



**IFA Submission on Ministry of Economic Development Discussion Document  
on  
Financial Service Providers (Registration and Dispute Resolution) Act 2008  
and Financial Advisers Act 2008:  
Fees Regulations**

**Key points**

1. Key points in this submission are:
  - IFA considers the fees proposal is unfair in terms of the way costs have been allocated to individual financial advisers.
  - The cost of development of the assessment system for AFA competency has been allocated to the expected 5,000 AFAs when QFEs should share a portion of the costs since they will benefit from the assessment system for their advisers of category 1 products. This would spread the cost over 10-15,000 advisers rather than 5,000.
  - Many other costs are shared on a per entity basis (e.g. registration and dispute resolution) which imposes a disproportionate cost on individual advisers. IFA considers in many cases the cost should be based upon the number of advisers rather than legal entities.
  - Overall, IFA considers that while the Fees Regulations are only one aspect of the regulatory changes, there is an overall pattern to the detailed proposals for implementation of regulation that we consider is systematically biasing regulation and will potentially reduce the availability of independent financial advice to the detriment of consumers.
  - IFA considers that the result will be a move back to the major product providers having tied agency forces. Advisers who are tied agents will almost exclusively offer advice only in relation to products issued by the QFE. However, the consumer may not be aware that the advice and range of solutions they are offered are constrained and that they may not have been given the choice of competing products that have either features better matched to their needs or that are lower cost.

**Introduction**

2. The Institute of Financial Advisers (IFA) welcomes the opportunity to formally comment on this discussion document. In making comments, we have been mindful of the likely overall impact of regulation of financial advisers, especially the potential impact on consumers of financial advice. While the Fees Regulations are only one aspect of the regulatory changes, there is an overall pattern to the detailed proposals for implementation of regulation that we consider is systematically biasing regulation and will potentially reduce the availability of independent financial advice to the detriment of consumers.

3. The fees regulations add to this by loading costs onto those who wish to be Authorised Financial Advisers (AFA) with minimal initial costs for Qualifying Financial Entities (QFEs) and

other financial institutions that are required to be registered. The proposal is that costs are shared equally between those that will be required to be “registered” without consideration of the disproportionate impact on small entities (stand-alone financial advisers who operate within SMEs) relative to very large financial institutions with thousands of staff who pay the same fee. IFA considers this is unfair and that many costs should be allocated based upon the number of advisers in each entity.

4. As explained later in this submission, IFA considers that QFEs should share more of the costs, as they will benefit from the development of the assessment systems for competency and we consider the cost should be shared based upon the number of advisers involved with category 1 products, rather than the number of entities.

5. There seems to be a systematic policy to favour having advisers working within the QFE regime, since the costs for stand-alone AFAs are more onerous than for advisers working within a QFE. In addition, the QFE regime favours QFEs that are product issuers with advisers who are either staff or nominated agents of the QFE, since these advisers do not need to be individually authorised or registered so avoid some of the costs, e.g. criminal record checks.

6. IFA considers that the result will be a move back to the major product providers having tied agency forces. Advisers who are tied agents will almost exclusively offer advice only in relation to products issued by the QFE. However, the consumer may not be aware that the advice and range of solutions they are offered are constrained and that they may not have been given the choice of competing products that have either features better matched to their needs or that are lower cost.

### **Specific questions for submitters**

7. IFA doesn't consider these are particularly useful questions and miss the main issue which is whether the proposed fees are fair especially relative to the sharing of costs between the various participants in the financial services sector. There is also the fundamental issue of whether it is fair to load the entire cost of the transition to regulation onto the industry when there will be benefits to consumers of financial advice. There is an argument that taxpayers should contribute some of the transitional costs as these changes bring in regulation that will become part of the overall social infrastructure of NZ society.

8. Turning to the two specific questions:

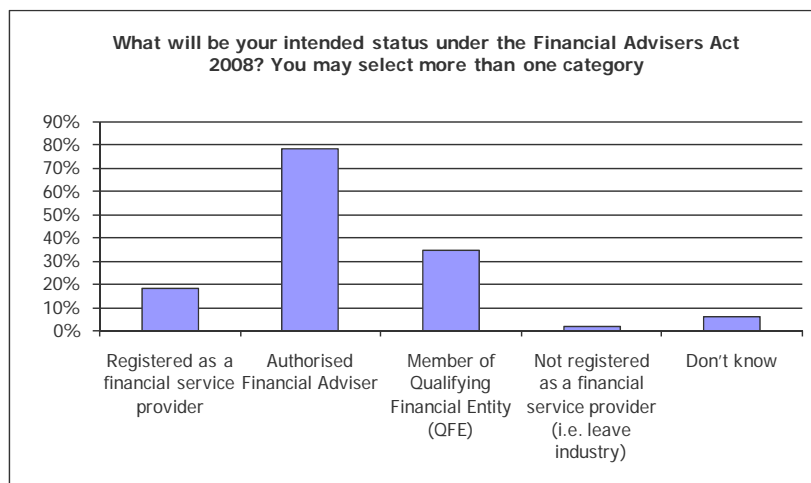
- We are unable to provide an accurate estimate of the number of financial service providers currently doing business in NZ.

The numbers used for the fees calculations do not recognise the significant numbers of advisers within QFEs, e.g. the banks estimate that around 18,000 staff are advisers affected by the introduction of regulation and the non-bank deposit taking sector may have another 1,000 advisers. If these entities become QFEs, their advisers will still need to be competent and operate at the same level as stand-alone AFAs if they are providing advice on category 1 products.

- Payment and collection of fees is not considered a significant issue. What is important is that the basis for calculation of the fees is seen as being fair and reasonable. The remainder of this submission will discuss this aspect.

## Is the basis for proposed fees fair and equitable?

9. Each of the proposed fees will be discussed in turn. The emphasis of our response is the impact on financial advisers rather than financial institutions, since our members are advisers. It should be noted that around 60% of IFA membership is advisers in small, adviser practices, though we also have members who are employees of banks and trustee corporations (typically those dealing with advice to high net worth clients), some stockbrokers as well as members who are also chartered accountants or lawyers. A survey in October showed the following intentions for IFA members who responded<sup>1</sup>:



10. While the proportion intending to leave the industry is small, this is to be expected as IFA members are generally those who most closely meet the draft competency requirements. Note that while 35% expect to be part of a QFE, many of these may already work for a bank or trustee corporation or are currently a tied adviser, so this doesn't necessarily reflect a major change in employment. Also, most IFA members provide advice on Category 1 products, so the fact that 78% expect to be AFA is not a surprise.

11. It should be borne in mind that IFA members are not typical of financial advisers, since a high proportion of non-IFA members do not have relevant educational qualifications or professional status (e.g. CFP<sup>CM</sup> or CLU) and will need to do much more to demonstrate competency if they are to remain in the industry. It should be anticipated that a much higher proportion of these advisers will leave the industry or become part of a QFE.

### Registration including criminal history checks

12. Registration is required for financial service providers and for individual financial advisers, unless they are part of a QFE. Most advisers in NZ (other than those who are employees of financial institutions) are either self employed or work in SMEs. They often establish a company as the basis for their adviser business, and the shareholders of the company are typically the adviser and their spouse or family trust. This means that the suggested number of financial service providers may be significantly understated as it may not take into account the requirement for both the company and individual adviser to be registered. If the number of entities to be registered is higher, the suggested fee will be too high as the fixed costs being recovered will be able to be spread over a larger number of registrations.

<sup>1</sup> The survey has a confidence interval of plus or minus 5.7%, at 95% confidence.

13. As many advisers will need to register both the company and themselves as financial service providers, criminal history checks will be required for the adviser as well as their spouse or trustee, if they are shareholders. So, the cost of registration will not be \$350 + \$35, but double that, i.e. \$770 or more if there are trustees.

14. We note that advisers working under the QFE regime will not be required to have criminal record checks so there will be lower costs for QFEs.

15. There is a suggestion that the criminal history checks would need to be repeated for at least the first two years of regulation. This repetition of checks seems excessive in relation to the low risk of finding new information. We suggest that instead, the Securities Commission monitors convictions for offences under securities legislation (since they administer the legislation) as well as new bankruptcy cases.

#### **Dispute Resolution regime**

16. As has been pointed out above, we consider that the number of financial service providers required to be registered will be much higher than the paper suggests, because of the need for both a company and an individual adviser to be registered. This will mean that even accepting the basis for the fee, the price per entity is overstated.

17. More importantly, we consider that the basis for calculation – registered entities – is unfair. IFA's views is that the basis for the fee should be the likely number of staff, advisers or agents exposed to potential complaints. The proposed basis has a very large entity such as a bank (with hundreds or thousands of employees) paying the same fee as a self-employed financial adviser, as if the benefits to each were the same.

#### **Securities Commission application and monitoring fees**

18. The proposal states that a component of the authorisation fee for financial advisers covers the one-off cost of establishing the assessment system to support minimum competency standards for financial adviser authorisation. This fixed cost appears to have been spread over the expected 5,000 AFAs.

19. IFA considers this is unfair as QFEs with advisers providing advice on category 1 products will also benefit from the assessment system. Regulation of QFEs will require them to ensure that their advisers for these products are competent and operate at the same level as AFAs. This will mean that they need to ensure that their employees or nominated agents meet the same competency requirements. It is likely that the QFEs will use the same competency structure as is approved in the Code, so will wish to use the same assessment processes as AFAs.

20. To be fair, IFA suggests that the cost of the assessment system should be shared between AFA candidates and QFEs, with QFEs contributions based upon the number of advisers who are either employees or nominated agents providing advice on category 1 products. This would mean that the fixed costs of establishing the assessment system would be shared amongst perhaps 10-15,000 advisers rather than 5,000.

#### **QFE application fee**

21. The proposed QFE application fee is \$4,000 and the paper anticipates that there will be around 200 applications. We consider that the number of QFE applications may be much higher than has been projected. Our reasoning is that the most recently proposed changes to the QFE regime allow them to cover "nominated agents" who provide advice on a QFE approved product list, rather than just products that are issued by the QFE. This will expand

the range of entities likely to wish to become QFEs.

22. The QFE regime, as set in the Financial Advisers Act 2008, enabled tied agents to be part of the QFE (without needing to be individually AFA) provided they gave advice only in relation to products issued by the QFE. If the agent provided advice on products that were not issued by the QFE, they would have needed to become AFA. This seemed a sensible approach.

23. The most recent proposal is to amend the legislation to enable the QFE to nominate agents who are able to advise on products other than those issued by the QFE, without the agents needing to become AFA. This is likely to increase the number of product issuers who will wish to become a QFE, since they will be able to have a tied agency force that is able to operate with a limited range of “approved products” and stay within the QFE regime without needing to be individually AFA.

24. The proposed change to the QFE regime is also likely to appeal to some adviser practices, especially those owned by financial institutions, as they will be able to avoid the cost of having individual AFAs. The fee proposals make this an attractive option for these groups. So, we anticipate some large adviser practices applying to become QFEs.

25. An aspect of concern to IFA is that a \$4,000 fee for a QFE application means that the Securities Commission is proposing very minimal evaluation and checking of QFE applications. This is because such a modest fee means that the Securities Commission must be intending to spend relatively little resources on evaluating each QFE application. This suggests that they probably intend accepting at face value what is included in the QFE applications, rather than undertaking formal reviews of the QFEs themselves. This may be a review of form rather than substance.

26. The conclusion we draw from this is that while AFA candidates will need to complete rigorous assessment processes to demonstrate competency, advisers within a QFE may not have to complete the same process. If this is correct, IFA considers this would be unfair.

### **Discipline**

27. Under the new regulatory regime, the Securities Commission will operate a disciplinary process with a formal Disciplinary Committee. We assume that the costs of this have been built into the fees as part of the cost of running the Securities Commission.

28. IFA currently operates a disciplinary process for its members, and this will continue even after regulation takes effect. We consider that this may provide cost savings to the Securities Commission as complaints may be considered by IFA’s Disciplinary Tribunal without the Securities Commission needing to incur the cost of investigation and building the “prosecution” case. If the IFA Disciplinary Tribunal made a serious adverse finding, then this would be referred to the Securities Commission for consideration of whether the adviser’s name should be removed from the register.

29. IFA considers that the Securities Commission should consider encouraging advisers to join a professional association such as IFA, so that initial disciplinary processes can be operated by the professional association, with resultant cost savings for the Commission. This would be similar to the Dispute Resolution Scheme with a default scheme and approved providers of discipline.

30. This could be achieved through allowing a fee “discount” to advisers who belonged to a professional association that undertook to operate a proper discipline process.

### **Overall impact for stand-alone, non-aligned advisers**

31. Taking the proposals as a whole, the proposed fees for a financial adviser who wishes to operate independently from product providers, outside a QFE, are substantial. Since the majority of these advisers operate as SMEs that are companies, we assess the fees impact as follows:

Financial Service Provider registration of company	350
Criminal history check of shareholder of company	35
Financial Service Provider registration of adviser	350
Criminal history check of adviser/director of company	35
Consumer Dispute Resolution contribution	30
Initial application fee	750
Base minimum annual supervision fee	250
<b>Total initial fees to Government agencies</b>	<b>1,800</b>

32. On top of these fees, the adviser will need to join an approved dispute resolution service which will have a joining fee probably in the range of \$300-500. Advisers who do not have their competency “recognised”, will need to undertake an assessment. Though no cost has been set for an assessment, we expect a full assessment could be at least \$500. In addition, anyone who does not pass all aspects of the assessment will probably need to take formal courses. Currently, the fees for gaining a National Certificate in Financial Services (Financial Advice) Level 5 total around \$6,000, with single courses costing \$690. There is currently only a single Private Training Entity approved to award the qualification.

33. Taken as a whole, the fees and costs of gaining AFA, total around \$10,000 and will create a significant barrier for entry and retention of existing advisers. This will encourage some advisers to retire and others to limit their advice to category 2 products, especially life insurance, but ceasing to advise on superannuation or KiwiSaver. Similarly, many will step back from comprehensive advice that might be considered a “financial planning service” and return to product sales without advice or with very limited advice.

34. Alternatively, advisers may become tied agents and part of a QFE, since this is the lower cost option. We consider significant numbers will seek this option.

35. IFA considers that if these actions are the end result, then the availability of quality, independent financial advice will reduce and many consumers will be disadvantaged.

### **Conclusion**

36. The aim of regulation is to promote the sound and efficient delivery of financial advice, and to encourage public confidence in the professionalism and integrity of financial advisers. There is a significant risk that these aims will not be achieved because of the systematic way in which the proposed rules, processes and fees favour QFEs over AFAs.

37. IFA is very concerned that the combined effect of these changes will be a move back to tied agency arrangements under QFEs. Tied agents will almost exclusively offer advice only in relation to products issued by the QFE or its owners. However, the consumer may not be

aware that the advice and range of solutions they are offered are constrained and that they may have not have been given the choice of competing products that have either features better matched to their needs or that are lower cost.

38. IFA is firmly of the view that New Zealand needs a strong adviser industry with well qualified advisers whose advice is independent from any particular product producer. We consider the current fee proposals will discourage advisers becoming AFA and lead to growth of tied agents. Consumers will be disadvantaged by the lack of genuinely independent advice.

39. IFA hopes these comments are useful. We are of course available to discuss our suggestions and to explain any aspects that are unclear.

40. Contact details and background information on IFA follows.

### **Background information on the Institute of Financial Advisers**

The Institute of Financial Advisers is the professional body for some 1,300 members, representing financial advisers in New Zealand. All members are individual members, not corporate members. We estimate that our members provide advice to some 200,000 New Zealanders each year, many of whom would be couples rather than individuals, with an overall client base of around 600,000.

Our members provide advice to their clients in the areas of insurance, investments, financial planning, work-based savings and insurance, retirement planning, estate planning and financial services generally. Their professional practices reflect the broad spectrum of New Zealand businesses – they operate as local SME's, are part of large regional or national dealer groups, are associated with strong financial organisations, services companies in banking, funds management, or insurance, work in employee benefits organisations, or sometimes practice as lawyers, accountants and other professional advisers.

The Institute reinforces compliance with a code of ethics and practice standards, runs a Professional Conduct Committee and Disciplinary Tribunal that are independently chaired, offers education pathways that can lead to professional designations and the attainment of internationally recognised adviser marks, maintains and ensures compliance with a continuing professional development programme, and provides networking, education, development, and business practice forums at a national and regional level for members.

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