



## **IFA Submission on Ministry of Consumer Affairs Discussion Document on Proposed Reserve Dispute Resolution Scheme**

### **Introduction**

1. The Institute of Financial Advisers (IFA) welcomes the opportunity to formally comment on this discussion document and on the dispute resolution provisions generally. In commenting, we draw upon our experience in successfully operating a complaints and disciplinary process relating to IFA members. This has provided us with a useful background of the issues that are likely to arise with the dispute resolution processes under the Financial Services Providers (Registration and Dispute Resolution) Act.

2. We have also gathered some information on the experience of Australian financial advisers with their equivalent processes.

### **General points**

3. Before responding to the specific questions in the discussion document, we would like to make some general points.

### **Financial Advisers and Product Providers**

4. The Act provides a single structure for all financial service providers. There are many different types of financial service providers. The product providers tend to be sizeable corporations with significant management structures and financial resources. Financial advisers work in a large variety of sized entities. Some are employed by large corporates, such as banks, trustee companies, and stockbrokers. Others work within financial adviser practices, which are moderate sized firms. But the majority are SMEs, typically with under 5 staff and with quite a few self employed individuals.

5. The point of this size comparison is relevant in considering design of a scheme that will work for the varied sizes and does not impose undue cost or work burdens on the small adviser firms. Cost will be a significant factor for advisers who may decide to cease practice and retire, rather than comply with regulation. This could potentially reduce the supply of advice to consumers, especially those of modest incomes and net worth.

6. It is also worth noting that the additional costs of dispute resolution will inevitably be passed on to the consumer. This becomes especially relevant as this scheme is supposed to be fully funded by industry. For example, we have been told that the cost of having a single complaint considered under the Australian dispute resolution system for an adviser might be \$3,500. This may be regarded as a modest fee for a corporate, but is a significant cost for a sole practitioner. We have also been told that the administrative burden for small firms of responding to complaints led to many Australian advisers settling complaints by paying

compensation, provided it was less than the minimum \$3,500 fee, even if they didn't consider the complaint justified.

7. The suggested compensation cap for the Reserve scheme is \$100,000 (Question 7). This may represent most or all of the annual pre-tax income for an individual adviser.

8. The point we are making is that it will be difficult for a single scheme to fairly provide for all financial service providers because of the variations in size, without making special provision for small adviser practices.

#### **Reducing the number of schemes**

9. When the legislation was being considered by the Select Committee, IFA advocated for a single sector-wide dispute resolution scheme based upon the aims of consistency, keeping costs down as well as reducing confusion for the consumer by providing a single point of contact for complaints. We are currently discussing with other industry participants, the possibility of a single scheme that would serve most of the sector. It is too early to know whether these discussions will lead to a single industry scheme.

10. Our experience with complaints is that a significant issue is the time and resources for providing the initial contact with consumers, often over the phone but also by mail, internet and e-mail. In many cases, consumers don't know where to go to make a complaint and often just want to talk to someone without any formal complaint ever being lodged.

11. IFA wishes to record its strong support for a single "clearing house" mentioned as a possibility at a briefing by ministry staff and in paragraph 32 of the paper. Irrespective of whether or not the various industry participants are successful in having a single scheme, we support having a single Contact Centre for all complaints under the Act. It would need to have a web site and be both a call centre and a contact centre for mail, e-mails and internet-sourced complaints. This would have the advantage of providing one point of contact for consumers and should lead to the lowest cost for the industry.

#### **Commencement date**

12. During the Select Committee stages of the Bill, IFA raised the need for the new complaints process to deal only with complaints that relate to activity that occurs after the date of implementation of the legislation. We are concerned that without such a limitation, there would be an initial flood of historical complaints, though we do note the suggested two-year rule for lodging a complaint. An important reason for our concern is that the new regulatory regime raises the standards, especially for financial advisers, and it is important to avoid judging past events by the new (higher) standards. A by-product would also be that this would enable the dispute schemes to establish their systems and processes while processing low volumes of complaints.

13. Turning now to the specific questions in the paper.

**Q1. Are there any reserve scheme functions that should be added, deleted or amended? If yes, please comment.**

14. Yes.

15. The first dot point in paragraph 33 refers to "individuals and businesses". It is acknowledged that the term "business" is given a wide definition in the Act, but use of the term in descriptions for members and the public is too restrictive. Our experience is that complaints may arise from a variety of entities such as partnerships, trusts (family trusts and some

charitable trusts) and incorporated societies that are users of financial services. Perhaps “businesses” could be replaced by “corporate entities” or “legal entities”.

16. We also suggest that the final dot point might benefit from adding “industry or professional associations” to the list of those the aim is to collaborate with, especially as professional associations such as IFA will probably retain discipline functions for members.

**Q2. Do you agree with the reserve scheme’s definition of “complaint”? If no, please give reasons and suggest alternatives.**

17. No.

18. The suggested definition uses the term “member company” which assumes that members of the scheme will be companies. Financial advisers may be members of the scheme and they do not all operate through companies, e.g. they may be self employed individuals or in a partnership.

19. The suggested definition also does not seem to match the Act terminology which refers to “provision of a financial service to the public” rather than “a service or a product”.

**Q3. Do you agree with the rule for when a complaint may be taken to the reserve scheme? If no, please give reasons and suggest alternatives.**

20. No.

21. In our general comments, we suggested that the legislation should not apply retrospectively and should take effect only from the time that regulation comes into force, covering activity that occurs on or after the date legislation comes into force. For the Financial Advisers Act, the current target date is 1 December 2010.

22. The discussion paper suggests that complaints could be considered relating to complaints lodged with a member of the scheme on or after 1 May 2010 and that complaints may be made to a provider for events that have occurred up to 6 years earlier. We suggest that this incorporates retroactivity into the legislation that was not intended.

23. We also note that on the proposed commencement date for the Reserve Scheme - 1 May 2010, many financial service providers may not have chosen a dispute resolution scheme and alternative schemes to the Reserve scheme may not have been approved or established. Alternatively, some financial advisers may join the Reserve scheme purely so that they are eligible to become an Authorised Financial Adviser (since membership of a dispute resolution scheme is a prerequisite) but with the intention of joining an industry scheme once it is established.

24. IFA suggests that the effective date for complaints be set as the date that regulation takes effect, not the date that the Reserve scheme is established or a member joins the Reserve scheme – which might be earlier.

**Q4. Do you agree with time limit of two years for taking complaints to the reserve scheme from the time the complaint was first lodged with the member? If no, please give reasons and suggest alternatives.**

25. Yes, we consider a two-year time limit is fair, provided this is not applied retroactively.

**Q5. Do you agree with the proposal to allow members to refer complaints to the reserve scheme? If no, please give reasons.**

26. Yes, in relation to unresolved complaints between a member and a client.

27. But, no in relation to disputes between financial service providers. There are already a range of alternative dispute resolutions processes available for businesses and the types of business to business disputes for financial service providers are likely to be very different from those from consumers. Examples of disputes between financial advisers include issues such as breach of copyright through copying a web site or an adviser allegedly breaking a commercial agreement by making sales on their own behalf that should have been through a partnership. We consider that such commercial disputes are best excluded from the scheme.

**Q6. Do you agree with having a compensation cap rather than a claim limit? If no, please give reasons and suggest alternatives.**

28. No. IFA prefers a claim limit as this will more clearly define the boundaries for complaints. The compensation cap would be the claim limit, or a lower sum if this was the demonstrated loss. Using a compensation cap raises the risk that a complainant would reduce the amount of compensation claimed to come within the compensation cap, since they can lodge a complaint without cost, but would need to incur cost to make a claim for a larger sum.

29. The issue is the need to be fair to the financial service supplier, who may be a small business or self-employed individual, who will be required to meet the cost of complaints – as well as their own costs of responding – yet the complainant has no cost.

**Q7. Do you agree with the caps of \$100,000 or \$1,000 per week in the case of disability insurance that provides for regular payments to the insured? If no, please give reasons and suggest alternatives.**

30. As noted under question 6, we prefer a claim limit rather than a compensation cap. Even so, the proposed cap maximums seem to have been developed with sizeable corporate entities in mind, rather than financial advisers who may be self employed sole practitioners or small firms with 1-5 advisers. For small firms, \$100,000 seems a very significant sum, especially since the concept is that compensation would be required to be paid and consumers may lodge complaints at no cost. IFA suggests that a lower cap be set for financial advisers than for product providers. In making this recommendation, we note that the Financial Advisers Act provides for penalties that differ in maximum for an individual and an entity. We also note that the maximum penalties that apply to real estate agents (who are another form of financial adviser, regulated under their own legislation) are much lower than for financial advisers under the Financial Advisers Act.

31. Accordingly, we suggest that the claim limit for individual advisers should be much lower than the levels suggested, perhaps \$30,000.

32. In addition, the suggested logic for setting a lower cap for the Reserve Scheme as encouraging a point of difference with existing scheme caps, may have the opposite effect than the intention. That is, some providers may deliberately join the scheme with the lower cap.

**Q8. Are the requirements for applying to join the reserve scheme too difficult to meet, inadequate or about right? Please give reasons.**

33. We agree the requirements are adequate.

**Q9. Is the requirement for all members to have some internal complaints resolution procedure too difficult to meet? If yes, please give reasons.**

34. No, but it would be very helpful for financial advisers (who may be sole traders or in small firms) for the suggested checklist of internal dispute resolution to be externally developed and provided to them as part of joining the scheme.

**Q10. Are the terms for having membership terminated reasonable? If no, please give reasons.**

35. Termination of membership of the Reserve scheme would leave customers of that financial service provider without a complaints service and could mean that someone was unable to operate as a registered financial service provider (or Authorised Financial Adviser), unless another scheme was prepared to accept them as a member. This is a very serious action as it could jeopardise a provider's livelihood. Accordingly, we consider this needs coordination with the Companies Office and Securities Commission over a fair process for deregistration or removal of AFA status. This process would need to protect the individual adviser from arbitrary deregistration as well as their clients and the public as it would remove their ability to access a complaints service.

**Q11. Are the time limits relating to advising receipt and acceptance of complaint and dispute resolution reasonable? If no, please give reasons and suggest alternatives.**

36. We agree that time limits are necessary. The document appears to only set out times for actions by the Reserve scheme, but not by the member. Our experience of dealing with complaints is that in many cases the ability to reach a conclusion is dependent upon the time it takes to gather information from the complainant and the member. In many cases, the information from the complainant is incomplete and the actual issues may not be clear. We suggest time limits for responses from both members and complainants, with a complaint being dropped if adequate information is not provided by a complainant within a reasonable time.

**Q12. Do you agree with this approach to dispute resolution? If no, please give reasons and suggest alternatives.**

37. IFA's experience of dealing with complaints relating to financial advisers is that many of them are complex and likely to be more time consuming to resolve than many other types of consumer disputes, e.g. telecommunications and energy where the service expectations are more straightforward and able to be measured objectively. This relates to the complexity of the advice process and the products themselves, as well as high consumer expectations of financial products where the outcomes may depend upon global financial markets that are beyond the ability of anyone to predict. This means that judgement will often be required and technical expertise needed to make such judgements. We note that the potential requirement for expert input is included in the scheme. Even so, financial advisers are wary about the compulsion aspect of compensation awards and whether these will be fair to the adviser since there is heavy emphasis on consumer redress and if a consumer does not accept the result, they may still take Court action. Advisers thus feel that the process (which they have to pay for, but is free to the complainant) has an inherent advantage in favour of the complainant.

38. There are two distinct aspects in the nature of a complaint that might arise in relation to a financial adviser. The first might be described as "behavioural" in the sense that it relates

to whether an adviser has followed proper professional processes, e.g. professional practice standards and ethics. The second issue is whether the specific advice or product is “fit for purpose”, which requires even greater judgment.

39. We wish to support the emphasis that the dispute resolution process must follow the rules of natural justice and for there to be adequate expert input into the more complex investigations. We consider that it is important for any determinations to closely follow codes of practice. There have not been codes of practice for financial advisers (other than those for organisations like IFA where membership is voluntary) but these will be developed for Authorised Financial Advisers as part of regulation.

40. It would be unfair to subject IFA members to a higher standard than other advisers who were not members, simply because IFA had detailed professional practice standards. It would similarly be unfair to apply these new codes of practice to complaints that relate to events that occurred prior to regulation – since there was no Code – as it would be unfair to judge the past using new (higher) standards.

41. This is why we have consistently recommended that the new process apply only to events after regulation takes effect.

**Q13. Are there any issues associated with the reserve scheme being a contracted dispute resolution service? Please explain.**

42. No, except that we have concerns about the level of the levy for financial advisers and whether this will be affordable by small adviser practices.

**Q14. Are there any functions of the advisory body that should be added, deleted or amended? If yes, please comment.**

43. No, though we wish to comment that some of these functions are policy advice to government which would seem to us to be more appropriately funded from taxpayer funds than by industry levies.

**Q15. Do you agree with the composition of the advisory body? If no, please give reasons and suggest alternatives.**

44. IFA agrees that governance bodies should ideally be small. However, the finance sector is very diverse and complex and will be difficult for three members to have knowledge of all sectors of the industry. We wonder if there needs to be three members representing consumer interests and suggest there is a greater requirement for technical knowledge. We do not consider that those with industry experience are inherently biased and would seek to act against the interests of consumers. Indeed, though IFA is a professional association for financial advisers, we place a high emphasis on consumers and the need for advice to be in the best interest of the client.

45. Accordingly, we support an advisory body of seven, but suggest more members with industry knowledge.

**Q16. Do you agree that the reserve scheme should commence with a foundation advisory body? If no, please give reasons and suggest alternatives.**

46. Yes. The sooner the better. As it seems to us that the proposed functions are wider than governance of the Reserve scheme, it would be logical for this to initially be a

government advisory body, funded by the taxpayer.

**Q17. Are there any Ministry of Consumer Affairs functions relating to reserve scheme governance that should be added, deleted or amended? If yes, please comment.**

47. No.

**Q18. Are there any issues in having the secretariat and contract manager/liaison person being housed and managed by the Ministry of Consumer Affairs? Please explain.**

48. We consider this initial phase is a government administrative role, rather than an industry function so management within the Ministry is appropriate, but should be taxpayer funded during this development phase.

**Q19. Do you agree with the overall governance arrangements for the reserve scheme? If no, please give reasons and suggest alternatives.**

49. There doesn't seem to be a need for as many consumer representatives on the advisory board, unless it is intended to function as a governmental advisory body rather than a governance body. Industry should not have to fund an advisory function.

50. IFA suggests that if government wishes to have an advisory body, it should fund it. The Reserve scheme should have a governance board, but this should not also be an advisory body.

## **Conclusion**

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

52. 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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