

Financial Advisers Bill and Financial Service Providers (Registration & Dispute Resolution) Bill: Supplementary Order Papers

Purpose

To seek your agreement to outstanding policy for inclusion in the Supplementary Order Papers, on the Financial Advisers Bill, and the Financial Service Providers (Registration and Dispute Resolution) Bill.

Date:	19 September 2008	Priority:	High
Security Level:	In Confidence	File Number:	P/017/PR015/003/001 & P/017/PR021/019/001

Action Sought

	Action Sought	Deadline
Minister of Commerce	Agree to the Recommendations	22 September 2008

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19 September 2008

Minister of Commerce

Financial Advisers Bill and Financial Service Providers (Registration & Dispute Resolution) Bill: Supplementary Order Papers

Purpose of Report

- 1 To seek your agreement to outstanding policy for inclusion in the Supplementary Order Papers ("SOP"), on the Financial Advisers Bill, and the Financial Service Providers (Registration and Dispute Resolution) Bill.

Analysis

Financial Advisers Bill (FAB)

- 2 Notwithstanding the recommended changes provided for the in the proposed SOP, note that officials will report back to you in the near future with a draft terms of reference for the establishment of working group to consider residual policy matters that have not adequately addressed in the legislation to date.
- 3 The proposed SOP amends a number of provisions in the FAB. In most part these decisions are of a minor and technical nature and are needed to give full effect to existing policy decisions (see EDC Min (08)13/6 for existing policy decisions).
- 4 The draft SOP is attached to this report for your information.
- 5 There are a number of amendments proposed that officials do not consider to be minor or technical in nature. This report seeks your agreement to proposals to resolve these issues. They include:
 - a Extending the current exemptions from the Bill to include additional classes of people;
 - b Extending the Qualifying Financial Entity (QFE) status to cover employees providing advice on products issued by a QFE;

- c Clarifying that employees of registered employers do not have to be a member of an approved dispute resolution scheme;
- d The creation of an offence for holding oneself out as a Sharebroker unless that person is a member of a registered exchange;
- e Enabling the Securities Commission to provide directions to financial advisers to comply with the law; and
- f Ensuring the territorial scope captures services provided in New Zealand, regardless of whether the provider is in New Zealand or offshore.

Exemptions

- 6 On consultation with several stakeholders, officials have been made aware that the Bill still includes a number of groups of people who ought to be excluded. These include:
- a Registered Valuers, who are registered under the Valuers Act 1948. Registered Valuers generally provide a valuation in respect of land. A valuation is a subjective process and thus likely to include an opinion, recommendation or guidance, in respect of the value of a piece of land. In the absence of an express exemption, such valuers may be subject to the requirements of the FAB, including the requirement that they be authorised by the Securities Commission. Under the Valuers Act, they are already required to satisfy a number of requirements before they are eligible for registration, including in relation to competency and good character requirements. Officials recommend that all registered valuers be exempt from the FAB if the financial advice is a necessary incident of professional services that they provide as a registered valuer.
 - b Employers who provide guidance (in respect of the purchase or disposal of a financial product) to employees on implementing a decision to purchase a financial product offered through the work place. A number of employers currently provide employees with a number of benefits through the work place in addition to their base remuneration. These include benefits such as private health care, group life insurance, membership in registered superannuation schemes and in some instances, with share options within the firm. There is a risk that this might in some instances be considered to be “guidance” within the definition of financial advice and so fall within the scope of the Bill. Officials recommend that employers providing guidance to their employees about the process of implementing any such benefit should not be subject to the FAB, as long as the employer does not provide advice on the merits of any product offered by the employer.
 - c Insurance Brokers who continue to service existing life insurance policies. The Bill currently provides that any person advising on a life insurance policy (which is defined by the Securities Act as a security) must be authorised by the Securities Commission. Life insurance policies with an investment element have become a small part of the insurance market. It

is apparent that many insurance advisers will choose to discontinue selling these products as they are a category 1 product and simply sell other insurance products, as they are a category 2 product, once the financial advisers regime is in place. However, advisers with existing clients holding existing policies (that are a category 1 type product) wish to be able to continue to service these existing policies without becoming authorised. Officials consider that allowing advisers to service existing policies without requiring authorisation poses little risk to these clients. As such, officials recommend that the Bill classify all life insurance policies issued before 31 December 2008 as a category 2 product. This will allow such advisers to continue servicing their existing policies, without creating scope for advice on new policies to avoid the authorisation requirements.

- 7 The SOP also provides for a number of further technical exemptions. They include exemptions for issuers receiving subscriptions from investors in their roles as issuers, including an exemption for employees of such issuers who receive funds on behalf of their employer. Further, [REFERENCE REMOVED] have raised concerns about the exemption for budget advisers, suggesting that the term budget advice, excluded a range of advice [REFERENCE REMOVED] provide in respect of credit products. As such, the SOP also clarifies extends the exemption for not for profit organisations providing free financial advisory services to any advice tendered on a category 2 product or a financial planning service.

QFE Employees and QFE Products

- 8 In the discussion in the Cabinet paper (EDC (08)115) it was suggested that QFE status would enable employees and agents to be exempt from authorisation if those employees and agents were providing advice on category 1 products offered by the QFE. In subsequent discussions, two concerns came to light that resulted in the exclusion of such a provision from the Bill.
- 9 The first of these concerns was that such a provision would have created scope for independent agents to be covered by multiple QFEs and effectively avoid regulatory coverage. Secondly, a number of stakeholders suggested that this approach may have resulted in some uncertainty about the treatment of advice in respect of products that were offered, but not issued by a QFE. In such cases, this would have created significant inequality issues between advisers that were not part of a QFE and those that were. It would have also created uncertainty about the liability for the products that were offered by a QFE but issued by different institutions.
- 10 On further consideration, officials consider that an exemption may still be provided, albeit in a more limited form. Officials recommend that employees of a QFE who provide advice on category 1 products issued by a QFE be exempt from personal liability. This option will not be open to agents of QFE's and will be limited to those products that are issued by QFEs, which will address the concerns that had been raised.

Employees and dispute resolution requirements

- 11 At present the FAB requires all financial advisers (who are not a member of a QFE) and the employers of financial advisers, to be registered under the Financial Service Providers (Registration and Dispute Resolution) Bill (FSP). In order to be registered the adviser and employer, respectively, is required to be part of a dispute resolution scheme, under the FSP.
- 12 Officials recognise that requiring the adviser as an individual to be part of dispute resolution is unnecessary, as the advisers employer will also be a member of dispute resolution and will be a more suitable vector for redress for a consumer.
- 13 Officials recommend that an employee not be required to be part of dispute resolution, under the FSP, when their employer is registered, and a member of dispute resolution. This will ensure that all clients of financial adviser have access to dispute resolution, without placing unnecessary compliance costs on organisations.

Restriction on holding out as a “sharebroker”

- 14 The FAB repeals the Sharebrokers Act 1908. The Sharebrokers Act requires any person, firm, or company who, for remuneration, sells or purchases shares for or on behalf of or as agent for any other person to be licensed as a sharebroker (unless exempted). A license is obtained on application to the District Court. If the District Court Judge is satisfied that the applicant is fit to hold a license, then upon payment of a fee the license is granted. The license is then renewable annually.
- 15 The FAB repeals the Act as those who currently perform the functions of sharebrokers will be required to be authorised as a financial adviser.
- 16 As the Act is being repealed there will no longer be any restrictions on the use of the term sharebroker. Officials recommend that use of the term sharebroker be restricted to those who are a member of a registered exchange. There are two main reasons for this restriction:
 - i strong public perception surrounding the term sharebroker, the role of a sharebroker, and their competency; and
 - ii the new financial advisers regime is likely to require a high level of competency to perform the current functions of a sharebroker.

Securities Commission’s ability to direct financial advisers

- 17 The FAB presently provides for the Securities Commission to direct authorised financial advisers and QFE’s, if the Securities Commission believes that they are in breach of the conditions of their relevant authorisation. It is an offence for an authorised financial adviser or QFE to not comply with a direction.
- 18 Officials recommend that the ability for the Securities Commission to provide a direction under the FAB be extended to include the ability for the Commission to direct any financial adviser that it believes to be in breach of their conduct or disclosure obligations.

- 19 Officials believe it is necessary to extend the Commissions ability to direct to all financial advisers, as this allows for the Commission to more easily encourage compliance with the Bill. Without this ability the Commission would only have the ability to threaten prosecution, in order to ensure compliance.

Territorial Scope

- 20 The territorial scope of the FAB as it was reported back from the Select Committee states that “This Act applies to a financial adviser service performed in New Zealand by a person in New Zealand, regardless of where that person is a resident, is incorporated, or carries on business.”
- 21 It has been raised by a number of people including the Securities Commission that this will not capture advice being offered into New Zealand from offshore. Officials believe this was an unintended consequence of changes and could present a risk to the New Zealand market. The Committee made changes to clarify that it is not the intention of the legislation to apply offshore. [REFERENCE REMOVED].
- 22 Officials have sought to further clarify this by recommending that it be clear that advice being offered into New Zealand from offshore is intended to be captured by the Bill, by removing the words “by a person in New Zealand” from the Territorial Scope provision.

Financial Service Providers (Registration and Dispute Resolution) Bill (FSP)

- 23 The proposed SOP amends a number of provisions in the FSP. In most part these decisions are of a minor and technical nature and are needed to give full effect to existing policy decisions (see EDC Min (07) 11/17 and CAB Min (07) 21/4 for existing policy decisions).
- 24 The draft SOP has been sent directly to the Ministers Office from PCO for your information.
- 25 The main technical changes are:
- a Clarifying the definition of insurance
 - b Clarifying Schedule 2 and the definitions of licensing authority, licensed provider, and licensed service.
- 26 In addition there are three amendments proposed that officials do not consider to be minor or technical in nature. This report seeks your agreement to proposals to resolve these issues. They are:
- a Clarifying the conditions of granting Responsible Entity Status;
 - b Clarification of the concept of "public" (in the requirement for a financial service provider to join a dispute resolution service or the reserve if they provide financial services to the public); and

- c Changes to the consultation requirements where the Minister appoints a dispute resolution service to fulfil the functions of the reserve scheme.

Responsible Entity Status

- 27 Clause 20B was inserted during the Select Committee process to account for the unique structure of organisations such as Lloyds of London and KiwiBank. The concern was that organisations such as these would face unnecessary compliance costs as all their members or franchises would need to be individually registered, despite the fact the overarching entity had sufficient controls over them to ensure that they were meeting the standards of the organisation.
- 28 The departmental report to the Select Committee recommended that the following exemption making process be included in the Bill:
- a The Minister may, by regulations, declare that any provider of financial services may, on behalf of any affiliated financial service provider, apply for the registration of all its affiliated financial service providers; and
 - b The regulations can prescribe conditions of registration (including requirements relating to the entity and the persons that must satisfy any disqualification requirements).
- 29 As a further check on this exemption making power, officials recommend that such regulations may not be promulgated unless the Minister is satisfied that the applicant is ultimately responsible for the provision for any financial service by any of the affiliated financial service providers and that the declaration is in the public interest.
- 30 It has been brought to the attention of Officials by Lloyds that this approach would be inconsistent with the legal and regulatory structure of the Lloyd's market, and would not properly recognise the entities which are responsible for the financial services provided, namely the Lloyds member not the Council of Lloyds.
- 31 Officials agree that this further requirement for responsibility for the overarching entity is inappropriate. Officials believe that it is more appropriate to deal with the specific requirements for each of the applicants for responsible entity status in the conditions of the grant of their status. Officials recommend removing the obligation for the requirement for the entity to undertake responsibility for the financial services provided by any affiliated entities.
- 32 Further as a more technical concern, Officials recommend replacing the requirement for granting the entity its responsible status to be in the public interest, with the requirement that granting the status be consistent with the purposes of the Act.

Providing to the Public

- 33 Clause 44 currently requires all financial service providers who provide a financial service to the public to be members of an approved dispute resolution scheme or the reserve scheme. The [REFERENCE REMOVED] has raised concerns that this requirement will cover all business lending. Officials and PCO are also concerned that the clause is not sufficiently clear and the definition could be viewed as too wide. This is because finance service providers are unable to determine if they are not obligated to belong to a dispute resolution scheme because they can not determine who is considered to be private given the current wording in the definition. For example, it would likely to require family trusts to have to belong as they would be viewed to be transacting with a member of the public under this definition rather than just a family member because there is not clear who is intended to be a non- public individual.
- 34 To resolve this the SOP provides two solutions. First, Officials and PCO recommend that the SOP clarifies the definition of "public" by using the approach used in the Securities Act and reworking it to fit the purpose of Clause 44. This definition also provides for regulation making powers to exempt classes of people if that meets prescribed criteria, it also uses the definition of relatives under the Human Rights Act 1993 to enable a recognition of wider affiliations, for example as recognised in Maori culture. Secondly for the avoidance of doubt clause 6 exempts family trusts and a definition of "family trust" is added to the interpretation section.

Consultation Requirements

- 35 The Minister of Consumer Affairs must consult with the Ministers of Commerce and Finance, and persons likely to be substantially affected, when recommending an Order in Council to:
- a appoint a dispute resolution scheme to fulfil the functions of the reserve scheme; and
 - b prescribe rules about the functions of the reserve scheme.
- 36 Officials recommend that the SOP change the consultation requirements in regards to the first scenario. When appointing the reserve scheme, the Minister of Consumer Affairs will only be required to consult with the Ministers of Commerce and Finance.

Single Point of Entry

- 37 Officials note that [REFERENCE REMOVED] in their letter to you have requested that a single point of contact for consumer complaints be legislated for. A single entry point of entry for consumer complaints was discussed during Select Committee deliberations. Increased information sharing between the Registrar and other regulators (i.e. the Securities Commission) were introduced to take account of this concern. Officials have also committed to the establishment of an 0800 number, funded through registration fees, that

consumers can use to access the reserve scheme and any approved dispute resolution schemes. As such no further amendments to the FSP have been recommended.

Recommended Action

We recommend you:

Financial Advisers Bill

- 38 **Agree** that all registered valuers be exempt from the Bill if the financial advice is a necessary incident of professional services that they provide as a registered valuer.
- agree/disagree
- 39 **Agree** that an employer providing assistance to an employee with the implementation of a decision to acquire or dispose of a financial product made available through the employee's workplace, unless the assistance includes or is accompanied by a recommendation or opinion as to the suitability of the financial product, is not subject to the FAB.
- agree/disagree
- 40 **Agree** that all life insurance policies issued before 31 December 2008 be classified as a category 2 product
- agree/disagree
- 41 **Agree** that the employees of a QFE that provide advice on category 1 products issued by a QFE be exempt from personal liability.
- agree/disagree
- 42 **Agree** that an employee, who is a financial adviser, not be required to be part of dispute resolution, when their employer is a member.
- agree/disagree
- 43 **Agree** that use of the term sharebroker be restricted to those who are a member of a registered exchange.
- agree/disagree
- 44 **Agree** that the ability for the Securities Commission to provide a direction be extended to include the ability for the Commission to direct any financial adviser that it believes to be in breach of their conduct or disclosure obligations.
- agree/disagree

- 45 **Note** that officials will report back to you with a draft terms of reference for the establishment of working group to consider residual policy matters that have not adequately addressed in the legislation to date.

Financial Service Providers (Registration and Dispute Resolution) Bill

- 46 **Agree** to remove the requirement for the entity to undertake responsibility for the financial services provided by any affiliated entities.

agree/disagree

- 47 **Agree** to that the definition of "public" be narrowed in a manner similar to the Securities Act, but which enables it to be used for the purposes of Clause 44.

agree/disagree

- 48 **Note** that this definition provides for regulation making powers to exempt classes of people if that meets prescribed criteria, and uses the definition of relatives under the Human Rights Act 1993 to enable a recognition of wider affiliations, for example as recognised in Maori culture.

- 49 **Agree** that for the avoidance of doubt clause 6 exempts family trusts and a definition of "family trust" is added to the interpretation section.

agree/disagree

- 50 **Agree** that when appointing the reserve scheme, the Minister of Consumer Affairs will only be required to consult with the Ministers of Commerce and Finance

agree/disagree

- 51 **Note** that while no provision in the legislation is needed for a single point of entry for consumer complaints, the regime will be designed to operate with a single point of entry.

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