility of Certified Finance Institutions to employees and agents giving advice on 'simple' products.

Also, it should make no difference whether an adviser advises on products 'offered by' a provider or 'sold by' the provider (for example, a bank teller selling house insurance, underwritten by a third party, in addition to a loan/mortgage product).

We recommend that the proposal should allow any registered financial service provider to apply for Certified Finance Institution status where it can demonstrate that it complies with set criteria.

We expect that the criteria would be similar to those we recommended for the accredited institutions, ie that the Certified Finance Institution would be required to:

- Take responsibility for the competence and performance of employees and agents and accept liability for the advice given;
- Undertake membership of an approved dispute resolution scheme on behalf of all its employees and agents;
- Ensure that those of its employees and agents who advise on ‘complex’ products are individually registered with the Registrar of Financial Advisers and Service Providers, comply with standards of competence set by the Minister and have adequate professional indemnity insurance;
- Demonstrate financial and organisational capacity.

We expect that an adviser who was not aligned to a Certified Finance Institution would be required to have individual membership of an approved dispute resolution scheme. Clients would be able to make a complaint against the adviser and seek recourse from the adviser’s professional indemnity insurance but would not have the benefit of a Certified Finance Institution standing behind the adviser and accepting liability for the advice that had been given.

Where an adviser has breached standards in a significant and/or persistent way, the Disciplinary Committee of the central regulator would recommend appropriate action which may extend to cancellation of registration, whether the adviser is independent or aligned to a Certified Finance Institution.

#### **4.4 Central Supervision**

ISI gave conditional support to the previous proposal to replace the Approved Professional Bodies with central regulation by the Securities Commission. The condition of our support was that the Securities Commission should not have sole responsibility for establishing rules, monitoring and enforcing compliance. We recommended that an independent statutory body, with industry representation, should be established to develop rules and standards.

We support the proposal to establish a Commissioner of Financial Advisers and to separate the rule-making function from the investigation and enforcement of breaches. While we would still prefer an independent statutory body, we welcome the proposal to establish a Rule-Making Committee and a Disciplinary Committee as long as the inclusion of industry representation is set by regulation.

In order to ensure independence, we recommend that the Commissioner of Financial Advisers should report directly to the Minister of Commerce, with only administrative responsibility to the Securities Commission.

It is not entirely clear what would be the respective roles of the Disciplinary Committee under this Bill and the Approved Disputes Resolution Schemes under the Financial Service Providers (Registration and Dispute Resolution) Bill. In our submission on the first interim report we requested clarification of the process that is envisaged for consumer complaints to the approved dispute resolution schemes, the Securities Commission and the Court. That process has not yet been clarified.

## 5.0 Conclusion

As noted earlier, ISI is concerned that the two interim reports from the Committee have proposed significant changes to the Financial Advisers Bill tabled in the House, without providing redrafted legislation. Without seeing a redrafted Bill we are unsure which provisions of the original Bill are to be retained and which replaced.

We recognise that considerable time has passed in the development of legislation for the regulation of financial advisers and ISI has shared the Minister's wish to see the legislation enacted as soon as possible. However, we emphasize to the Committee that our comments on the second interim report are provided on the basis of our understanding of the Committee's intentions.

Our preference would be to see redrafted legislation before the Bill is reported back to the House but we recognise that there may be insufficient time left in the current Parliamentary term for that to happen. Consequently, in the drafting of regulations, it is essential that:

- the redrafted Bill includes a requirement for officials to consult with the industry
- consultation on regulations commences before the legislation has been enacted, in order to allow the industry adequate time to make necessary changes.

The second interim report does not make any reference to the expected implementation date of the legislation. We reiterate our recommendation from our submission on the first interim report, that advisers should be given interim registration from the commencement date of the legislation, with 2 years to become fully compliant with the competency standards before final registration.

## **ISI MEMBERS**

AIG Life  
AMP Financial Services  
Asteron Life Ltd  
AXA New Zealand  
BNZ Life Insurance 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  
Westpac/ BT Funds Management Ltd

## **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  
Morningstar Research Ltd  
Phillips Fox  
PricewaterhouseCoopers  
Russell Investment Group Ltd  
Russell McVeagh  
Simpson Grierson

## Appendix One

### Proposed Definition of Financial Advice

#### Definition from the Financial Advisers Bill with suggested changes

- 6. Meaning of advice, financial advice and financial decision**
- (1) **Advice** means a recommendation or guidance that is given in the course of business...
- (2) For the avoidance of doubt, the provision of information, whether orally or in writing, is not advice unless it is accompanied by a recommendation or guidance.
- (3) **Financial advice-**
- (a) means any advice relating to the financial implications of a financial decision; and
  - (b) includes a recommendation or guidance as to the financial advantage or disadvantage of a financial product or a financial decision; but
  - (c) does not include factual or descriptive information about the features or benefits of a financial product or the procedure for taking or implementing a financial decision; and
  - (d) does not include any of the following:
    - (i) a prospectus; or
    - (ii) an investment statement; or
    - (iii) an authorised advertisement or an advertisement; or
    - (iv) a bank disclosure statement; or
    - (v) a document or documents issued in lieu of a prospectus or investment statement in accordance with an exemption under the Securities Act 1978; or
    - (vi) a disclosure statement that is required under the Credit Contracts and Consumer Finance Act 2003; and
  - (e) does not include collecting financial information from a member of the public.
- (4) Whether advice is financial advice or not is not affected by how the advice is given or communicated.
- (5) **Financial decision** includes any decision made or contemplated by a person in relation to financial products used for:
- (a) saving money:
  - (b) investing, holding, or realising money or property:
  - (c) borrowing money:
  - (d) incurring a debt:
  - (e) giving a security, including a guarantee or indemnity:
  - (f) taking out insurance:
  - (g) making financial provision for the future.

### Proposed Definition of Financial Advice

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